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A Code of Ethics for the Bankers – Challenges and Opportunities

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Today banking ethics is often seen as an oxymoron. Jokes about the bad ethics of the banking community are a staple of comedians:

> "Hospitals report that the hearts of bankers are in strong demand by transplant patients, because they've never been used."
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> "A young banker decided to get his first tailor-made suit. As he tried it on, he reached down to put his hands in the pockets, but to his surprise found none. He mentioned this to the tailor, who asked him, "You're a banker, right?" The young man answered, "Yes, I am." The tailor replied, "Well, you don't need them, whoever heard of a banker putting his hand in his own pocket."
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> "Resolving to surprise her husband, an investment banker's wife pops by his office. She finds him in an unorthodox position, with his secretary sitting on his lap. Without hesitation, he starts dictating, " . . . and in conclusion, gentlemen, credit crunch or no credit crunch, I cannot continue to operate this office with just one chair."

Heartless. Greedy. Dishonest (and sexist, to boot). That is how bankers are known today. While it is unfair to tar the entire industry with the behavior of some, in many ways the banks have called this opprobrium down upon themselves. Each month brings a new major scandal. Billion dollar fines are now common. Bankers on both sides of the Atlantic have admitted to lying to clients, forging or falsifying records, evading anti-money laundering and sanctions rules, encouraging tax fraud, mis-selling products to retail and manipulating financial benchmarks.

In the wake of that wave of disgraceful conduct, the industry and the broader society have been reflecting on causes and cures. [1] Much recent public discussion has focused on bank "culture" and how it can be improved. The debate has centered on the role of

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[1]It is hard to know whether banker malfeasance has been overstated, compared to other parts of society. No other type of institution is as laden with such extensive rule sets governing so many aspects of individual behavior as is a banking institution; rule breaches, as a result, are inevitable. In no other type of organization are electronic and voice communications, political contributions and other activities subject to such continuous intensive review. No other business or organization has comparable percentages of its people employed as internal watchdogs. In my own firm 3.0% of all employees are compliance officers, employed to check up on the behavior of other employees. If a similar level of scrutiny were applied to the emails, phone calls, written work and contracts of news organizations, the police, the entertainment industry, NGO's, government offices or universities, how different would the results be? (In 2013, an officer of a major aid organization told me that his organization regularly paid bribes in emerging markets, because that was the only way he could make sure his aid could make it to its intended recipients – and that his organization was not unique in that regard).

regulators and regulation, creating appropriate bank governance, establishing an appropriate "tone from the top," (or sometimes "tone from the middle," or "tone at point of sale"), incentivizing individual bankers to act as we would want them to, measuring employee conduct, embedding culture and conduct into employee assessments, identifying "bad apples" in order to keep them out of the industry, and more.

This discussion has assumed that the desired bank culture is easy to define; so, comparatively little discussion has focused on what good culture looks like. And when it has, the conversation has been at a highly general level: Bankers must follow the law; because banks are "special," bankers need to uphold the "highest ethical standards." [2] That seems simple enough. In fact, though, while it is relatively easy to know what the law requires, it is far more difficult to define what ethical standards should guide bankers.

This paper aims to fill that gap by trying to define what ethics, and in particular an ethics code, means in the context of banking. After identifying some of the problems inherent in trying to set down ethical intuitions into a code, it suggests a way forward – offering both a methodology for creating such a code, and some principles that might be candidates for inclusion in that code. It is perhaps better for me to say "codes," as the paper argues that no single code of ethics can meaningfully cover all parts of banking, but rather a series of codes is needed, highly dependent on the nature of the particular kind of banking activity involved (e.g., trading, asset management, sales).

[2] See, e.g., Christine Lagarde, "The Role of Personal Accountability in Reforming Culture and Behavior in the Financial Services Industry," (delivered at the New York Fed, Nov 2015); William Dudley, "Opening Remarks at Reforming Culture and Behavior in the Financial Services Industry: Workshop on Progress and Challenges," (delivered at the New York Fed, Nov 2015); E. Gerald Corrigan, "Are Banks Special," (Federal Reserve Board of Minneapolis, 1982).

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1. What is a code of ethics for bankers?

What do I mean when I speak of a code of ethics for bankers? I mean a statement of principles directed to individual bankers, which specifies their obligations as individuals carrying out the business of banking. As such, it will guide them in deciding how they should act and permit others to judge them when they do. By a code of ethics for bankers, I do not mean a statement of a bank's obligations as an institution to the larger society in which it is nested. Such a code, while interesting, would not instruct an individual banker as to how to act, although it might guide a bank Board or leadership in formulating bank policy. As such, the banker's code I describe below will not cover such important issues as what kind of services banks should provide to customers, whether there should be limits on the profits they can make, how they should relate to the communities in which they are located, whether they should be constrained in how they deal with legislatures or regulators, etc.[3] Nor, for that matter, will it cover the bankers as they conduct their private lives, but only as they conduct the business of the bank.

Second, a code of ethics for bankers concerns only those aspects of banker conduct that are grounded in ethics or morality. It specifies which behaviors will be praised (or at least deemed acceptable) and which will be condemned as unethical. It is not a general code of behavior covering all aspects of how an employee should act (e.g., specifying how employees should dress). Nor is it a code of professional responsibility aimed at defining the behaviors most conducive to the success of the profession. While ethical considerations inform both employee conduct and professional codes, they are only one of many factors underpinning such codes.

Third, it is a code – a series of propositions or rules specifying appropriate and inappropriate behaviors. It is a series of "do's and don'ts." It is neither a philosophical or religious exploration of what constitutes ethical character,[4] an analytic framework designed to clarify our thinking about ethical issues,[5] a series of aphorisms designed to teach ethics[6] nor a series of stories meant to inspire ethical behavior.[7] It is a very specific form of ethical guidance, with benefits and disadvantages compared to other forms of ethical guidance. Its principal advantage is its compactness – its ability to give guidance in a few words, which makes it particularly congenial to being applied in a corporate setting. But, developing a workable ethics code will not be easy; it is to the limitations and methods of the project of ethics code creation to which I now turn.

2. Ethical codes and ethical sentiments

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[3] Arguably, some such obligations might be incorporated into a banker code of ethics, perhaps through an obligation for disobedience, where a bank requires an employee to act in a way that offends his conscience or the bank's broader obligations to society.

[4] See, e.g., Aristotle, *Nichomachean Ethics*; Thomas Acquinas, *Summa Theologica*

[5] See, e.g., Stearne, *Ethicability: How to decide what's right and find the courage to do it* (Roger Steare Consulting, 2011)

[6] See, e.g., *Proverbs; Sayings of the Fathers (Pirkei Avot);* La Rochefoucauld, *Maximes* (1678/1817); Franklin, *Poor Richard's Almanac* (1733)

[7] See, e.g., Plutarch, *Lives of the Noble Greeks and* Romans; Brooks, *The Road to Character* (Allen Lane, 2015)

a. Ethical codes are inevitably incomplete

As Aristotle recognized, over two thousand years ago, any set of rules can only imperfectly describe ethically appropriate (”decent”) behavior. In that way all codes of behavior are necessarily incomplete as ethics codes. In order to create a rule or regulation, a rule maker must classify together a large number of situations and treat them all in the same way. He must generalize. In doing so, he either must create a rule that has determinate results in all cases and is therefore unjust (given its goals) in some cases, or a rule so indeterminate that it cannot give effective guidance. Aristotle puts it this way:

> “[E]very law is universal, and there are some things about which it is not possible to speak rightly when speaking universally. . . . This is the nature of what is decent, a setting straight of a law, insofar as it leaves something out as a result of being universal. For this is also the reason why not all things are in accord with law, because it is impossible to set down a law about some things . . . . For the rule for something indeterminate is indeterminate.”[8]

Because of this dilemma, which is inherent in the nature of rules, Aristotle suggests that sometimes the only decent thing to do “for someone who is inclined to choose and to do things of that sort,” is to go beyond the legal requirements. In other words, Aristotle teaches that rules will inevitably fail us (in places) if they are our sole guides to acting ethically. They are inevitably incomplete in that they cannot take into account every situation.[9]

b. To compensate for incompleteness, ethics codes often incorporate vague language

Over the last few years, there have been a number of attempts to create ethics codes for finance. Writers of these codes and rules seem to have implicitly recognized the problem in attempting to write a set of rules that would give ethical (decent) results in all cases, by not even trying to explicate our ethical sensibilities in rule form. They, instead, have resorted simply to writing vague exhortations into their codes to “act ethically.”

These high-minded phrases unfortunately can have legal effect, while simultaneously providing little guidance to anyone trying to decide how to act or to judge the actions of others. They thus fail the most fundamental test for any code of conduct – to provide determinate, consistent results when applied to the same set of facts, no

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[8] Aristotle, *Nichomachean Ethics*, Bk V, Ch 10, p. 100 (trns. Joe Sachs, Focus Press, 2002).

[9] Aristotle developed a highly influential understanding of the good – the end towards which all human life should be directed. One need not share his view on the end of life, or even whether there is a single such end that our reason can reveal, to recognize the flaw in believing that ethical behavior can be fully described through a rule set alone.

matter who applies them.[10] Thus, they not only fail to help bankers resolve difficult issues, but also give a dangerous, virtually unreviewable discretion to regulators to create new standards of conduct and apply those standards retrospectively.

Financial regulation is filled with such vague phrases. The UK FCA and PRA's Conduct Rules each require that "you must act with integrity." The US FINRA prohibits behavior that violates "just and equitable principles of trade." The UK FCA further requires that firms and individuals observe "proper standards" of market conduct, pay "due regard" to the interests of its customers and treat them "fairly." The writings and speeches of our regulatory community are filled with words like "integrity," "fairness," "open and transparent," "probity, customer service and ethical conduct," and "honesty." Unfortunately, none of those regulators has done the hard work of trying to define specifically what those words mean in the context of financial services.

The Group of 30, an organization of senior representatives from the private and public sectors and academics, published a well-received report in 2015 entitled "Banking Culture and Conduct: A Call for Sustained and Comprehensive Reform." In it, as its title suggests, they called for a change in banking culture and the conduct of bankers. While not formally defining an ethics code, they listed the kinds of behavior they wanted to foster. While some of the behaviors listed relate to risk management, good management and other goals, with respect to those parts that dealt with banker ethics, the Group did not advance the dialogue. Here is the list of desired behaviors, in its entirety:

- "Acts with integrity
- Acts fairly, ethically, and within the law at all times
- Risk aware and mindful of risk management
- Approachable, engages in open dialogue and open to challenge, willing to escalate to address improprieties
- Customer-focused in all business considerations
- Long-term perspective and economically rational
- Creates and promotes an inclusive and collaborative environment
- Compliant with laws, policies, and management demands" (p. 60)

The only current example of a binding ethical code for bankers, of which I am aware, is from Holland. In 2013, the Dutch Financial Supervision Act created a Bankers' Oath. Bankers are required to swear that:

- "I will execute my function ethically and with care

[10] A credible set of ethical principles must be "such that, if any competent man were to apply them intelligently and consistently to the same cases under review, his judgments, made systematically nonintuitive by the explicit and conscious use of the principles, would be, nevertheless identical, case by case, with the considered judgments of the group of competent judges." John Rawls, "Outline for a Decision Procedure for Ethics (1951)," in *Collected Papers* (Harvard, 1999), p.7.

- I will draw a careful balance between the interests of all parties associated with the business, being the customers, shareholders, employees and the society in which the business operates;
- When drawing that balance, I will make the customers' interests central;
- I will comply with the laws, regulations and codes of conduct that apply to me;
- I will keep confidential that which has been entrusted to me;
- I will not abuse my knowledge;
- I will act openly and accountably and I know my responsibility to society;
- I will make every effort to retain and improve trust in the financial sector.

So help me God, I declare and promise."

There is much wrong with this code, but for now, let me just note that, with the possible exception of the provision on confidentiality, there is no substantive guidance provided by this code. It does not provide a way of deciding hard cases, or frankly, easy cases; and, so, it gives little guidance to bankers, permits different judges applying the code (whether individual bankers, their supervisors or the Dutch Disciplinary Committee) to come to different judgments on the same facts, and provides only the most minimal framework for conversation to try to resolve those differences.

c. The importance of moral sentiments to ethical analysis

Although public discussion has focused on developing a code of ethics, the starting point of ethical analysis is not a set of rules. Underlying Aristotle's insight is an assumption that we need to make explicit, namely that the ultimate arbiter of "decency" is an internal sense, an "inclination," that we each possess – not a set of rules – that can trump the requirement of a rule. In this regard, moral reasoning may be quite different from scientific and mathematical reasoning. In those disciplines, a proposition expressed in words or symbols can often fully capture a truth. That is not true of morality. The ultimate arbiter of moral truth is our own moral intuition, which is at its core non-verbal. The feeling that something is wrong is itself the best evidence of its wrong-ness, at least prima facie, and perhaps even conclusively.

The first philosopher to explore extensively this moral intuition using what he called "the experimental method of reasoning," was David Hume in his works, *A Treatise of Human Nature* (1739-40) and *An Enquiry Concerning the Principles of Morals* (1751). Hume takes intuitions or sentiments as the universal source of morality.

> "[M]orality is determined by sentiment. It defines virtue to be *whatever mental action or quality gives to a spectator the pleasing sentiment of approbation*; and vice the contrary." (emphasis in original);[11]

[11] *Enquiry*, Appendix I ("Concerning Moral Sentiments"), p. 85 (Hackett, 1983).

> "[W]hen you pronounce any action or character to be vicious, you mean nothing but that from the constitution of your nature you have a feeling or sentiment of blame from the contemplation of it."[12]

> "The sense of justice, therefore, is not founded on our ideas, but on our impressions."[13]

Accurately cataloging these moral sentiments in a pure and unreflective way is not, however, what he has in mind. We start with those sentiments and then we interrogate them. We identify those sentiments which seem biased, because of our personal distance or closeness to the person or situation we are examining; and then we try to correct those sentiments by "choos[ing] some common point of view, from which [men] might survey their object, and which might cause it to appear the same to all of them."[14] We see how strongly or hesitantly we hold our views. We might call to mind other similar cases and see how our moral sense assesses those cases, looking for consistencies and inconsistencies. Or we may notice whether we are in a pre-existing emotional state (e.g., anger, fear) that might cause us to doubt the reliability of our moral sentiments at that moment. Sometimes on the focusing again on our original sentiments, we see that they, having been schooled by our reason, actually have changed. For example, if we discover a bias, we may come to doubt the validity of our moral sense or even reject it for another view. In these and other ways, we try to refine our moral sentiments.[15]

This "corrected sympathy,"[16] shares much with aesthetic judgments, which can also be refined and schooled by reason and reflection:

> "It is probable, I say that this final sentence [which pronounces characters and actions amiable or odious, praiseworthy or blamable] depends on some internal sense or feeling, which nature has made universal in the whole species. For what else can have an influence of this nature? But in order to pave the way for such a sentiment, and give a proper discernment of its object, it is often necessary, we find, that much reasoning should precede, that nice distinction be made, just conclusions drawn, distant comparison formed complicated relations examined, and general facts fixed and ascertained. Some species of beauty, especially the natural kinds, on their first appearance, command our affection and approbation; and where they fail of this effect, it is impossible for any reasoning to redress the influence, or adapt them better to

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[12] *Treatise*, Book 3, Part I, Section I ("Moral distinctions not deriv'd from reason"), p.520 (Penguin, 1969). See also, Aristotle, *Ethics, supra*, p. 99 (exploration of the acts or people "we praise" as decent).

[13] *Ibid,* Book 3, Part I, Section II("Moral distinctions deriv'd from a moral sense"), p. 548.

[14] *Ibid,* Book 3, Part III, Section I, ("Of the origin of the natural virtues and vices"), p. 641.

[15] See, John Rawls, *A Theory of Justice,* p.47 (Harvard, 1971); Annette Baier, "Knowing Our Place in the Animal World," in *Postures of the Mind: Essays on Mind & Morals* (Methuen, 1985).

[16] See Annette Baier, "Hume, the Women's Moral Theorist," in *Moral Prejudices*, p. 55 (Harvard, 1994).

> our taste and sentiment. But in many orders of beauty, particularly those of the finer arts, it is requisite to employ much reasoning, in order to feel the proper sentiment; and a false relish may frequently be corrected by argument and reflection. There are just grounds to conclude, that moral beauty partakes much of this latter species, and demands the assistance of our intellectual faculties, in order to give it a suitable influence on the human mind."[17]

An explication of Hume's intricate archeology of the moral sentiments is far beyond the scope of this paper. For the purposes of what follows below, however, one need not accept Hume's empiricism, nor even his full theory of moral sentiments. All one need share is his view of the importance of consulting our corrected or refined moral sentiments when deciding what is ethical.

d. The interplay between sentiments and rules

Since our goal here is to create a set of ethical rules for bankers, I want to examine the work of John Rawls, who described a useful methodology for using our moral sentiments to help develop a set of ethical principles. Although Hume and Rawls disagree on a great deal (since Hume bases ethics on sentiments and Rawls is the most well-known modern representative of the major opposing philosophical tradition (deontology), which bases ethics on rules), they both would likely agree on the centrality of ethical intuitions or sentiments to moral reasoning.

While we often associate Rawls with the principles he develops and defends in his classic work *A Theory of Justice* (e.g., justice as fairness, the difference principle), Rawls himself describes his project as "a theory of the moral sentiments (to recall an eighteenth century titled) setting out the principles governing our moral powers, or more specifically, our sense of justice."[18] He can say that because he identified the enterprise of his book as developing:

> "a set of principles which, when conjoined to our beliefs and knowledge of the circumstances, would lead us to make these [moral] judgments with their supporting reasons, were we to apply these principles conscientiously and intelligently. A conception of justice characterizes our moral sensibility when the everyday judgments we do make are in accordance with its principles." [19]

Or, as he says in an early paper, one of the key conditions for moral principles is that they match our "intuitive judgments." In other words, if a set of principles competently applied to specific morally fraught situations always produced the same result as one's considered ethical judgments or intuitions about those situations, then those principles would meet one his key tests for a valid ethical theory. [20]

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[17] *Enquiry*, *supra*, Section I ("Of the General Principles of Morals"), p. 15.
[18] John Rawls, *A Theory of Justice*, *supra*, p. 51.
[19] *Ibid*, p. 46 (Harvard, 1971).
[20] See John Rawls, "Outline for a Decision Procedure for Ethics," *supra*, p.6. Rawls would go further and say not just that those principles will produce the same result, but that they explain, explicate or underlie our ethical sentiments. We need not take that view to believe that there is value in trying to match a set of principles to our intuitions – even if that value is wholly instrumental in that such a set of principles

The process Rawls identifies for the development of ethical principles is iterative; we propose standards which appear to "explicate" our moral judgments about some situations and then apply those standards to new cases and check those results against our judgments. We may find that applying the proposed ethical standard to our new case produces a result inconsistent with our moral intuitions; and, as a result, we may need to modify our standard to more closely match our intuitions. However, equally it is possible that, when such a conflict occurs, our belief in the appropriateness of the standard may make us question our own intuitions and we may actually come to revise them. When through this Socratic process of comparison and reflection we find "principles which match our considered judgments duly pruned and adjusted, we have reached a reflective equilibrium." He says that, "It is an equilibrium because at last our principles and judgments coincide and it is reflective since we know to what principles our judgments conform and the premises of their derivation."[21]

However, "this equilibrium is not necessarily stable."[22] Because of the complexity of the moral world, this process of examination, reflection, and revision is never final; it is always liable to be upset by a new set of facts or a new perspective we bring to an old set of facts (perhaps based on new information or experience), which causes us to judge a situation differently than what our principles would dictate. Rawls recognizes, as did Aristotle, the inevitable incompleteness of any set of ethical principles. He speaks at one point about the possibility of developing a complete theory covering all ethical judgments and says that, "it is doubtful whether one can ever reach this state." In another place he says, "[a]ll theories are presumably mistaken in places."[23] And, surely he is right.

The process of comparing judgments backed by sentiments with those derived from rules in an effort to reach a reflective equilibrium is the method I find most close to my own moral reasoning. And, it is the process through which I came to the tentative ethical principles I propose below.

e. The value of publicly testing ethical rules against intuitions

The process Rawls describes necessarily begins as a private one, in which, through reflection, an individual tries to clarify his own moral thinking. Nonetheless, the process of examining ethical dilemmas, exposing the resulting moral sentiments, formulating tentative principles to explain those sentiments and then testing them, is most effectively done in public – and the writing of *A Theory of Justice* is itself a way in which Rawls publicly tested his thinking with that of his readers. Conducting such a review openly with others, will – because of each of our limited rationalities -- undoubtedly lead to a better result than any of us could do alone. Again, Rawls:

> "[T]he reasonableness of a principle is tested by seeing whether it shows a capacity to become accepted by competent moral judges after they have freely

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gives us an easy way for our to describe to others what behaviors we think are ethical and which unethical.

[21] *Theory of Justice, supra,* pp. 20-21, 46-53.

[22] *Ibid,* p. 20.

[23] *Ibid,* pp. 49, 52.

> weighed its merits by criticism and open discussion, and after each has thought it over and compared it with his own considered judgments. It is hoped that some principles will exhibit a capacity to win free and willing allegiance and be able to implement a gradual convergence of uncoerced opinion." [24]

Even a philosopher as different from Rawls as Pragmatist Richard Rorty, has described this "search for acceptable justification and eventual agreement" as the essence of ethical reasoning.[25]

This process of justifying our beliefs to audiences can in fact lead to agreement or consensus, because (as I discuss in section 5 below) shared social practices underlie our moral sentiments.[26] Moral reasoning is thus a way in which we can "interpret to [our] fellow citizens the world of meanings that we share." [27] Or, as Rawls puts it:

> "What justifies a conception of justice is . . . its congruence with our deeper understanding of ourselves and our aspirations, and our realization that, given our history and the traditions embedded in our public life, it is the most reasonable doctrine for us."[28]

When public reasoned discussion identifies doctrines consistent with our traditions and history, they will tend to be affirmed as consistent with our ethical understandings. And because of the process through which they emerged, will tend be viewed as legitimate.

This is the method that I propose should be used to develop our banker code of ethics -- use our moral intuitions to develop principles and then publicly test and refine them until they settle into a reflective equilibrium with those intuitions.

f. An illustration of rule development using this method

Lest I be accused of asking too much of an ethics code, let me illustrate how this process of testing rules against intuitions can be used to produce a specific (i.e., non-vague) ethical rule applicable to derivatives marketing.

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[24] Rawls, "Outline," *infra,* pp.10-11.
[25] Rorty, "Ethics without Principles," in *The Rorty Reader* (eds. Voparil and Bermstein, Wiley-Blackwell, 2010), p. 425. He further calls this "ability to sustain a conversation" among members of a society to clarify their beliefs as the essence of wisdom. Richard Rorty, *Philosophy and the Mirror of Nature*, (Princeton, 1979), p. 378. See also Rorty, "The Priority of Democracy to Philosophy," *Rorty Reader, supra*.
[26] See also Richard Rory, "Truth Without Correspondence to Reality," in *Rorty Reader*, *supra*, p. 422.
[27] Michael Walzer, *Spheres of Justice: A Defense of Pluralism and Equality,* p. xiv (Basic Books, 1983).
[28] John Rawls, "Kantian Constructivism in Moral Theory (1980)," in *Collected Papers, infra*, pp. 306-07.

A current US rule requires that a derivatives dealer must provide a customer two prices before trading -- the price the dealer is proposing for the trade and a second price, called a "mid." The mid is essentially a hypothetical average price for derivatives of that type in the market at that moment, which is calculated based on a formula set by the regulation. The idea behind the rule is that if a dealer proposes to charge a customer 65 for the derivative, but the mid is 63, the customer would be able to question the dealer as to why he is being charged more than the norm. The rule, describing how to calculate the mid, groups derivatives into a few major categories and prescribes precisely how the mid should be calculated for trades in each category. For common trades of each type, the mid often provides a customer with the information it needs to evaluate whether the price on offer is fair. ("Why am I being charged 65 when the average is 63?")

But, where the transaction being discussed is unusual or customized, the rule specifying how to calculate the mid does not produce a meaningful number – one that will help the customer evaluate the fairness of the price of the proposed derivative. For example, the rule – for ease of calculation or comparison -- might require that dealers calculate the mid on the assumption that all customers are AA credits and prohibit the dealer from taking the credit-worthiness of the specific customer into account – even though customer credit-worthiness might be very material to the pricing of a derivative in a particular case. In such a case, the dealer might price the trade at 70 to compensate himself for the increased credit risk, but be required to provide a mid of 63 – from which the customer can only determine that he is being charged an additional amount for credit risk, but not whether the credit charge is fair. Thus, providing the customer with the required mid of 63 would give him little useful information, not achieve the regulatory purpose, and not be "decent" (to use Aristotle's word). However, it would be in compliance with the rule.

If one wanted to create an ethics code for salespeople that covered this situation, one has a number of choices. If the code simply required compliance with the regulations, then one might take the view all that ethics required was to give the client the mid of 63. But, our intuitions, or at least mine, tell me that would not always be sufficient. Given the complexity of derivatives and the opacity of derivative markets, if a rule was to mandate that bankers do the decent thing, it would need to require them to be more helpful to clients than that. Thus, an ethical rule requiring a banker simply to "follow the law" would be incomplete.

Alternatively, the code drafters might have used the Dutch rule's language requiring the banker to "draw a careful balance between the interests of all parties associated with the business, being the customers, shareholders, employees and the society in which the business operates; and when drawing that balance, . . . make the customers' interests central." That ethical rule is more complete, but suffers from vagueness. What does balance mean? How can one know what the interests of all those parties are so one can balance them? And what does it even mean to make some interests "central?" Does that mean that other interests are "peripheral?"

If we want to get out of this bind – incompleteness or vagueness -- it will be necessary to reason carefully. We start with our moral intuitions as to what is right or fair in some circumstances. We will then want to test and refine those moral intuitions through the formulation of principles that appear to explain them and then apply those principles to other cases. Only through repeated testing, refinement and readjustment will we be able to reach a workable rule (or rules) in "reflective equilibrium" with our intuitions. Although there will inevitably be some level of ambiguity or vagueness in any rule, we will try to minimize that.

We might want to ask questions like the following: Does everyone actually need to get a mid? Are we offended where the dealer does not provide a mid price at all where the customer is highly sophisticated and generally gets prices from multiple dealers? Is dealer profit (which is the way in which mid-market pricing information is useful to a client) even relevant to our sense of what a customer needs to know to make an informed decision? How should the mid be calculated, in the absence of regulatory guidance – does our intuition tell us anything at all about that? Is it the dealer's obligation to ensure the client understands the significance of the mid or how it was calculated? Are we offended if the client transacts after getting clear and correct information but misunderstands it? Is the dealer morally obliged to explain the calculation methodology to the customer? If he does describe the methodology, does he need to understand the methodology? In the case of an institutional customer with many employees, is the transacting employee the only one who needs to understand? Would we be offended if only he understood, and more senior responsible supervisors did not understand? Does it make a difference to our intuitions if the customer is getting competing prices from multiple dealers? And there are many such questions.

We would start with answers to those questions and then consider what those answers reveal about the nature of the relationship that our intuitions imply exist between a bank and its customer? What rule might describe that relationship and the obligations it entails? Does that rule, when applied to the cases above, produce the same answers as our moral sentiments do? How might we want to modify the rule (or reconceptualize our view of the relationship between dealer and client) to have the rule more comport with our sentiments? Or alternatively, might our struggling with these issues school our sentiments and lead us to judge the ethics of the case differently ("corrected sympathy")?

My own process of introspection and analysis produced the following tentative rule: "A banker needs to disclose to a customer all information about a proposed derivative transaction which a customer with knowledge and experience typical for customers in that particular market would normally use to evaluate the appropriateness of the transaction or its pricing, if that information was not commonly available from public sources. If he is actually aware that the customer does not have such knowledge and experience, then he needs to show the customer special care." I mention the rule, not to defend it as final and correct, but rather as an example of a highly specific rule that could result from the type of ethical analysis I am recommending.

3. Developing ethical codes for bankers from well-understood social practices

Let's now begin the exercise of identifying some of the key principles that underlie our intuitions about ethics in banking.

If you suddenly dropped a football you were carrying under your arm, would it be unethical for me to pick it up and run away? The answer to that question depends on the relationship between us. If we were strangers and I saw you drop the football in the street, it would be unethical for me to take it and run. However, if we were playing a game of American football and you fumbled it on a field, it would be perfectly appropriate for me to pick up the ball and run away from you – indeed, it would feel vaguely unsettling if I did not do so and rather returned it to you. The reason is that our moral "inclinations" or intuitions are fundamentally dependent on social practices. That is not moral relativism; it is the core of our ethical intuitions.

From the time we were small children we have interacted with others. Sometimes, our interactions have developed in such repeated and well-understood ways that they have come to constitute social practices or social conventions -- governed by explicit or implicit goals, roles, and norms. The violation of those norms can upset our expectations and lead to our condemning the offensive act or the offending actor as "unfair" or "unethical." This is a natural process, which David Hume identified 300 years ago. He recognized that these practices could be formed either through conscious agreement or by convention, "if by convention is meant a sense of common interest; which sense each man feels in his own breast, which he remarks in his fellow, and which carries him, in concurrence with others into a general plan or system of actions, which tends to public utility."[29]

Note that Hume's believed that these conventions, with their supportive practices of moral praise and condemnation, arose because of their utility to the growth and happiness of society.

> "[M]oral distinctions arise, in a great measure, from the tendency of qualities and characters to the interests of society, and that 'tis our concern for that interest which makes us approve or disapprove of them." [30]
>
> "[E]very thing, which contributes to the happiness of society, recommends itself directly to our approbation and good will. Here is a principle, which accounts, in great part, for the origin of morality: And what need we seek for abstruse and remote systems, when there occurs one so obvious and natural."[31]

Thus, those behaviors that promote human flourishing are approved of and are labeled moral or virtuous.

> "[L]anguage . . . must invent a peculiar set of terms in order to express those universal sentiments of censure or approbation which arise from humanity or from views of general usefulness and its contrary, VIRTUE and VICE become then known: Morals are recognized."[32]

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[29] *Enquiry, supra,* Appendix III ("Some farther Considerations with regard to Justice"), p.90.
[30] *Treatise, supra*, Book 3, Part III, Section I ("Of the origin of natural virtues and vices"), p. 630.
[31] *Enquiry, supra,* Section V ("Why Utility pleases"), p. 43.
[32] *Ibid,* Section IX ("Conclusion"), p. 76.

Labeling the destructive as immoral and the constructive as moral is not just a linguistic exercise. By a mechanism that modern evolutionary biologists are probably best suited to describe, that labeling tunnels its way into our emotional makeup and becomes biologically wired into our sentiments of moral censure or approval. According to Hume, "[a]fter the interest is once establis'd and acknowledg'd, the sense of morality in the observance of these rules follows *naturally*, and of itself." [33]

Whether or not one agrees fully with Hume's analysis, there is little question that social practices or conventions are associated with deeply embedded emotional sentiments and, sometimes, associated rule sets, designed to protect the proper functioning of the related social practices. It is our acceptance of those protective frameworks that creates the sense of violation we feel when our settled expectations about how people should act in a particular practice are upset. These frameworks are hard to shut off. They are present regardless of whether any formal law is violated, and surface as moral outrage at people whose behavior offends those expectations. They are available and deployed constantly -- whether we are buying a cup of coffee, playing a game of tennis, lending something to officemates, or trying to convince a friend to see a new movie.

As a result, these protective frameworks are readily available to guide bankers to act ethically and to inform policy-makers writing workable codes of ethics for the banking world. I show below that well-established social practices with well-understood normative frameworks underlie much of the business of banking. My claim is that if we start by analyzing the ethics of those particular practices, we can create more satisfactory ethical codes, than we can if we try to base our code on general exhortations to act with integrity or even on more general ethical principles (like the golden rule or utilitarianism).

If we build codes around these practices, we will create four positive effects – compliance, completion, certainty, consistency. First, since bankers, like most people, view themselves as ethical, where a code is formulated in a manner consistent with the fundamental ethical intuitions that they already understand as undergirding a specific type of banking business,[34] bankers will naturally want to follow the code (the "compliance" effect) in order to avoid both the internal discomfort and the potential public condemnation that might attend their acting unethically. The more we can harness the power of those sensibilities to guide behavior, the more the code will be self-policing.[35]

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[33] *Treatise*, *supra*, Book III, Part II, SectionVI ("Some farther reflections concerning justice and injustice") p. 585.

[34] "A pre-requisite for deciding to abide by the norms of a particular relationship is seeing that they apply. Hence the considerations that motivate a person depend on the relationship that she takes herself to be in, how she 'frames' her situation, and hence the norms that govern her interactions." Natalie Gold, "Trustworthiness and Motivations," in *Capital Failure* (eds. Morris and Vines, Oxford 2014), p __.

[35] One might object that if these moral intuitions were really so powerful, they should have prevented bankers from engaging in unethical behavior even in the absence of codes. Therefore, what added compliance value is there in formulating those weak intuitions into a code? Codes can be of value in clarifying for bankers which intuitions they should draw upon in particular situations, but they are of course only

Second, where following a well-formulated ethical code strictly would permit a banker to do something unjust – as it must because of the incompleteness of any ethical rule set – bankers would be more likely to recognize the result as unjust and act to a higher standard than the rule demands – to act "ethically" when the rule did not require them to (the "completion" effect).

Third, since rules would be grounded in real world social practices, they could be framed with some specificity and so be more certain in application than general ethical principles (the "certainty" effect).

And, finally, to the extent a rule used vague terms, or terms subject to multiple interpretations, since the code would derive from well-accepted social practices, bankers, customers, regulators and the public would be more likely to interpret those terms in a way consistent with each other's interpretation (the "consistency" effect). A code grounded in well-accepted social practices with associated well-understood ethical frameworks, will create these "4C effects".

Below I attempt to identify four well-accepted social practices on which I think we can comfortably base ethical codes for banking, as well as some ways in which laws and policy goals have intruded in the discussion and created confusion for practitioners. The identification of these practices, and their related principles, is my attempt to explicate my own ethical intuitions in the context of my experience in banking.

4. Mutual promising as a social practice

Mutual exchange of promises (and, if certain formal requirements are met, the making of a contracts) is a foundational aspect of human relations. Our willingness to make promises to others and to expect others to fulfill corresponding promises made to us is central to living a civilized life. All of us understand this practice and engage in mutual promising every day. As a result, we intuitively know what is fair practice and what foul. If someone does the wrong thing, our moral sense is offended.

I stated earlier that social practices giving rise to ethical frameworks are characterized by well-understood goals, roles and, to some extent, norms. By goal, I mean the point of the practice, the utility of the practice in the lives of the participants, or the end (or ends) to which it is directed. By role, I mean the place occupied by each participant in the practice. For our purposes, role is best understood by examining the level of trust among the participants, where trust is defined as "accepted vulnerability to another's power to harm one." [36] By norms, I mean the principles that define what

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one tool. Other factors can check the power of ethical intuitions to guide behavior – like bank culture, incentive structures, governance, controls, peer pressure, and excessive regulation. I also argue below that bankers have at times been unable to unleash the power of their ethical intuitions to support their behavior because they often have been confused as to which ethical framework they should apply.

[36] Annette Baier, "Trust and its Vulnerabilities," in *Moral Prejudices, supra,* p.133. Most of the essays in Baier's book explore the variety of relationships of trust that undergird our ethical intuitions.

conduct is to be condemned and what is to be praised, and that, when applied to particular situations, generate the same results as our moral intuitions. Those norms should sit in reflective equilibrium with the moral intuitions of those participating in the practice.

The goal of the practice of mutual promising is for each individual promisor to obtain something of value he could not by himself obtain, or obtain as cheaply or easily. In making mutual promises, both promisors have the hope that their lives will be improved. The promisors are of equal status and have the capacity to understand what they are doing and commit to one another – thereby expressing trust in each other to the extent of the promises. We accept mutual promises as legitimate only when all those conditions are present. Where one is perceived as unequal in status – e.g., a king and a commoner, centuries ago – the promise might be of no moral effect. Where one of the contractors has impaired mental faculties, a drunk or a minor, we also likely view that person as not capable of freely willing and so also not responsible for his promises.

Two core norms apply to mutual promising. The violation of either causes us to condemn as immoral the promisor who violates it. Those norms are:

- Don't lie about material facts to induce the returning promise
- Make every possible effort to fulfill your promises[37]

a. Lying

One of the key requirements for any promise received is that it not be obtained by fraud – that it not be obtained by lies about something important. This is at the core of ethical intuition in both social and business promising. This norm supports the fundamental goal of the practice of mutual promising. Where someone is willfully misled into making a promise by a false promise made to him, he may not judge himself benefited by the exchange of promises; and, thus, the principal goal of the practice -- the mutual benefit -- is undermined.

The "no lying" rule also derives from the roles involved in the practice. If the promisor is lied to about material facts, then he may not be said to have freely consented to making his promise or, alternatively, the trust he placed in the other was violated.

A few clarifications about lies and promising. A lie is a false statement its maker knows is false – a mistake is not a lie. We might absolve a promisor from the obligation to fulfill a promise if a material fact stated by the co-promisor, on which the promisor had based his decision to promise, was false. We would not, however, condemn the co-promisor unless the co-promisor knew that what he was saying was false, or he had been so reckless in speaking that his recklessness was itself condemnable.

[37] For this formulation of the norm, as well as some valuable insights about fulfilling promises and trust, I thank Professor Michael Brimm of INSEAD Business School.

An obligation not to lie does not generally imply an obligation to speak at all. If you attend a movie, the person selling you the ticket has not acted immorally if the movie is bad – even if the ticket seller thinks it is a bad one and has not spoken. Where however the promisor knows that the co-promisor makes his promise under a false belief about material facts, we will condemn the silence of the promisor. If the ticket seller sold a ticket to a patron in a wheel chair -- knowing that there were no wheelchair accessible spots left in the theatre – we would condemn him even though he did not lie.

And if one does speak, what one says has not just to be literally true, but also must not convey a false impression so serious, that the statement is in substance false. In an iconic scene from the movie The Pink Panther Strikes Again, Inspector Clouseau (played by Peter Sellers), after checking into a hotel, walks over to a small dog resting in the hotel lobby, looks over at the proprietor and asks, "Does your dog bite?" The proprietor looks up at him, shakes his head from side to side and says no. Clouseau then reaches down to pet the dog, saying "nice doggie," only to find that the dog viciously bites his hand and refuses to let go. Clouseau frees himself from the dog's grip, looks up at the proprietor and says angrily, "I thought you said your dog does not bite." The proprietor calmly responds, "That is not my dog." Clouseau's anger, while funny, is also fully consistent with the moral intuition that saying what is literally true can be morally wrong where the speaker should know that his listener will be materially misled by the speaker's truthful words.

b. Fulfilling promises

It is unethical not to do one's utmost to fulfill a promise. The idea of trying hard to fulfill promises runs deep in our ethical intuitions. Absent sincere effort, people will not regularly fulfill promises and the goal of the co-promising practice – which is the exchange of benefits – will not likely be achieved. This norm is also consistent with our showing respect for the other as an equal and our demonstrating our trustworthiness to someone who has made herself vulnerable to us.

If one fails to fulfill a promise, not for lack of trying, but rather because of unavoidable circumstances out of one's control, we usually do not blame the promisor (even though the promisor may still be legally liable). For example, if a company fails to pay timely its promised bond coupon, and it does so because an economic downturn has so materially impacted the company's profits that paying that coupon would be imprudent, bondholders may be unhappy with company management (and may have a legal cause of action against the company), but, in the absence of fraud or other mismanagement, we do not typically call those managers immoral.

However, there are circumstances in which we would blame a diligent but unsuccessful promisor. One such circumstance is where he recklessly made the promise in the first place – heedless of whether he would be able to fulfill it – and ultimately failed. Such an ethical sentiment may underlie the uneasiness some people have about short-selling – where one sells a stock that one doesn't own. If the seller fails to deliver the stock when the time comes for delivery because the seller has been unable to locate and purchase the shares, he would likely be condemned as immoral – unless, at the time he sold the shares, he had good reason to believe he would have been able to procure them by the time of delivery. Interestingly, laws on short sales are often consistent with this moral intuition, permitting short sales, but requiring that before anyone be permitted to sell short, the short-seller's stock broker record in its books the name of a source which the broker has good reason to believe has enough shares available to be able to sell them to the short-seller to allow it to fulfill its promise, in the event the short seller cannot otherwise cannot find other shares to deliver (a "locate").

Another circumstance in which diligence in trying to fulfill a promise might not be enough is where the promisor realizes he cannot fulfill his promise, but does not quickly tell his co-promisor of the fact that he will fail. At every moment during the life of a promise, the promisor is essentially continually representing that he will fulfill the promise and the co-promisor is continually trusting him to do so. During each moment the promisor knows that he will not be able to fulfill his promise, but the co-promisor does not know, the promisor is breaching the trust the co-promisor has placed in him. At the moment the promisor knows that he can no longer be relied on to fulfill his promise, despite his diligent efforts, he must tell the co-promisor. I suspect that this moral intuition is based on the fact that only when the co-promisor knows that his expectations will be disappointed, will he try to procure a substitute for the good he was promised. When a promisor fails to disclose his inability to fulfill the promise, he deprives the co-promisor of potential opportunities to procure that substitute and make good his potential loss – and the more delay in the disclosure, the more potential opportunities missed.

While mutual promising is the social practice I have been discussing, sometimes the failure to fulfill a promise which is not tied to a responding co-promise can also be morally condemnable. But, it depends on expectations and reliance. Some statements, like "I promise to be there at 6:00," typically do not create expectations so significant as to draw moral condemnation when violated. We might believe that a perpetual latecomer is lazy or disorganized, but we generally don't view him as unethical. We might however morally condemn someone on whom we relied to our detriment as a result of the promise if he knew we were relying on him and did not fulfill the promise. If you promise to lend me money that I need for something important and you know that I am relying on your promise and not asking anyone else; and, then you renege on your promise when my need for the money is urgent, I would be right to condemn you. But that is a different sort of moral situation from that relating to breach of a co-promise.

c. One size does not fit all

Since mutual promises must be made to form a contract, the norms (and their supporting moral intuitions) at the core of mutual promising are also at the core of the ethics of financial services (which is governed by contracts of various sorts), and should form a part of our code of ethics. However, those intuitions need to be supplemented by many others if we want to sketch out a code of ethics for all of banking.

To the public, banking seems monolithic: since all banking is of the same nature, all bankers should be subject to the same code of ethics. In fact, banking is hugely varied. Most people have the view that a bank is an institution that takes deposits and lends money -- with the associated practices of making and servicing mortgages, and providing people with access to their money on-line, though tellers or ATM's. In fact, banks contain within their physical and legal walls businesses that a generation or two ago were not considered banking business or may not even have existed at all – securities brokers, futures brokers, clearing brokers, alternative trading facility, internal agency matching engines (i.e., internal stock exchanges), foreign currency dealers, asset managers, commodities trading houses, merger and acquisition investment bankers, new issue investment bankers, private equity funds, hedge funds, merchant bankers, derivatives dealers, etc. Those businesses developed independent of the traditional banking world, dealt with customers in different ways than banks did, developed different practices from banks, and were governed by different rules and regulators than were banks.

Once one reframes the world of "banking" in that way, it does not seem likely that a single simple set of ethical principles would sensibly apply across the entirety of that world. Beyond the core rules underpinning the practice of mutual promise-making, and perhaps a rule saying that everyone should be committed to following the law,[38] I have been unable to find any other rule that fits the ethical intuitions that undergird all of these businesses. I have, however, found three social practices with well-accepted ethical frameworks that appear to correspond very nicely to three important types of financial service businesses. Those three social practices are game-playing, persuasion, and guardianship; and, they map roughly onto the trading world, the sales world and the asset management world, respectively. Each of those social practices appears so foundational for those businesses that, if we are able to develop codes based on the ethical norms of those practices, we could have codes that produce the 4C effects of compliance, completion, certainty, and consistency that we desire.

5. Game-playing as a social practice

The first practice is that of a game or competition in which there are fixed rules and in which people compete with one another for defined rewards. [39] The goal of each game is to distribute rewards, according to the rules. The role of each person in the social practice is a player – deemed equal in his status and his capacity to compete with each other player. The interests of each player are opposed and each is striving to win. While the game may have been designed for an end wholly separate from the game itself, as far as the players are concerned, they are typically just supposed to follow the rules.

The gamer's ethic is quite clear:

[38] There is likely a general ethical demand to follow laws made through fair democratic procedures. Nonetheless, we should recognize that specific laws and regulations only tangentially overlap with ethics. Some laws conform to well-accepted social practices, but most are morally neutral, especially in the financial services space, with its multi-thousand page rulebooks. For every law that prohibits lying to clients there are a hundred specifying the exact manner in which data needs to be formatted when provided to the regulator.

[39] "War has its laws as well as peace; and even that sportive kind of war, carried on among wrestlers, boxers, cudgelplayers, gladiators, is regulated by fixed principles. Common interest and utility beget infallibly a standard of right and wrong among the parties concerned." Hume, *Enquiry*, Section IV, "Of Political Society, " *supra*, p. 38.

- Play by the rules ("don't cheat")
- Play to win
    - Ok to work in temporary alliance with a competitor if that will help you overall gain on other competitors

This is an ethic that is well understood by virtually everyone, because we learned it when we were very young and, by the time we have become adults, we have played thousands of games. We feel the morality of the fair competitor or the cheater viscerally. It is usually easy to classify behavior as good or bad under this framework, although there are always – as in all ethics codes -- some edge cases, e.g., someone who takes a fall on a playing field to try to fool the referee. It is the ethic of competitors playing hard and by the rules – and it is the ethic of the marketplace.

Most traders in the capital markets believe that they are fierce competitors, playing to win according to the rules of the game. This struggle is the essence of a market. Although in playing the game selfishly according to the rules, traders may help society achieve another goal – namely, the efficient pricing of goods and therefore the most efficient distribution of capital – that social goal is not what they are thinking about as they trade. As Adam Smith put it famously in *The Wealth of Nations:*

> "It is not from the benevolence of the butcher, brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love, and never talk to them of our necessities but of their advantages."[40]
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> "Each individual . . . neither intends to promote the public interest, nor knows how much he is promoting it . . . [H]e intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention."[41]

I would suggest that the core rules of the trading game are the following:

- Buy for the lowest price you can find a willing seller prepared to sell to you
- Sell for the highest price you can find a willing buyer prepared to buy from you
- Make every effort to fulfill your contracts (same as the mutual promising practice)

Those basic principles (plus those underlying the mutual promising practice) are what traders believe govern the game they are playing. To be successful they must evaluate the size of supply and demand at various price levels and then find people willing to transact with them at a profit. If pricing anomalies are discovered because of information imbalances or otherwise, the trader does not believe it is morally inappropriate to exploit them. That is the essence of playing this game. He does not feel obliged – under penalty of being accused of immoral conduct – of announcing the

[40] Adam Smith, *Wealth of Nations*, Book I, Chapter II, 26-7, para 12.
[41] *Ibid,* Book IV, Chap II, 456 para 9.

pricing anomaly to the market. He is in a constant search for buyers who want to pay more or sellers who will accept less. He may have a view of intrinsic worth, based on his assessment of supply and demand over some time horizon, but that is only a tool to help him trade. The market-clearing price (the actual price at which he can buy or sell) is all that really matters to him.

He does not feel it is necessary to declare his own intentions as to how much he wants to buy or sell in the future, at what price and over what period of time. In fact, lying about his own future intentions (as opposed to lying about real world facts) is often considered part of the game. Being able to successfully disguise intentions is part of the skill involved in playing.

If we form clear ethics rules based on these principles, they quickly would gain the allegiance of traders and would be likely followed very consistently. Interestingly, however, much current regulation governing trading embodies social goals that conflict with some of these principles. I do not view such rules as bad ones. However, such rules are often counterintuitive for traders and so we should not be surprised, or morally outraged, that their moral intuitions do not guide them very reliably when trying to understand how to comply with those rules in edge cases. Nor should we condemn them as unethical for violating one of those non-gaming-based rules.

a. Market manipulation rules

Market manipulation rules are one such type of social goal-based regulation. Manipulation is typically defined as trading with the intent or effect of creating a market not reflective of actual supply and demand.[42] It thus brings into the frame two problematic concepts –that certain trading behaviors designed to uncover actual supply and demand are improper; and that certain prices actually achieved in the market through real trading are artificial ("not reflective of actual supply and demand").

- **Spoofing**

Spoofing -- placing and then withdrawing orders with the intent of suggesting that you have buying or selling interest that you don't in fact have -- is illegal in most markets. [43] The danger spoofing poses to markets is that the spoofer misleads other market participants as to his true buying or selling interest and, as other traders react

[42] See, e.g., the FCA definition: transactions or orders "likely to give a false or misleading impression as to the supply of, or demand for, or as to the price of one or more qualifying investments" to "secure the price of one or more such investments at an abnormal or artificial level." (MAR 1.6.1); and the CFTC definition: "specifically intend[ing] to create or effect a price or price trend that does not reflect legitimate forces of supply and demand . . . [and] caus[ing] artificial prices." CFTC Fact Sheet: Anti-Manipulation and Anti-Fraud Final Rules (2010).
[43] By definition, these are all real orders, which, if accepted by another party, would result in an actual transaction. Thus charges of spoofing are typically based on orders being displayed and cancelled so quickly that market participants are not likely to be able to interact with them – so in that sense they are not "real."

to his misleading signals, the resulting market price will not reflect real supply and demand.

There is a fundamental difficulty with anti-spoofing rules that makes them difficult for a game-player to follow. Markets are never at "equilibrium." Traders are constantly trying to discover what others' intentions are, at the same time that they are hiding their own.[44] In sports, players "fake left and go right." In competitive trading markets, people try to mask their future buying and selling interest in order to achieve the best price for themselves ("intending [their] own gain" – in Smith's words). They show just as much as they need to show in order to encourage others to show their interest, and no more. So, e.g., to minimize their purchase price when they want to buy a large quantity, traders may hide from the market the large size they intend to buy by (1) buying in small lots over time,[45] (2) buying up all the sellers' volume that has been publicly disclosed in order to see how much other interest is behind those sellers, (3) selling small quantities before or in the midst of their purchases, and (4) stating that they intend to sell or that the market seem expensive.

The problem with anti-spoofing rules is that spoofing is completely consistent in intent and impact with the strategies just described, yet is the only spoofing that is singled out for condemnation. If those other strategies are ethically appropriate under the rules of the game (and there is little question that they are), then so is spoofing. While there is a debate around whether, in the new world of electronic trading, spoofing assists or detracts from the achievement of market prices reflective of supply and demand, there is little debate that the underlying intent of spoofing is no different from strategies historically deemed completely acceptable to most traders.[46]

- **Orderly markets**

For similar reasons, the price achieved by any contract freely – non-collusively -- entered into should be the appropriate price for that moment. Just as there is no "right" score for a game at any moment (other than the actual score), there should be no "right" price for a market at any moment, other than the actual price. Any price actually achieved in a free market is by definition "reflective of actual supply and demand" at that moment. [47] Nonetheless, certain regulators – under the banner of

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[44] Israel Kirzner, "Competition, Regulation and the Market Process: An 'Austrian' Perspective," (Cato Policy Analysis, 1982), http://www.cato.org/pubs/pas/pa018.html.
[45] In the late 1990's Warren Buffett executed a carefully constructed plan to buy 129 million ounces of silver, slowly over time. With each purchase he made, he hid from the market the fact that he had more to buy; if he had disclosed to the market his long-term intentions at the start of his buying program, he would have undoubtedly bought at higher prices than he was able to by hiding those intentions. Thus, his deception of the market caused the price to be lower than it would have been if he had disclosed. Was that ethically wrong?
[46] See Matt Levine, "Why is Spoofing Bad?" http://www.bloombergview.com/articles/2015-04-22/why-is-spoofing-bad-
[47] In a conversation with me, the late Fischer Black, one of the originators of the Black-Scholes options pricing model, stated that he viewed as legitimate any trade that involved a transfer of risk to another party and that anti-manipulation law, in

"orderly markets" – try to limit market movements to prevent the market from moving up or down too quickly, especially near a market close or open. Regulators prefer markets which move smoothly – e.g., trading at each hundredth of a point between 20.00 to 20.05, as opposed to trading at 20.00 and then trading next at 20.10 (a phenomenon called "gapping"). Regulators may be correct that smoothing contributes to public confidence in markets, but such interventions actually detract from the integrity of a competitive market, by keeping the market from reaching its natural price level as quickly as it should.

It should not be a surprise that spoofing and orderly market rules are not effectively policed by the moral intuitions of traders – as those rules do not derive from the moral intuitions underlying the social practice in which they are engaged. We should demand that traders follow such rules, but we should not expect our ethics code to be helpful here and should not criticize traders as being immoral for not being able to police the boundaries of such rules or for resolving ambiguities in those rules in the same way a regulator might. While there are genuine policy reasons underlying these rules, our ethical code should do no more than require that orders and trades be real, that traders try to sell high and buy low – regardless of the level of the transparency of their intentions to the market or the price they achieve – and, of course, that they fulfill their promises and not lie about material facts.

b. When amateurs play with professionals

Professional football teams play by a single set of rules. We do not create different rules for each of the teams on the field, based on their relative strength. One set of rules exists for all. We do not say that if a high school team wanders onto the playing field, the professional team must change the way it plays. That would change the game. We tell the high school team to get off the field. [48]

Yet, in the world of wholesale trading markets, we are increasingly telling the professional team that it needs to change the way it plays depending on who shows up for the competition. Now, sometimes traders are judged by different standards of conduct based on whether they are trading with an individual, a pension fund, a hedge fund, a state or local government or another wholesale bank. This has particularly come to the surface as markets have become more electronic and non-professional participants have been able to obtain easy and cheap access to trading venues traditionally open just to professionals. Regulators, rather than keeping the line between professional markets and retail markets clear (or requiring retail participants to hire professionals), have tried to make the professional markets safe for non-

delegitimizing some classes of trades involving genuine risk transfer, could not be justified under economic theory.

[48] In some sports, golf most famously, players are given handicaps in order to create a fairer contest – or at least one that makes the likely winner less predictable. Handicapping is an exception to the general rule of games, in which people compete equally on the basis of the skills they individually bring to the sport. Golf handicapping may have arisen out of a desire to maximize the opportunities for "gentlemen" of the same social status to socialize with others, despite being of different skill-levels. Thus, golf rules may be a blending of two social practices (gaming and -- what me might call today -- networking).

professionals. So, we have seen the expansion of "best execution" rules, profit disclosure requirements, and the like, across the trading world. Regulators naturally try to protect those new entrants, but often at the expense of muddying the model and confusing the players as to what constitutes ethical behavior.

c. Helping a competitor

If the goal of each of the actors in the gaming social practice is to win, and the game is multiplayer, sometimes a temporary alliance with another player may be in that actor's best interest. So long as his goal is to win, such an alliance typically does not offend his or our ethical sensibilities.

Thus, it is not surprising that, in markets where there are many players and no one has ultimate power, many market makers share their views about markets (i.e., make temporary alliances) with other market makers. Information imbalances are common in markets and need to be exploited if markets are to find the market-clearing price quickly ("market equilibrium"). Since success in the trading game is in large part determined by who has the best view of the future, traders are constantly trying to uncover new sources of information about that future – from customers, data providers, industry participants, and news sources. Traders will often share their views of the market ("market color ") with others with informed views of supply and demand, in the hope those market experts will in turn share with them. The goal is making them smarter about the markets, so they can play the game better. For this reason, players generally view information sharing as legitimate.

Unfortunately, EU regulators in some cases have taken the view that the mere sharing of information (the making of the markets "less opaque") among competitors violates competition laws – regardless of whether they are acting collusively. This flies in the face of the very every essence of what traders view the trading game to be about – developing a more accurate, a less opaque, view of supply and demand and then exploiting that view. Without expressing an opinion on the public policy underlying this aspect of competition law, I simply want to note that it should come as no surprise that, in a highly competitive market governed by the gaming ethical framework, traders might not understand that the mere sharing of views on the market with a competitor is any more than normal price discovery.

d. When playing to win isn't enough

Interestingly, even the "Play to win" norm is likely incomplete. As the game is played, situations may arise in which the application of that rule produces a morally inappropriate result as understood by the players; and, those intuitions drive different behaviour than that required by the core stated rule. I am told that in rugby, when a clean hit results in a player falling to the ground with no formal stoppage of play declared, and an instantaneous consensus emerges among the players on the field that the player has been badly hurt, an informal rule is invoked. The team advantaged kicks the ball out of play to create a game stoppage to allow the second team to take the hurt player off the field and replace him with a healthy player. In return, the second team, now at full strength, inbounds the ball directly to the other team to, essentially, return the favour. The breach of any part of this unofficial rule set is viewed as unethical and will call down opprobrium on the offending team or player from the opposing team and the crowd. If the injury is mild, that rule is not invoked.

Such an intuition might be explicated with a rule that recognizes that a game is simply a game, in the end; and, that other social practices or ethical frameworks may also be implicated in certain circumstances. When continuing to play a game might result in serious bodily harm, the "Play to win" norm will be suspended until the harm is averted. Similar eethical sentiments may also limit the full application of the "play to win" norm in competitive markets, e.g., where there may be material harm to an individual's life or health or when the implications to society from particular behavior -- e.g., cornering a market – might be severe (see section e below). Alternatively, we could view this an example of rule incompleteness.

In sum, the ethical framework supporting the practice of competitive games is quite helpful in defining the expectations for traders in the wholesale markets. Such a framework can be used to craft an ethics code for traders, which will be of value to them in guiding their behavior. When governments intervene in trading markets by creating rules which smooth price movements, grant retail direct access to wholesale markets and or try to restrict information flow among market makers, they need to recognize that these rules may not be easily assimilable into a readily understood ethical framework. And in particular they need to recognize that traders may not view breaches of those rules as unethical or know how to act when those rules are incomplete or vague.

6. Persuasion as a social practice

Salesmanship is not a dirty word. We are all trying to sell – or persuade – all the time. From our days as small children we have tried to convince people of one thing or another – to buy us a desired toy, to vote for us for student counsel, to take us out to a favorite movie. And as adults, the social practice of persuasion is all around us. A large portion of our daily conversations, as well as all sales practices (from one-on-one persuasion, to the layout of advertising copy, to the design of websites), is designed to persuade. The practice also includes much of the work of politicians, lawyers, journalists and essayists – who are frequently encouraging someone to believe something. Like gaming, the practice of ethical persuasion is defined by intuitions and rules or principles.

I will call the participants in the practice, the persuader and the target of persuasion. The goal of the practice of persuasion is for a persuader to convince a target to believe a proposition or take an action for the target's benefit. It is to improve the position of the target. The target, while perhaps not as knowledgeable as the persuader, is presumed to be able to think rationally and is free to agree or disagree with the persuader. To participate in the practice, the target places a limited trust or reliance in the persuader. The parameters of that trust will be the principal subject of this section.

I would suggest that the norms of persuasion practice are as follows:

- Only sell products or ideas you understand and sincerely believe in
- Disclose hidden material biases
    - Evident biases do not need explicit disclosure

- Don’t lie about material facts (same as from the mutual promising practice)

a. Sincerity

If a salesperson sells a product he believes defective, that would be unethical. However if he sells a product that he believes is a good one for the target of his persuasion, but does not alert the target to products sold by others that she might like better or that are cheaper, he is not unethical. He does not need to believe that his persuasion is designed to put the target in the best possible position, but only that it is designed to put the target in a better position.

Interestingly, in financial services, the view that the persuader needs to believe sincerely that the product will be good for the client has been embodied in regulation as the “suitability” requirement. Anyone who wants to persuade someone to purchase a product subject to suitability needs to believe, based on reasonable inquiry into the client’s situation, that the product is suitable for the client, given the client’s objectives.

b. Competence

Sincerity may not be enough, when the persuader does not know whereof he speaks. If a well-informed, truth-telling and sincere bond salesperson persuades someone to buy a product that does not turn out well for the target, we will not likely view the persuader as unethical. However, if the salesperson didn’t understand the product, no matter how sincere he was, we would likely be angry and say “he had no business selling the product if he did not understand it.” In this way, a requirement of competence is built into the ethics of persuasion. Implicit in the ethical norms surrounding persuasion practice is the expectation that the persuader has an appropriate minimum level of competence in the topic that is the subject of his persuasion. The persuader need not be an expert, because the practice is based on the ability of the target to think through the issue rationally and choose for himself, but we generally expect the persuader to have done her homework and possess some minimal level of knowledge and understanding.

In my moral universe, the level of competence we will demand of the persuader for her to escape the charge of immorality varies based on how important the matter is to the target of the persuasion. If someone is writing a blog on a topic of current interest or trying to convince me to spend my money on a new I-phone, less is at stake than when that person is trying to convince me to buy my first house or invest my life savings. We are thus more likely to criticize uninformed bankers and real estate agents as unethical, than we are equally uninformed junior salespeople at the Apple store or bloggers at the Huffington Post. We are more likely to call the latter incompetent than immoral. We move into the realm of morality when important interests of the target are at stake.

Thus, given the importance of financial well-being to living a comfortable life, an ethics scheme for bankers might require that a salesperson be trained in and understand a sufficient amount about the product she is selling, portfolio construction and tax law so that he can express a view based on facts, with supporting reasons, to the target about whether the product would be a good one for him. We would not necessarily require him to be an expert in the product, but rather to know enough to be able to marshal cogent arguments based on facts in support of the product.

c. Bias

Since the practice assumes the sincerity of the persuader, it is important that the target know of anything special that might be biasing the presentation, so he can evaluate the argument in that light. In most persuasion situations, the bias of the persuader is clear – a salesperson for a company has a financial incentive to sell her product; a surrogate for a candidate has a personal incentive to have his candidate elected; a lawyer is being paid to advocate. All those biases are on the surface. A target in the practice is presumed to be intelligent enough to be aware of those standard biases and able to evaluate the persuader's argument in light of those biases, without the persuader having to formally disclose it. Our moral sensibilities are not offended by the mere existence of bias. Thus, e.g., we do not generally view salespeople in financial services as unethical merely because a benefit will accrue to them from closing a sale, because it is obvious that they have a bias.

Only when a bias is material and hidden do we feel offended when it is not disclosed. A researcher may have a bias to describe his results as significant because a publishable paper will further her career – but we don't criticize her as unethical for not describing that bias in a footnote, because such bias is so well-understood. However, if a private company or foundation with a strong policy bias funded her research, we would view her as unethical for not disclosing that funding.

d. Fairness and balance

Interestingly, while the practice demands (as does the mutual promising practice) truth telling about material facts, it does not demand fairness and balance in the actual presentation. The persuader need not present each key fact that the target might want to consider or present the argument against his own position equally with the argument in favor, so long as he is sincere and truthful. An obviously unbalanced presentation may not be persuasive, but it is not thereby immoral. If a political surrogate asks you to support his candidate, and sincerely and honestly presents his views, but does not discuss certain of the candidate's less savory positions, you do not necessarily think the surrogate dishonest.

I suspect that our moral intuitions developed in this way because experience teaches that it is hard for anyone with a bias to be perfectly fair and balanced; and because there is a cost to balance – both in time and focus, for the persuader and his target. If we required fairness and balance each time someone tried to persuade us of something, we would be offended most of the time. For these reasons, our moral sensibilities rarely demand that persuaders be balanced.

It is therefore often difficult in financial services for salespeople to calibrate how much they need to disclose of the risks of a transaction and how far they have to go to compare their product to other products. If they believe that the product they are selling is a good one for their client, their ethical antennae are not raised by marketing material that does not explain everything that might go wrong with their product or compare the product to other similar products. In fact, the natural inclination of an honest and sincere salesperson who believes in his product is to focus virtually exclusively on how beneficial the product would be for the client's portfolio, rather than to specify in detail all the future scenarios in which the product might lose money.

Extensive regulation and case law has filled this gap -- specifying in great detail what needs to be disclosed about products in order to effect legal sales. Questions can be raised about the value of those disclosures to many investors (targets), but there is no question that absent those rules, it is highly unlikely that the ethical intuitions of salespeople would have led them to make as full a set of disclosures as they are now required to make.

Lest you think that the standards of persuasion ethics particularly low in the financial services world, I would argue that it is no different in the academic or regulatory world. Presentations of one-sided papers or speeches, which are truthful and sincere but do not fully treat opposing views, may be unpersuasive, but are rarely viewed as unethical.

e. Where the target cannot fairly judge

Our comfort in applying the persuasion framework to any social situation is based on our assessment that the target has the ability to weigh the validity and force of the persuader's argument and to decide the matter for himself. As a result, we do not see the persuader model as appropriate to evaluate the morality of conduct where the target of a persuader is viewed as not fully rational. It is immoral (as well as illegal) to contract with children, who presumably do not understand the full implications of what they are doing. The same is true of those who try to take advantage of recent widows or widowers or of parents mourning children – who are not likely to be able to think rationally at that moment.

In banking, which often concerns highly complex subjects, certain matters that are regularly the subject of persuasion practice may be so hard to evaluate fairly without special expertise or information, that we may find persuasion unethical unless important information only available to the persuader is affirmatively disclosed to the target, or unless an expert is available to assist the target in evaluating it.[49] These are the intuitions that I believe underlie the ethical analysis of disclosure requirements for derivative pricing that I discussed in section 2f above.

In more extreme cases, we may find matters not proper subjects of persuasion practice at all even for healthy adults of normal intelligence, where it is believed that no one without special expertise or high intelligence can rationally evaluate those topics. This view underlies a recent UK FCA ruling that banned the sale of Contingent Capital Bonds to retail investors. The FCA concluded that individual investors were

[49] Such situations involve what has been called "asymmetric expertise." Gold, *supra*, p. __. One must be careful when using that label to analyze ethical requirements in persuasion practice, as expertise is virtually always asymmetric. It is rare that persuader and target are equally expert. Only extreme asymmetries are morally relevant.

not likely to understand the risks and characteristics of those bonds. Whether or not that ruling was the correct one for these bonds, such boundary cases can create confusion on the part of financial service salespeople, who presume that the products they sell can all be sold, perhaps with greater disclosure than usual, under the persuasion framework to other adults.

f. The impact of Behavioral Economics

If a politician starts a speech with a joke or delivers his speech against a backdrop of buntings or colored banners designed by psychologists to evince trustworthiness, we think his exploitation of behavioral biases intelligent, not unethical. We do not criticize him for not presenting his concepts in the most sterile way possible in order to ensure that people only think through his arguments rationally and without emotion. So long as we view him as sincerely believing in his themes and as telling the truth, we may actually think him admirable.

Much recent academic work has demonstrated that behavioral biases make rational choice difficult in many circumstances, not just in the edge cases described above involving widows and mourning parents.[50] Thus, it could be argued that any persuasion practice that tries to take advantage of behavioral biases is unethical. For example, we might say that products must not be structured to include high "teaser" interest rates of return in the early years, balanced by lower or more risky returns in later years, as such products take advantage of behavioral biases which cause investors to overvalue present gains versus future potential losses. Or we might call salespeople unethical who devote the early pages of presentations exclusively to the potential benefits of a product, rather than its risks, in order to take advantage of people's natural tendency to "anchor" their thoughts early and not change them.

However, our ethical sensibilities are not generally attuned to those biases and are offended only in extreme circumstances. In fact, a complete genus of literature exists identifying how to exploit behavioral biases to persuade (e.g. Dale Carnegie's *How to Make Friends and Influence People*) and the well-respected discipline called "leadership studies" is in large part training in how to take advantage of behavioral biases and emotions. Shakespeare's stirring "band of brothers" speech from Henry V, [51]often lauded as a model of how to inspire, is actually Henry's attempt to bypass his solders' rational mind and appeal to their emotions to encourage them to put their lives at risk for him (exploiting the bandwagon effect, the halo effect and the framing effect).

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[50] See, e.g., Kahneman: *Thinking Fast and Slow* (Farrar, Straus and Giroux, 2011); Sunstein and Thaler, *Nudge: Improving Decisions about Health, Wealth and Happiness (*Yale, 2008).

[51] William Shakespeare, *Henry V,* Act 4, Scene 3, Lines 18-67 ("We few, we happy few, we band of brothers/For he to-day that sheds his blood with me/Shall be my brother; be he ne'er so vile,/This day shall gentle his condition:/And gentlemen in England now a-bed/Shall think themselves accursed they were not here,/And hold their manhoods cheap while any speaks/That fought with us upon Saint Crispin's day.")

I do not know why such explicit attempts to bypass our rational cognitive apparatuses generally do not offend, and in the case of leadership skills, are admired – although I suspect it has something to do, as Hume might suggest, with the "utility" of leadership for a well functioning society. Interestingly, Sunstein and Thaler's proposal to have government try to neutralize the exploitation of biases by commercial actors – through consciously engaging in "choice architecture" -- itself has offended some as too Big Brother-like, i.e., as not properly respecting the moral agency of the targets of the persuasion. In any event, as we become more aware of cognitive biases and the ways in which they can be exploited, that awareness may come to impact the way in which we judge persuasion practices as ethical or not. But, for right now, the exploitation of behavioral biases does not generally appear to violate our ethical sensibilities.

g. Persuasion of friends

In persuasion practice, the target has placed some, not unlimited, trust in the persuader. He has no "special" relationship with the persuader, which might create special obligations on the part of the persuader. By contrast, if the persuader is a friend of the target, our intuitions might demand a higher standard of conduct. We expect more from a friend than a stranger. We would expect one friend to sell another friend the best product he is aware of, not just a good one. If the friend learned that a better or cheaper product was available in the market, we would be offended if he tried to persuade the target friend to buy the less good or more expensive product, even if that product was of good quality and fairly priced.

These intuitions enter the world of financial services where salespeople blur the line between customer and friend -- through trying to build a personal relationship with customers through friendly telephone calls, dinners, entertainment and the like. Good salespeople pride themselves on knowing and talking with clients about the clients' spouses, children, favorite restaurants, hobbies and vacation spots – just as friends do. In doing so, they are trying to encourage the customer to trust them "specially." If they are successful, the customer will likely make herself more vulnerable to being hurt by the salesperson than she would in a standard sales relationship. While such a relationship may bring additional business, it may also create additional ethical obligations. We owe a greater duty to a friend than we do to a stranger whom we are trying to persuade – and that duty (which may include fuller disclosure and an intent that the product sold be the best available for the client, not just suitable for him) goes beyond that required of the persuasion model.

By contrast, some sales relationships may not even rise to the level of a persuasion relationship. A salesperson may transact with his client in a product she has made no effort to persuade him to buy, and instead act simply as an agent of a client to source the product for him in the market. In those circumstances, the salesperson feels no obligation to determine whether that product is even a good one for the client and the client may view it as inappropriate even to be questioned about his choice. I would suggest that such "unsolicited" transactions do not create any ethical obligations under persuasion practice. And, the law agrees – as it generally does not impose a suitability obligation under these circumstances. The salesperson is permitted to conduct the business, even if he thinks it will not advance his client's interests at all.

The ethical framework of the persuasion practice can perform useful service by guiding sales practices, but if we want to make use of the value of the 4C's, we must create a code that is respectful of the boundaries of the practice and makes clear when the persuasion code applies and when it does not.

7. Guardianship as a social practice

Perhaps the most clearly defined of the ethical frameworks we develop as we grow is that of the guardian, the person who is obliged to act in the best interests of another. From the time we first borrow another child's toy to play with, we learn that there are special rules that apply to that situation. I become a guardian for something belonging to another. I must treat that toy differently from the way either I treat my own toy or I treat anyone else's toy over which I have not been given guardianship. I am free to dispose of my toy as I wish, but I have an obligation to preserve another's that I hold. I need to protect that toy, but I have no obligation to protect another toy not placed in my care, even if I see it at risk.

Guardianship practice allows beneficiaries to manage their affairs with greater expertise than they alone could bring to bear, and otherwise expands the range of value they can achieve in their lives, beyond what they might have obtained if they had needed to rely solely on themselves. The roles are that of guardian and beneficiary and equality of status does not exist – the beneficiary has intentionally made herself vulnerable to the guardian, with respect to the interest placed under the guardian's care.

The guardian's ethic is based on the following rules:

- Act solely in the best interests of the beneficiary with respect to the matter entrusted to you
- Disclose and get beneficiary consent for any conflicts of interest
    - If the conflict is so great that a trustee can not plausibly act in the best interests of the beneficiary, withdraw
    - If the beneficiary can not plausibly give informed consent, withdraw

These rules are easy to understand – although they are sometimes difficult to apply in practice. Investment advisors, who manage people's money, are the quintessential guardians in financial services. They are required to act solely in the best interests of their investors, who are beneficiaries of their guardianship. The same framework also applies to investment bankers acting as advisors to companies.

a. Competence

I noted earlier that our ethical sentiments demand that someone trying to persuade be knowledgeable in the topic of the persuasion. A similar, if even stronger, ethical demand of competence exists when someone is a guardian, because the beneficiary is relying on the guardian to act in its best interests. A guardian cannot act in a beneficiary's best interests on a matter unless the guardian has sufficient competence to understand and analyze the matter entrusted to her; without that competence, she is flying blind. The vulnerability of the beneficiary to the guardian arouses that ethical intuition.

And because a beneficiary's vulnerability is so much greater than that of a target of persuasion practice, we will likely hold guardians to even higher standards of competence than we will persuaders. While we presume a persuader's target is capable of analyzing a topic for herself and so rejecting an argument of the persuader, no such assumption exists in guardianship practice. The guardian is acting for the beneficiary, who often has no ability to overrule his choices. The guardian substitutes his judgment for that of the beneficiary. Thus, he must act with special care, and if he is not competent to do so, he is acting shamefully.

For these reasons, in matters in which expertise is possible, guardians must be expert, not just minimally competent. (An example of a guardianship situation in which expertise may not apply might be a simple "watch my bicycle for a moment please"-type of guardianship). Thus, our ethical intuitions might require a higher level of training for an investment advisor than for a salesperson.

b. Conflicts of interest

Understanding and dealing with conflicts of interest between guardian and beneficiary is the most fraught part of this framework. Let's look at a simple conflict of interest. I am a guardian and responsible to you for purchasing products on your behalf, based solely on my judgment of what is in your best interest. If I receive a commission from the company manufacturing the product for each purchase I make, my judgment may be clouded by the financial interest I have in receiving that commission; and, it may be hard for me to know and for you to judge whether I act solely in your best interest in buying that product. Such conflicts can only be resolved by disclosure and beneficiary consent. Disclosure permits the beneficiary to evaluate the conflict and its impact on the guardian's ability to provide fair unbiased advice. Failure to disclose the conflict would be unethical.

There has been a recent effort in the UK and Europe to require asset managers, who are guardians/trustees for investors in their funds, to be more explicit about who is paying the costs incurred by the manager in managing the fund. The most prominent discussion focuses on how managers are paying for the research they are using to guide their investment decisions. The concern is that research can be funded by managers themselves out of the fees they earn for managing the fund's money, or by the fund itself, thereby reducing the fund's (the beneficiary's) returns. Unless charging research costs to the fund is fully disclosed and consented to by the fund, it would be hard to justify that billing practice as ethical under the guardianship framework.

Sometimes commercial transactions **between** a guardian and a beneficiary are proposed – where the guardian will sell something to the beneficiary. Such transactions create an irremediable conflict. Every extra dollar the guardian receives is one more dollar the beneficiary must pay. If the guardian is to act solely in the best interest of the beneficiary in such a transaction, he must provide the service to the beneficiary for free. Because of that conflict, it is hard to understand how a guardian could ethically sell any good or service to a beneficiary.

Where the beneficiary is unable to properly assess the significance of a conflicts disclosure, we may view him as unable to make an informed consent. In that case, consent would be insufficient to mitigate the conflict. A doctor/patient relationship is a type of guardianship in my typology (since the doctor is to guard the health of the patient). If a doctor were to ask a patient to consent to medical tests being sent to a facility that the doctor owns, patient consent might not be sufficient to vitiate the conflict, since the patient might not have the expertise to evaluate the quality of the facility and the significance of the conflict. A doctor who tried to convince the patient to consent to the doctor's using his own facility for the patient's tests might be viewed as unethical.

Similarly, there are certain kinds of conflicts that asset managers may have with their investors for which we might view the investor as unqualified to waive through consent, because they require special expertise that the investor does not have. One could argue, for example, that part of moral force behind the efforts in Europe discussed above to examine the charging of investors for research is the intuition that investors can not be presumed to understand enough about the intricacies of operating and managing an asset manager to be able truly to give informed consent to research fee structures.

The completeness of conflicts disclosure and the ability of the beneficiary to properly evaluate the way the guardian has resolved the conflict have been at the center of much controversy in investment banking, as well as asset management. Those discussions, often quite complicated, have in large part been conducted under the ethical framework of the guardianship model.[52]

c. Framework confusion

The greatest criticisms of the ethics of the financial industry has arisen where attempts were made to apply the guardianship framework to the entire industry – including business practices that bear little relationship to the social practice from which this framework derives. In particular, there have been attempts to try to apply this framework to standard trading and sales businesses – to which the game-playing and persuasion frameworks more naturally apply.

During Senate hearings in the United States in 2010, we saw mortgage traders who believed they were in the game-playing framework being questioned as if they were guardians. They were being asked how they could simultaneously sell a particular risky mortgage derivative to a sophisticated mortgage hedge fund, while taking the other side of that derivative trade and knowing that other sophisticated investors believed the product would decline in price. In the words of Senator Carl Levin "how could you bet against your clients?"[53] The traders believed they were acting ethically – and they were, under the game-playing framework. They were dealing with equals, playing by the rules, playing to win, and not conspiring with other competitors. Thus, they believed that they were free to sell a bullish mortgage product to a customer while either believing that the market would decline or knowing that other smart clients so believed. The questioners viewed the traders as being in a stronger position

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[52] See, e.g., *In re* El Paso Corp. Shareholder Litigation, 41 A.3d 431 (Del. Ch. 2012).
[53] See, e.g., "Panel's Blunt Questions Put Goldman on the Defensive," http://www.nytimes.com/2010/04/28/business/28goldman.html?pagewanted=all&_r=0

than their customers and obliged to act in their customers' best interests; thus, they were required to disclose their opinions and all material conflicts of interest and were shamefully "betting against" the success of those they were supposed to protect.

Similarly, in the US, criticism of salespeople servicing retail clients for not acting in the best interest of their clients has produced an explicit attempt to apply the guardianship framework to normal sales relationships governed traditionally by a persuasion ethical framework. The US Department of Labor has proposed a rule that would require a salesperson when covering an individual's retirement account -- to always act as a fiduciary. Making the proposed change in framework explicit and subject to public debate has exposed some of the consequences of the proposal – which may include raising costs and limiting the choices available to clients. [54]

One final point on framework confusion. I have argued that, in the financial services world, three frameworks correspond to common segments of the financial services industry: traders are gamers; salespeople are persuaders and asset managers and investment bankers are guardians; and the lines between those categories are generally clean. Nonetheless, framework confusion can arise. Let's look at an investment banker trying to convince a corporate executive to hire his firm to advise the corporation on a potential merger deal, when that banker is competing against other firms for that merger assignment. The banker will need to be conscious of all three models. The banker is trying to convince (persuader) the client that he should become the trusted advisor (guardian) through a competition (gamer) against other firms trying to do the same. An ethical banker will have to be very sensitive to his role as it changes throughout the process in order not to misstep.

8. The role of compassion

One of the traditional criticisms of bankers' ethics is what I will label the Henry Potter complaint (based on the Scrooge-like banker of the movie "It's a Wonderful Life.") The complaint is that a banker needs to be kind and show compassion for those with whom he deals – even if it means that the bank will lose money on those deals. This view might require a banker to make mortgage loans to people who need them, even if the borrowers will not qualify under the bank's underwriting standards; and require a banker to hesitate to foreclose on a mortgage if the mortgagor has lost his job, through no fault of his own, and cannot pay.

My own ethical sensibility tells me that the sanctity of contract -- deriving from the mutual promise framework -- does need to be tempered by compassion in circumstances such as these. Servicing a mortgage on a family's primary residence feels different than servicing a piece of commercial property owned by a real estate

[54] One financial services CEO implicitly referenced the change of ethical frameworks required by the proposed rule: "Imagine . . . a consumer going into a Chevrolet dealership and looking at a [sic] SUV, and the Chevy dealer says, 'In all honesty, the guys across the street, the Ford dealership, they really have a vehicle that fits you better than mine.' There is [sic] not going to be a lot of Chevy dealers, or at least guys or women selling Chevys anymore." "Financial Firms Seek to Scale Bank 'Best Interest' Proposal," http://www.wsj.com/articles/financial-firms-seek-to-scale-back-best-interest-proposal-1434491745.

company. In the first case I would want to think twice before foreclosing; in the later I would be less concerned. How do we explain and incorporate those moral sentiments into our banker code?

There are many theories about the origin of our feelings of compassion, or empathy, how natural they are, and how they develop. But, it is clear that we all have such feelings to one degree or another and that am important role of religious or moral education is to help us develop that sensibility. My own view is that such sentiments do not derive from the particular social practices that I have talked about, but derive instead from our participation in the "society" of a family. We initially develop compassion towards our family. Then religious and moral education stretches our sense of compassion. It "acquaints people of different kinds with one another so that . . . we expand the reference of the terms 'our kind of people' and 'people like us.'"[55] As we expand the circle of people whom we identify as "our kind of people" – i.e., like our family – we expand the network of those towards whom we feel compassion and to whom are prepared to act with compassion. We first expand the circle to members of our community and then later to strangers. When we see the strangers to whom we are lending money as proper subjects of our compassion, it is very hard ethically to evict them from their homes.

Regardless of how we come to be compassionate, we all know that sometimes our moral sense commands us to act with compassion – towards those in pain or towards those to whom we could cause pain. How to embed the sense of compassion that underpins those moral sentiments into a moral code for bankers, however, is not easy to do.

First, I might conclude that my exercise of compassion to stop the pain I see immediately before me might in fact not be compassionate in the long run. If I am deciding whether to give a mortgage to someone who does not meet my lending standards, it may actually be better for me to deny her the mortgage, even though she may be in distress, as in the end she may not be able to afford the payments. I might conclude that she might benefit more by an act of severity than of compassion and so might feel that the right thing to do is to look past my immediate feelings of empathy and not be compassionate – or, put that sentiment another way, that by overcoming my immediate feelings of empathy I am exercising greater compassion.

Second, in my moral universe, compassion is often at war with other moral sentiments. I might feel compassionate towards the family that cannot qualify for a mortgage, but also believe that, since the money I would be lending is not mine (but rather my company's), it would be immoral to lend that money when the company would not likely be repaid. I am a fiduciary (a guardian) for the interests of my employer – which in turn is a fiduciary for the interests of its investors, who have placed their assets in the safekeeping of the company. What I might want to do with my own money might be unethical for me to do with the money of someone else who has reposed that money into my care – as a guardian of her interests. [56]

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[55] Richard Rorty, "Human Rights, Rationality and Sentimentality," in *Rorty Reader, supra,* p. 358.

[56] For practical reasons, as well, it is hard to see how we could want individual employees to each apply their own senses of compassion to their daily decision-

Also, compassion, by its nature, is not an easily bounded sentiment. There are many levels of compassion I can exercise, all of which may be morally good, but only some of which may be morally required. Most acts of compassion are supererogatory, not obligatory. For example, I might feel morally obliged to lift someone who has fallen, rather than ignore him. However, I might not feel obligated to come to the defense of someone being attacked on the street with a knife, at the risk of my own life. My sense of what acts compassion demands is in part based on how difficult or dangerous it would be for a person to act compassionately in those circumstances – the easier the act, the more that is required. It is also based on the extent to which I believe that the person in harm's way is morally responsible for the difficult situation in which she finds herself. And, there are undoubtedly other factors at play. Thus, it would be hard to explicate principles that describe precisely those situations in which compassion would require me to act.

Nonetheless, let me suggest the following as a first attempt to describe a compassionate standard for a banker:

- When taking an action that could have a material impact on an individual customer's health or home, act with special care.

This standard would embed a special obligation of care into relationships between banks and individuals. It would require that a banker review particularly carefully with other responsible officials within the bank, the specific circumstances of each situation that might have a particularly heavy impact on the life or health of a client, before deciding how to act. Those circumstances might include the costs to the bank of exercising compassion, other options available to the borrower and her family, alternatives available to the bank, and the responsibility of the borrower for her own situation. In the case of a potential foreclosure on a primary residence, for example, this rule would prohibit robo-signing and perhaps require consideration of a grace period and opportunity to cure before foreclosure.

9. Other approaches

Finally, I turn to some other approaches to banker ethical codes that have arisen in the recent debate and that I believe are mischievous or wrong.

a. Ethical codes and social policy

In 2008, Rahm Emanuel Chief of Staff for then President-Elect Barack Obama famously said, "You never want a serious crisis to go to waste. And what I mean by that, it's an opportunity to do things you think you could not do before." I fear that the same attitude has pervaded the regulatory community when thinking about a banker's code of ethics. They have used the financial crisis to try to put forward

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making. It would lead to chaos within companies if each employee were guided in his day-to-day lending activities by his sense of compassion (or his other deeply held moral or political views).

agendas that neither have anything to do with the cause of the crisis nor with bankers' ethical failures.

The reason we are talking about ethics is because of badly motivated individual behavior by bankers in the last decade – predatory lending, unethical selling, and collusive manipulation of markets. Yet, code-writers seem to want to go farther than stopping that conduct. They appear to be using the opportunity the crisis affords to fulfill other social goals. How else can we explain the inclusion in the G30 report of the requirement that a banker "[c]reates and promotes an inclusive and collaborative environment," their demand that banks be "'socially accountable' to the public and community at large," [57] and their goals that banks "[c]ontribute to education and develop talents in the community," "[s]upport and contribute toward development of a sustainable environment," and "[p]rovide and facilitate charitable investment in the community."[58] As laudable as diversity, sustainability and charity are as goals, they had little or nothing to do with the financial crisis and are not what most people would view as part of the ethical obligation of an individual banker, *qua* banker. In other words, they do not belong in an ethics code for bankers.[59]

While it is understandable that banks and their regulators would want to propitiate angry public constituencies, because otherwise banks would be "likely . . . increasingly vulnerable to political and other challenges,"[60] that does not mean that requiring, e.g., "investment in the community" is an ethical requirement for individual bankers. But, more than that, the shoehorning of such policy goals into an ethics code may itself be unethical.

First, there are multiple views within any polity as to what the good society should look like and any decision made by management or an individual employee is likely to disserve some interest group within the polity or polities in which the banks operate.[61] Where a majority in a democratic society views a business or practice as inappropriate, laws are passed prohibiting or regulating that activity. When a company caves to pressure from a particularly aggressive regulatory examiner, industry group, press or segment of the public to back away from doing business that has not been prohibited by the majority or by appropriate administrative rulemaking, the result can actually subvert democratic processes and so be in that way "unethical."[62]

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[57] "Banking Culture and Conduct," *supra*, p. 24.
[58] *Ibid*, p. 60.
[59] The G30's view appears to be based on the assumption that what is ethical and what is good for society are the same – i.e., they appear to adopt *sub silencio* utilitarian ethics as their guiding principal – sloppily lumping both together. "[T]he overall culture of a bank determines how it views its social responsibility, how clients are treated and what ethical norms exist in a bank. It is about doing the right thing – even in the absence of rules." (*Ibid*, 23)
[60] *Ibid*, p. 24.
[61] Most international banks serve multiple polities across the globe.
[62] We have seen just such a result in the last year or two, as banks have backed away – after intense pressure from regulatory examiners -- from lending to politically disfavored groups engaged in legal activities – a practice the banks call "derisking." Those groups have included central governments in Africa and Asia with reputations

Second, I suspect that our process of reflective equilibrium would not likely end in our identifying any of the items on the public's latest social agenda as driving our ethical sentiments – even after reflection. If I am right, then none of the value we derive from harnessing the power of "corrected" moral intuition to bolster our ethical codes (the 4C effects), will likely be present in a purported ethics code based on that agenda. The values underlying social policies are not generally wired into the sentiments driving our ethical judgments. Intellectually we may believe we should support solar energy, for example; but, for most of us, our moral intuitions are not offended by driving a gasoline-fueled car – as they would be, for example, when we see someone cheating. Thus, if we want to encourage investments in solar technology, traditionally underserved communities, or our crumbling infrastructure, the most appropriate way to do so is through legislation or formal rule-making, not an ethics code.

Third, if I am right that support for items on today's social action agenda would not likely be chosen as ethical principles that are in reflective equilibrium with our moral sensibilities, then there is an unbecoming arrogance in trying to use an ethics code, to further a contested social agenda. The imposition of such a code itself then might be an immoral act, a form of bullying or force.

b. Supererogatory actions

Another approach to an ethics code is to have it explicitly draw from the core ethical teachings of our tradition. I am thinking of Moses's injunction to "Love your neighbor as yourself," Aristotle or Thomas's virtue ethics, Kant's categorical imperative[63] or Bentham's "greatest good for the greatest number." While those principles clearly are in the background, a number of problems arise if we try to apply these principles in any direct, unmediated way to the ethics of the business world.

As heirs to the Judeo-Christian and Greco-Roman traditions[64] and children of the Enlightenment, we have grown up in institutions formed by those traditions. Our social practices, and therefore our moral sentiments, have been molded and supported by those traditions. We have been taught the principles underlying those traditions explicitly by our parents, teachers and religious leaders in our homes, schools, workplaces and pulpits. As noted by former Chief Rabbi Jonathan Sachs, moral behavior has "[o]ften . . . involved people acting against their instincts, so they had to be taught through habit rather than by appeal to inclination. Moral education became a matter of imitation, learning by doing, the handing on of tradition by habituation."[65] And, as Hume wrote, "the sense of justice and injustice is not deriv'd from nature, but

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for corruption (all of whom the US and UK governments are willing to do business with), payday lenders, for-profit universities, gaming companies, and companies who, although complying with existing environmental law, may not be doing enough to meet NGO "sustainability" standards.

[63] Christine Lagarde, Managing Director of the International Monetary Fund, specifically quoted Kant in a November 5, 2015 speech at a Federal Reserve Board conference on bank culture.

[64] Ms. Lagarde quoted Seneca in her November 2015 speech, as well.

[65] Jonathan Sachs, *Morals and Markets,* p. 10 (IEA, 1999).

arises artificially, tho' necessarily from education, and human conventions;"[66] and, "as publick praise and blame increase our esteem for justice; so private education and instruction contribute to the same effect." [67]

Put simply we have the moral intuitions we have in large part because of our religious and enlightenment traditions – because of Moses, Aristotle, Jesus, Thomas, Hume, Bentham and Kant. Through our growing up in institutions imbued with those values, we have embodied their teachings in the conventions through which we lead our lives – how we treat our friends and families, our charitable life, the laws of property and contract, etc. Our moral intuitions are thus derived from the lived morality they helped create.

That being said, those teachings in their purest forms – not as refracted through the norms of our social practices -- are largely aspirational. They are hortatory. While we may want to aspire to be a fully virtuous person, as Aristotle or Thomas defined them; or to turn the other cheek as Jesus taught; or to create the greatest good for the greatest number, with Bentham;[68] not to meet those tests does not mean that we are immoral. These ethical systems tell one how to be good, virtuous and, in some cases, holy. They tell us what actions are good (or right) to do, but they do not specify as clearly those actions that are bad not to do. They tell us what is morally praiseworthy but not what is obligatory. They describe the supererogatory.

To hold bankers to a code requiring them to take supererogatory actions is wrong for several reasons. First, to call a purely supererogatory action an obligation is to make a category mistake – such actions by nature are not morally required. Second, requiring supererogatory acts conflicts with our moral intuitions – which reflect the standards of decency expected of the honorable average citizen, not those of the saint. Our intuitions require what is "universally expected of all members of society [and so] presuppose . . . the general *ability* of all moral agents to act in the light of these norms. Ideals of goodness and virtue, in their open ended texture cannot be similarly expected of everyone."[69] (emphasis in original). What is universally expected is typically defined by the ethical intuitions and related principles that are derived from our social practices, not by the aspirational leadership of our greatest teachers.

Third, supererogatory actions do not have a natural limit and so cannot easily be used to generate specific code requirements. How much gratitude, charity, or compassion must one exercise in order to pass the test of morality? Fourth, I am aware of codes in no other walks of life – commercial or professional – which call for conformance to a supererogatory ethical standard; thus, to single bankers out for this treatment seems unfair. Finally, it is particularly unjust to subject someone to jail or fine (which

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[66] *Treatise, supra,* Book III, Part II, Section I ("Justice, whether a natural or artificial virtue?" p. 535.

[67] *Ibid,* Book III, Part II, Section II ("On the Origin of Justice and Property "), p. 552.

[68] I use "or" because, while there is broad agreement across these traditions in many cases as to what constitutes ethical behavior, that agreement is far from complete.

[69] "Supererogation," *Stanford Encyclopedia of Philosophy,* http://plato.stanford.edu/entries/supererogation, 2011

would be the case for a legally enforceable ethical code, like the Dutch code) for falling short of an ethical ideal. [70]

The kind of ethics that people generally mean when they say that bankers need to be ethical is neither virtue ethics nor the universal principle-based ethics that demands of us the highest possible standard for our behavior towards another. The public doesn't demand that bankers be saints or that they love their customers – they just want bankers to treat them decently.

10. The way forward

I have tried to sketch a way forward for the development of an ethics code for bankers. To summarize that path, distinct ethical codes should be developed for each type of business under the financial services umbrella. These codes should be built around the ethical frameworks underpinning the core social practices on which those businesses are based. I have suggested four core social practices that will underpin much of the work – mutual promising, game-playing (trading), persuasion (sales) and guardianship (asset management), as well as two other social institutions that may also be relevant – friendship (e.g., when salespeople become friends with their customers) and family (e.g., when bankers hold the key to an individual's eviction from her primary residence).[71] And, there will undoubtedly be other social practices on which we can draw as we try to explicate the moral intuitions underlying our judgments about ethical and unethical banking practices.

Working with those practices, code development should be done through a process of public study, discussion and testing, which will help us decode our shared ethical heritage. That process will require that industry, government and consumer groups be constituted and led through guided conversations towards consensus on the codes. The process may lead to consensus, produce agreement on many issues and/or reveal fundamental disagreements among the various participants as to the nature of what is ethical. (For example, some may disagree that traders can ethically simply focus on buying low and selling high.) Whatever the result, the conversation will be important.

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[70] The Archbishop of Canterbury, Justin Welby, announced in 2014 that he was creating a monastic community for bankers prepared to spend a year with him cultivating their character. While this is a wonderful development and will doubtless produce a cadre of more virtuous bankers, his work is not likely to help us in designing a banker's ethics code.

[71] Professor David Vines, of Balliol College, Oxford, has suggested to me that mutual promising should not be viewed as a social practice like gaming, persuasion and guardianship. Rather it is simply one context in which bankers need to display trustworthiness. He is right to focus on the importance of trustworthiness in banking ethics. I tried to build my descriptions of gaming, persuasion and guardianship around the notion of people trusting bankers – albeit to different degrees and on different matters -- and of bankers doing what that trust demanded of them. I agree that those descriptions would benefit from further exploration of the manner in which trustworthiness is manifested in those practices. Nonetheless, mutual promising appears to me still to be a unique social practice in which trustworthiness needs to be displayed in a slightly different manner than in other contexts.

Once the codes are developed, it will be important to make sure that the specific banking businesses to which each code is applicable are made very clear. Bankers need to know what is expected of them. And, banks will need to implement a formal program of ethics training, through which bankers will be instructed in the industry codes and called on to identify, justify and perhaps "correct" their moral sentiments – or, in some cases, ask for revisions of the codes. Finally, I would recommend that each bank set up an ethics panel at which bankers can raise, discuss and resolve in real time the inevitable edge cases that will occur in the conduct of their businesses.

This process should result in a set of living, breathing codes, with a mechanism for revision as reflective equilibrium changes. If developed in this way, these codes should be accepted as valid, easily understood by practitioners, and consistent with practitioners' existing moral sensibilities. They will thus, when supplemented by the moral education program described, tend to produce the 4C effects – compliance, completion, certainty and consistency.

In another context, the late Norman Barry, Professor of Social and Political Theory of the University of Buckingham, praised a traditional understandings of business ethics, in the following words:

> "There is none of the moral pretentiousness and commercial naivety, of those who would urge the 'social responsibility of the corporation' or make business the bearers of the costs of the latest fashion of political philosophy and supererogatory morality; but instead there is the less glamorous emphasis on the more mundane but absolutely necessary virtues of honesty, fair dealing, respect for contract and property, and the refusal to exploit egoistically and egregiously those informational asymmetries that often occur in business life."[72]

That view is one that I hope will guide our code development; because, paradoxically, to the extent we can make our codes reflect those "mundane" virtues, we will have accomplished something far from mundane.

[72] Norman Barry "The Market Still Adequate?" in Jonathan Sacks, *Morals and Markets*, p. 30 (IEA, 2000) (in praise of traditional Jewish business ethics, as described by Rabbi Sacks).