International Review of Accounting, Banking and Finance
Volume 5, No. 1, Spring 2013 Page 17~41
IRABF
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THE NEED FOR ETHICAL REFORM IN THE US FINANCIAL INDUSTRY

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Abstract: This study reviews and highlights existing ethical financial issues and the current legal and regulatory landscape within the U.S. financial industry. We also discuss triggers that may prompt unethical behaviors in financial practices, such as those observed in the 2008 financial crisis. In addition, we provide suggestions and food for thought for change in ethical behaviors. Although it is important for financial firms to make profit, it is equally important for them to follow ethical standards in practice. Without proper ethical behaviors, a sound financial system is not sustainable. In the end, only a financial industry that does no harm to society can successfully fulfill the profit-maximizing motive.

JEL Code: G3, G20, N2, M14

Key Words: Ethics; Financial Markets and Institutions, Corporate Governance, Corporate Culture; Social Responsibility

1. Introduction

What ethical standards are appropriate in financial institutions, markets, and practices? What is right? What is wrong? Who makes that decision? Is an ethical decision merely compliance with laws and regulations? Or must generally held values of trust, fairness, respect, integrity, and honesty be adhered to? In the world of finance, does profit maximization also mean serving the common good?

Ethical norms are important to maintain social stability and harmony with people interacting with each other (Mousa 2012). Obviously, market participants interact among themselves through financial transactions, and thousands of these sound transactions occur every day. But, what are "ethical norms" in finance? Who teaches financial professionals what "ethical norms" are? A natural follow-up issue to these questions is: What are the consequences if "ethical norms" are not followed?

Most financial services, including management of retirement savings, money market, and fixed income investments, are entrusted to financial professionals because individual investors typically do not have the time or the expertise to effectively manage the funds on their own (Mousa 2012). At the same time, it is also difficult to know the exact quality of investment products, of which there are plenty in number and diversity. Unfortunately, financial professionals and seasoned investors often do not completely understand the financial products being bought and sold. Transparency regarding the investments is frequently unavailable. Even law enforcement and regulators often have difficulty identifying problems because of the complexity and globalization of the investments at issue. Making this industry more troubling for investors is the fact that scandals and legal punishment for wrong doings often do not drive a business in the financial industry out of business. Rather, financial institutions often treat regulatory fines as a cost of doing business, obscuring the importance of ethical concerns beyond laws (Plender 2012).

In this paper, we have several objectives. First, we explain and discuss current ethical issues facing the financial industry. Second, we identify and analyze the legal and regulatory framework surrounding these issues. Third, we discuss triggers that are associated with the ethical lapses, which are potentially leading to the current issues. Finally, we suggest changes that may provide guidance for professionals in the financial industry. One of the key elements in the changes should include curriculum changes of business education on ethics.

2. Current Finance Ethical Issues

Unscrupulous finance dealings are present throughout U.S. and world history. In fact, all world religions counsel against greed and teach of “sharing, trust, fairness and mutual benefit in trade and economic transactions” (Stuckelberger 2012). The magnitude of the ethical violations in recent years, however, has increased this generation’s level of concern. Beginning in 2008 with the financial crisis, the revelation of Bernie Madoff’s Ponzi scheme, and the credit rating agency concerns, the United States has witnessed a pattern of failures in transparency, trust, and competence. More recently, the world has been made aware of the LIBOR rate-fixing scandal and anti-money laundering violations providing possible funding to terrorist activity and drug trafficking.

The United States, among other nations, have laws in place to prevent many of the violations just described. Because the laws are not always effective at deterring this behavior, we need to understand the ethical issues underlying these events in an effort to help prevent similar situations in the future and to help protect the consumers harmed by these events. It is necessary that we examine the current legal and regulatory framework to determine the base responsibilities of financial professionals. From there, we must consider other options that would potentially discourage financial professionals from engaging in unethical behaviors.

2.1. 2008 Financial Crisis

In October 2008, investors in the United States and around the world watched the value of their investment portfolios and retirement savings plummet. Employees feared for their jobs as many were laid off or found their employer out of business. Homeowners found themselves in the midst of foreclosure proceedings. Taxpayers cringed as they paid hundreds of millions of dollars to bail out those firms in the financial industry that the U.S. government deemed were "too big to fail."

In 2009, the American Bar Association Task Force on Financial Markets Regulatory Reform reported that the market deficiencies leading to the 2008 financial crisis included:

"at the retail level, through the conduct of certain mortgage brokers in selling products unsuitable for their customers; at the wholesale level, through the creation and sale of complex financial instruments that obscured and magnified risk; and, at the service level, through the unwarranted reliance by regulators and investors, including financial institutions, on the assessments by credit rating agencies regarding the risks of investment opportunities" (Prezioso and Kroener 2009).

The U.S. Treasury also commented that:

"At some of our most sophisticated financial firms, risk management systems did not keep pace with the complexity of new financial products. The lack of transparency and standards in markets for securitized loans helped to weaken underwriting standards. Market discipline broke down as investors relied excessively on credit rating agencies. Compensation practices throughout the financial services industry rewarded short-term profits at the expense of long-term value.

Households saw significant increases in access to credit, but those gains were overshadowed by pervasive failures in consumer protection, leaving many Americans with obligations that they did not understand and could not afford.

Taking access to short-term credit for granted, firms did not plan for the potential demands on their liquidity during a crisis. When asset prices started to fall and market liquidity froze, firms were forced to pull back from lending, limiting credit for households and businesses" (U.S. Department of Treasury 2009).

Both of these reports highlight the perceived causes of the financial crisis in their post-mortem analyses. The blame is spread from financial firms to credit agencies to regulators; from complex investments to lack of transparency; and from over-compensated executives to credit-laden consumers. Take note that none of the issues raised in these report excerpts describe illegal conduct.

From an ethical perspective, however, financial firms took on risks that were not in the best interests of their clients and violated any measure of trust that formerly existed. Credit rating agencies failed to disclose and manage conflicts of interests for short-term market gains. Regulators were unable to competently discover the risks inherent in the complex products on the market or did not have the authority to regulate them. Executives being paid millions of dollars in salaries, bonuses and perks within the industry believed they could escape accountability, while consumers were over-confident that the market would continue to flourish taking on more risk and debt than appropriate. Each of these ethical lapses contributed to the collapse of the financial market and become lessons from which the financial industry should learn, correct its behavior, and prevent similar future events.

2.2. Bernie Madoff Ponzi scheme

Bernard Madoff was charged with anti-fraud violations of the 1933 and 1934 Securities Acts, and the Investment Advisers Act of 1940, as well as criminal violations (including money laundering and perjury), as a result of a multi-billion dollar Ponzi scheme (U.S. Securities and Exchange Commission Office of Investigations 2009). Madoff pled guilty and was sentenced to 150 years in prison, the maximum sentence allowed by law (U.S. Securities and Exchange Commission Office of Investigations 2009).

The SEC defines a Ponzi scheme as follows:

> A Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors and to use for personal expenses, instead of engaging in any legitimate investment activity.

Madoff started his Ponzi scheme by soliciting local investors, those who knew of his successful reputation on Wall Street as a former chairman of NASDAQ (New York Times 2012). In later years, Madoff solicited international clients, including Banco Santander ($2.8 billion in losses), Bank Medici ($2.1 billion in losses), and Fortis ($1.3 billion in losses) (*'Madoff's Victims'* 2009).

In the Complaint filed by the federal prosecutors, Madoff admitted that he had "paid investors with money that wasn't there." Madoff further explained that he had personally traded or lost money from institutional investors, that he was insolvent, and that he could not continue the scheme (*U.S. v. Madoff* 2008).

Investor account statements for Madoff's investment management business reflected $65 billion under management, when in reality only $17.3 billion was invested ('Bernard L. Madoff: Overview' 2012). At the end of 2008, when the financial crisis was well underway, Madoff needed to cover $7 billion in requested client redemptions, but he did not have the money and admitted to his family that his investment management business was "one big lie" (*U.S. v. Madoff* 2008).

While Ponzi schemes like the one pulled off by Madoff have been illegal for decades, the scheme was perpetuated for years before government regulators were made aware of the fraud on investors (U.S. SEC Office of Investigations 2009). The fact that Madoff was able to elude the regulators despite complaints, tips, and articles resulted from inexperienced investigators, failure to follow up with third parties, unexplained delays, and failure to focus on the activity that constituted the Ponzi scheme (U.S SEC Office of Investigations 2009).

The inability of the regulators to detect the Ponzi scheme only exacerbated the fact that an individual could perpetrate a fraud on so many people for so long. Madoff's ability to convince wealthy individuals, charitable organizations, educational institutions, and financial institutions to invest in a scheme he knew was only benefitting himself demonstrates his failure to act in his client's best interests, or quite possibly a complete disregard for others. Madoff's untruthfulness to investigators and co-workers (including his own sons) in maintaining separate books to appear to be running a legitimate business reflects his dishonest nature, his failure to disclose information to his clients, his failure to avoid conflicts of interest, and his failure to maintain any kind of compliance system as required by industry rules and regulations.

2.3. Credit Rating Agency Cases

In February 2013, the U.S. Department of Justice (DOJ) announced that it had filed a civil lawsuit against Standard & Poor's Ratings Services (U.S. DOJ Office of Public Affairs 2013). The complaint alleges that S&P defrauded investors, resulting in billions of dollars of losses via Residential Mortgage-Backed Securities (RMBS) and Collateralized Debt Obligations (CDOs). Specifically, the DOJ claimed that S&P issued inflated ratings and falsely represented that its ratings were "objective, independent, and uninfluenced by S&P's relationships with investment banks" (U.S. DOJ Office of Public Affairs 2013).

The complaint supports these allegations through internal S&P e-mails, memos, and instant messages. As evidenced by these documents, the DOJ contends that S&P was well aware of the conflicts of interest that existed with the companies being rated to ensure that they maintained their revenue stream, the risk inherent in the products being rated, and the delay in implementing updated analytical models and downgrading the RMBS and CDOs (*U.S. v. McGraw-Hill Companies, Inc. and Standard & Poor's Financial Services LLC* 2013). Specifically, S&P appears to have been concerned that if their rating methodologies reduced the ratings given to these structured products, they would lose business to the other credit rating agencies (CRAs), specifically Moody's and Fitch, thereby diminishing their profits (*U.S. v. McGraw-Hill, et al.* 2013). As a result of the inflated ratings, federally insured institutions purchased and held investments that were in an imminent position to default (U.S. DOJ Office of Public Affairs 2013).

Just months prior to the DOJ's lawsuit, an Illinois county court allowed a case filed by the Illinois Attorney General to proceed based upon allegations that S&P's ratings misled consumers during the financial crisis constituting fraudulent activity. The Illinois state court judge denied the credit rating agency's defense that the ratings are protected under its First Amendment rights allowing Illinois' attorney general's case of fraud to proceed (Neumann 2012).

An Australian court also held that S&P misled its investors by giving AAA ratings to constant proportion debt obligations, or CPDOs, in 2006, which collapsed during the financial crisis of 2008. The judge found that S&P failed to assess the risk of the products it was rating. S&P, however, is in the process of appealing the Australian court's decision (Kelly 2012).

Other cases have been filed in United States courts against S&P and Moody's by Abu Dhabi Commercial Bank and California Public Employees' Retirement System, CalPERS (Neumann 2012). The lawsuit filed by Abu Dhabi Commercial Bank alleges that Morgan Stanley encouraged Moody's and S&P to allocate unwarranted investment-grade ratings to $23 billion worth of notes backed by subprime mortgages (Lippert, Faux, and Feeley 2012). The product at issue in the lawsuit is a structured-investment vehicle (SIV) that collapsed in 2007. The SIVs were rated AAA in 2006, the same rating given to U.S. Treasury bonds. When borrowers defaulted on mortgages that secured the notes, the SIV declared bankruptcy. The New York U.S. District Judge in the Abu Dhabi Commercial Bank case refused to dismiss the case on the grounds of economic downturn causing the plaintiff's losses (Lippert, Faux, and Feeley 2012; s*ee Abu Dhabi Commercial Bank v. Morgan Stanley, et al.,* 2009).

A California state court judge also allowed the lawsuit filed by CalPERS against Moody's and S&P to proceed alleging misrepresentation with regard to the purchase of SIVs based upon inaccurate risk-assessment (Gullo 2012). The complaint alleged that the credit rating agencies allocated top marks to the SIVs that ultimately defaulted (Gullo 2012; *See California Public Employees' Retirement Systems v. Moody's Corp. (MCO) and Standard & Poor's* 2009).

Ethically speaking, it is clear that the credit rating agencies failed to act in the best interests of their clients, primarily by allegedly not managing and disclosing conflicts of interest. The credit rating agencies appeared to have been far more interested in making a short-term profit than protecting their clients from undue risk of default. Further, the culture at S&P specifically discouraged blowing the whistle as alleged within the complaint against the company. An unwillingness to be transparent and accountable for actions taken creates serious ethical concerns.

2.4. LIBOR Scandal

Barclays Bank's CEO Bob Diamond resigned in the summer of 2012 amidst the London Interbank Offered Rate (LIBOR) rate-fixing scandal. The LIBOR rate is set daily and is the rate at which banks borrow money from each other. Barclays is under investigation for lowering the LIBOR rate to appear financially healthier affecting trillions of dollars' worth of financial products across the globe (Munoz and Colchester 2012).

Following Diamond's resignation, it was discovered that the scandal was more widespread than initially thought (Matthews 2012). In December 2012, Swiss bank UBS was fined $1.5 billion, more than one-third of its 2011 profits, by the U.S., U.K., and Switzerland regulators for manipulating LIBOR and EURIBOR (Euro Interbank Offered Rate) undermining the integrity of the financial market (Matthews 2012; FSA 2012). The British Financial Services Authority (FSA) published a 40-page report setting forth evidence that UBS employees, including managers and senior managers, were colluding among themselves, as well as with traders and brokers at other financial institutions, to benefit their trading position and avoid negative media attention about its creditworthiness. UBS' compliance and audit efforts failed to fully detect and address the manipulation (FSA 2012).

With regard to the ethical challenges posed as part of the LIBOR rate-fixing scandals, the individuals involved clearly failed to act in the best interests of their clients. Rather, they acted deceptively to create short-term gains (which are likely linked to the trader's bonus resulting from the trading performance) for themselves at the expense of others. In addition, they colluded together to perpetrate the fraud and purposely attempted to hide the scheme. Moreover, the companies' compliance and audit departments either did not have sufficient procedures in place to detect the infractions or did not effectively follow their own procedures. The scope of this scheme was so extensive that the impact will likely be felt for years to come. In fact, the procedures by financial institutions to monitor trading behavior have been a problem for a long time. Better concerted efforts in financial institutions for trading practices need to be revisited and implemented.

2.5. Insufficient Money Laundering Controls

The world's largest bank, HBSC, recently settled with the U.S. Department of Justice, the Treasury Department, and other federal agencies in an effort to avoid federal prosecution by agreeing to forfeit $1.3 billion and pay a civil fine of $650 million dollars (Mullis 2012). The deferred prosecution agreement stems from insufficient money laundering controls and processing banned transactions. HBSC can avoid criminal prosecution upon payment of the agreed amount and by implementing stronger internal AML controls as promised (McCoy 2012).

Specifically, HBSC was cited for having long-standing severe AML deficiencies, including over 17,000 un-reviewed AML alerts and late or missing Suspicious Activity Reports (SARs) “exposing the United States to money laundering, drug trafficking, and terrorist finance risks” (U.S. Senate Permanent Subcommittee on Investigations 2012). HBUS (HBSC’s U.S. affiliate) also failed to assess the AML risk associated with other HBSC affiliates before opening correspondent accounts, circumvented OFAC (Office of Foreign Asset Control) prohibitions involving transactions with Iran, North Korea, and Sudan, disregarded terrorist links, cleared over $290 million of suspicious bulk Travelers Cheques regularly deposited in amounts over $500,000 per day, and offered bearer share accounts with inadequate AML controls (U.S. Senate Permanent Subcommittee on Investigations 2012).

HBSC will also pay out almost $2 billion for allegations of inappropriate sales of loan insurance and complex interest rate hedge funds in the United Kingdom, as well as its involvement in the LIBOR rate-rigging scandal (McCoy 2012).

Obviously, HBSC’s disregard for the current laws, including compliance requirements, demonstrates its lack of accountability. Not only did their actions have potential to harm clients, but national security as well. Without adequate compliance procedures and enforcement mechanisms in place, a firm cannot adequately maintain client trust.

3. Legal and Regulatory Framework

Next, we review the legal and regulatory framework surrounding the above-referenced infractions in order to better understand the minimum standards that exist (at least within the United States).

3.1. Dodd-Frank Act

As a result of the 2008 financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in 2010. An overview of the Act identifies the numerous initiatives mandated in an effort to prevent this type of financial event to occur in the future (U.S. Senate Committee on Banking, Housing, & Urban Affairs2010). The sweeping legislation includes the following:

- Creation of the Consumer Financial Protection Bureau Systemic risks addressed
- Limits “too big to fail” situations to prevent the need for future bailouts
- Reformation of the Federal Reserve
- Transparency and accountability for the derivatives market created
- Development of mortgage reform, including revision of lending standards, assistance and funding to address the mortgage crisis
- Standards raised and regulation created for hedge funds
- Development of ratings and oversight of credit rating agencies
- Corporate shareholders given a “say on pay” for executives and allows SEC oversight
- Bank and thrift regulations improved

- Oversight authority over the insurance industry created
- Credit score protection provided for consumers
- SEC authorized to impose fiduciary duty upon brokers, encourages whistleblowers, and increases funding for SEC to carry out new duties
- Reduction in risks of securitization
- Oversight of municipal securities industry improved (U.S. Senate Committee on Banking, Housing, & Urban Affairs2010).

As noted above, the Act increases authority and funding for regulators to enforce laws and regulations. The Act also creates oversight on hedge funds and executive pay where little to none previously existed. In addition, Dodd-Frank's reach extends to many of the laws, regulations, and studies discussed below. While much has been accomplished, many of the initiatives established by the Dodd-Frank Act have yet to be implemented (Horn, Pinedo, and Smith 2013).[1] As such, resources may not be available to complete all of the requirements set forth in the Act. As it is often the case with legislation, the loopholes became gaping holes resulting in a crisis before real action was taken. With the implementation of the Dodd-Frank Act, we are hopeful that it will drastically reduce the likelihood that the nation's economy will be subject to such a high level of systemic risk again.

3.2. SEC Study on Investment Advisers and Broker-Dealers

Section 913 of the Dodd-Frank Act required the SEC to "evaluate the effectiveness of legal and regulatory standards of care . . . for providing personalized investment advice and recommendations about securities to retail customers." The conflict stems from two different standards in force for investment advisers and broker-dealers. Investment advisers, governed by the Investment Advisers Act of 1940 and regulated by the SEC, serve as a fiduciary for their clients, and as such are required to exercise a duty of loyalty and a duty of care in the best interests of their clients (U.S. SEC 2011). Broker-dealers, in contrast, are governed by the Securities Exchange Act of 1934 and are regulated by the Financial Industry Regulatory Authority (FINRA). While the 1934 Act includes anti-fraud provisions, broker-dealers generally do not have a mandated fiduciary duty to their clients (U.S. SEC 2011). Broker–dealers, however, are subject to FINRA Suitability Rule 2111 which states:

- (a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

[1] According to regulatory reform updates linked to Horn, Pinedo, and Smith;s law firm, Morrison Foerster, as of May 31, 2013: 203 of the 400 required and discretionary rule-making and other actions had been completed; 94 of the 148 required actions had been completed; and all 103 required studies had been completed.

- (b) A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in Rule 4512(c), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decision-making authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.

The reality is that consumers are not aware of the separate legal standards to which investment advisers and broker-dealers are held. Moreover, many do not know the difference between an investment adviser and broker-dealer. In fact, many financial professionals are both investment advisers and registered representatives of a broker-dealer and wear different “hats” depending on the account or transaction (U.S. SEC 2011). As a result, the SEC has recommended a “uniform fiduciary standard” which states:

The standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice (U.S. SEC 2011).

The Securities Industry and Financial Markets Association (SIFMA) is a leading securities industry trade group that supports the change to require the same standard of care for brokers and investment advisers, i.e., both professionals acting in the investors’ best interests (DeSouza 2013). The difficulty remains in determining what that standard should be and how to implement it. Part of the delay in enacting the standard is gathering sufficient data in an effort to assess the costs and benefits of changing the standard (Barlyn 2013).

Regardless of the outcome of this debate, investment advisers and broker-dealers have ample guidance by which to execute their responsibilities. Acting in the best interest of the investor is presumably preferred by lawmakers, regulators, and investors.

Laws on this topic have been in effect for years, yet individuals like Bernie Madoff, regardless of his capacity as a financial industry professional, choose to violate them. After Madoff admitted to the fraud he had engaged in for decades, Madoff’s sons explained that they oversaw the trading desk, but that Madoff kept his investment management business separate (‘Bernard L. Madoff: An Overview’ 2012). The investment management side, in which he was a fiduciary and was required to act in the best interests of his clients under the laws already in effect, was where he defrauded his clients out of billions of dollars (‘Bernard L. Madoff: An Overview’ 2012).

3.3. Credit Rating Agency Reform Act

In 2006, Congress enacted the Credit Rating Agency Reform Act amending the Securities Exchange Act of 1934 requiring Nationally Recognized Statistical Rating Organizations

(NRSRO) to register with the SEC.[2] The Act specifically requires NRSROs to prevent the misuse of nonpublic information and manage conflicts of interest. In addition, the Act prohibits NRSROs from unfair, coercive, or abusive acts or practices. The Act, however, does not permit the SEC to regulate the substance of the NRSRO's ratings or the methodology or procedures for calculating ratings. Rather, the SEC is required to report annually to Congressional committees on the NRSRO applications and the state of their competition, transparency, and conflicts of interest. Further, the Comptroller General is required to study and report on the impact of this Act on credit ratings issued, the financial markets, competition among credit rating agencies, and inappropriate conflicts of interest and sales practices by NRSROs (Congressional Research Service 2006).

Title IX, Subsection C, of the Dodd-Frank Act more recently required the SEC to create an Office of Credit Ratings (OCR). The OCR's core activities include monitoring risks and industry trends and developments, as well as performing annual, risk-based examinations of NRSROs (U.S. SEC 2012).

With regard to the credit rating agency lawsuits discussed above, laws were in place by 2006 prohibiting inappropriate conflicts of interest and unfair, coercive or abusive acts or practices by NRSROs. Yet, the complaints allege that the credit rating agencies misled and deceived consumers by failing to manage and disclose conflicts of interest and giving investment-grade ratings to products that were undeserving of such ratings.

Similar to the review of an initial public offering, however, the Credit Rating Agency Reform Act does not permit the SEC to regulate the substance of the NRSRO's ratings or the methodology or procedures for calculating ratings limiting the supervising agencies' review of fairness, transparency, and conflicts of interest. The Dodd-Frank Act does not change this standard. As a result, it is the investor's responsibility to take the credit rating as one *opinion* in making an investment decision.

Ironically, credit rating agencies were created to help investors better understand the risks they were undertaking when investing in certain companies (*See* Standard & Poor's). When the credit rating agencies fail to uphold their legal, ethical, and professional responsibilities to provide transparency to consumers, the reliance upon credit ratings is manipulated thereby reducing the confidence of investors and the integrity of the market.

3.4. Sarbanes-Oxley Act

Following the Enron, Arthur Andersen, TYCO, and WorldCom scandals at the turn of the century, Congress enacted the Sarbanes-Oxley Act in 2002. The purpose of the Act is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." Specifically, the Act:

> Creates Public Company Accounting Oversight Board • Requires independent auditors • Imposes corporate responsibility upon executives to certify financial reports and tax returns • Enhances financial disclosures • Reduces analysts conflicts of interest • Provides funding and authority for SEC • Requires studies and reports to be conducted (including the role of credit rating agencies in the securities markets) • Imposes

[2] Standard & Poor's Rating Services, Moody's Investor Services, Inc., and Fitch, Inc. are among the ten Nationally Recognized Statistical Rating Organizations (U.S. SEC 2012).

> accountability for corporate and criminal fraud • Enhances white collar crime penalties (Williamson 2002).

Sarbanes-Oxley's attempt to provide oversight of accountability and responsibility has come with a tremendous financial cost to firms covered by the law. The debate continues as to whether the benefit of building confidence with stakeholders is appropriately balanced with the costs of meeting the legislative requirements (Hartman and DesJardins 2011).

On December 19, 2012, the U.S. Department of Justice held a press conference explaining that UBS entered into a non-prosecution agreement on the condition that it pay $400 million to the U.S. government, admit and accept responsibility for its criminal conduct, and cooperate with the department's ongoing investigation. The U.S. DOJ charged UBS with wire fraud and engaging in a scheme to manipulate LIBOR (U.S. DOJ 2012).

While the Sarbanes-Oxley Act was not specifically identified as the Act under which the charges were brought (and other laws were certainly violated as a result of the rate-fixing), the Act does increase the penalties for wire fraud, authorizes the SEC to discipline officers and directors of publicly traded companies who engage in manipulative, deceptive devices or fraudulent interstate transactions, as well as imposes fines or imprisonment for anyone who knowingly defrauds shareholders of a publicly traded company (Sarbanes-Oxley Act of 2002).[3]

Additionally, Sarbanes-Oxley required the U.S. Sentencing Commission to review its guidelines regarding securities and accounting fraud and obstruction of justice. The Act also asked for severe and aggressive deterrents with regard to these corporate infractions (Hartman and DesJardins 2011).

As is the case with many of the other current issues discussed, laws were already in place that prohibited the conduct described above. Regardless, the financial professionals charged acted with a "motive to make money and avoid being caught", ignored conflicts of interest and allowed traders to set rates and developed culture of manipulation that was overlooked by the company's internal compliance department (FSA 2012).

3.5. USA PATRIOT Act

Following the terrorist attacks on the United States on September 11, 2001, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act), commonly known as the Patriot Act. The purpose of this Act is to deter and punish terrorist acts in the United States and around the world, to enhance law enforcement investigatory tools, and other purposes, including:

> Encouraging cooperation between law enforcement, regulators, and financial institutions to deter money laundering • Requiring the establishment of regulations to identify consumers opening accounts at financial institutions and the maintenance of concentration accounts • Expanding immunity from liability for reporting suspicious activity • Requiring financial institutions to create anti-money laundering programs • Establishing a highly secure network for communications between Financial Crimes Enforcement Network (FinCEN) and financial institutions (FinCEN).

[3] UBS is a publicly traded company on the New York Stock Exchange (www.nyse.nyx.com).

The Patriot Act significantly expanded the surveillance and information gathering authority of the government and, as such, has been challenged for exceeding the federal government's powers pursuant to the Fourth Amendment of the U.S. Constitution. Although parts of the Act have been deemed unconstitutional and subsequently revised, the Act continues to be the subject of debate and requires considerable information from financial institutions on an ongoing basis (Beatty and Samuelson 2008; Hartman and DesJardins 2011).

We note that the HBSC scandal described above included blatant violations of the Patriot Act. The individuals involved had absolutely no regard for the requirements set forth in the Act, or other international laws by which they were bound. Further, the extent of violations by the time of being finally discovered had escalated much while those enforcing the law appear to have inadequately performed their responsibilities.

4. Triggers – Rationale that Prompts Ethical Issues

Not only are many of the actions associated with the recent matters previously described illegal, we submit that almost all of them would be considered unethical. Behavior that triggers some of the events referenced above, as well as some measures already in place to help prevent such behavior (in addition to the laws and regulations discussed above), include:

4.1 Failure to Act in the Client's Best Interest

All of the current financial ethics issues highlighted above violate the standard to act in the best interest of the client in some way. Without putting the needs and interests of clients first, a variety of ethical lapses will naturally follow.

In an effort to set the scene, consider the number of individuals required to carry out a scheme like the one of which S&P has been accused. First, the mortgage lenders allegedly engaged in inappropriate lending practices by lending more to consumers than the consumers could afford resulting in the loan being at high risk of default. Second, the issuer and/or investment bank structured a product that included underlying high-risk mortgages. Third, the credit rating agency seemingly coordinated its efforts with the issuer and/or investment bank to inflate the rating of the structured product knowing that it was less desirable than represented to investors. Fourth, the regulators were apparently unaware of the complexity of the structured product, as well as the conflict of interest inherent in the rating agency's business. As a result, the institutional investors who purchased the structured product to be sold to individuals, pension funds, etc., relied almost solely on the opinion of the credit rating agency and unknowingly misrepresented the suitability of the product to its clients. This chain of events would have to had occurred repeatedly among mortgage lenders, issuers, investment banks, credit rating agencies, and regulators to the extent that it created systemic risk triggering much of the recent financial crisis. Internal controls must be improved and implemented to prevent these industry-wide ethical lapses that allow financial professionals to replace long-term goals of commercial success and reputation with a short-term pursuit for personal profit.

Further, as set forth above, the SEC and FINRA continue to discuss the implementation of clear standards requiring licensed individuals to act in the best interests of their clients. This over-arching need applies to all stages of the investment process – developing products, rating products, buying and selling products.

In addition, professional organizations have in place ethical standards expected of their members working within the financial industry. The CFA Institute published its updated Code of Ethics in 2010 requiring that all members and candidates: "place the integrity of the profession and the interests of clients above their own interests; act with integrity, competence, and respect; and maintain and develop their professional competence" (CFA Institute). In addition, the Certified Financial Planners Board of Standard's Code of Ethics (2011) includes the following responsibilities to the public, clients, colleagues and employers: integrity, objectivity, competence, fairness, confidentiality, professionalism, and diligence. Unfortunately, as demonstrated by the violations previously discussed, we must do more to help prevent such serious ethical lapses within the industry.

4.2 Failure to Understand the Products Being Purchased, Sold, and Rated

We contend that this failure applies to financial professionals, regulators, and investors. Unfortunately, all of these groups fail to completely understand the complex products and fraudulent schemes within the industry.

In light of the fast pace and the broad impact of decisions made every day, financial professionals, including regulators, should be properly trained and educated to ethically, competently, and professionally handle such an environment. Instead, business schools focus on helping business students succeed within the existing corporate system, rather than helping their students shape it (See 2012). As a result, business schools that do not create a culture of ethics are likely to fail to develop business leaders who are capable of questioning unethical practices in finance and other industries (See 2012).

The government, however, seems to make the assumption that it is primarily the investors who need to be educated. In that vein, the Dodd-Frank Act required the SEC to complete a study regarding investor's financial literacy. The Act also created the Consumer Financial Protection Bureau, which, in part, works to educate consumers about financial products and services (Consumer Financial Protection Bureau 2013).

The SEC also maintains an Office of Investor Education and Advocacy (OIEA) and a website, investor.gov, which includes "Classroom Resources" for education. In addition, FINRA created an Investor Education Foundation partnering with the United Way to educate investors at a community level (FINRA Investor Education Foundation 2013). While all worthwhile efforts, given the current landscape, it appears that the financial professionals and the individuals within enforcement agencies need to be better trained and educated as well.

4.3 Failure to Disclose Pertinent Information for Full Transparency

The lack of understandable information available to and/or provided to individuals limits investors' ability to monitor a financial professional's behavior. Equal access to information will likely always be a concern given that those within the financial industry are privy to vast amounts of information, including proprietary information that is not required to be disclosed, and the average consumer must rely upon their financial professional to provide them with appropriate information needed to make an informed investment decision.

The Dodd-Frank Act created an "independent watchdog," the Consumer Financial Protection Bureau (mentioned above), within the Federal Reserve to balance access to information. This organization is charged with increasing transparency and ensuring investors receive information necessary for financial transactions (U.S. Senate Committee on Banking, Housing, & Urban Affairs 2010). As mentioned above, the Dodd-Frank Act also created the Office of Credit Ratings (OCR). The OCR is charged with regulating NRSROs and enhancing the accountability and transparency of the credit rating agencies' practices (U.S. SEC 2012).

As evidenced by the violations discovered in the Bernie Madoff case, the credit rating agency cases, and the LIBOR scandal, transparency is vital to investors being able to make informed decisions, as well as the stability and integrity of the market.

4.4 Failure to Remedy Conflicts of Interest

As demonstrated by the lawsuits recently filed against the credit rating agencies, conflicts of interest can significantly harm investors. Identification, management, and disclosure of conflicts of interest are imperative for financial transactions to be fair to consumers, whether they be institutions or individuals.

The International Organization of Securities Commissions published a Code of Conduct Fundamentals for Credit Rating Agencies in 2004. The code focuses on: (1) quality and integrity of the rating process, (2) independence and avoidance of conflicts, and (3) responsibility to market participants through greater methodology transparency and adequate treatment of confidential information provided by issuers (Motsi-Omoijiada, 2012).

Regulators are also trying to address this issue. The OCR division of the SEC is also charged with ensuring that credit rating agencies are not "unduly influenced by conflicts of interest" (U.S. SEC 2012). In July 2012, FINRA initiated a sweep request regarding conflicts of interests at broker-dealer firms (FINRA Industry Professionals 2012). The "Targeted Examination Letters" sought information about how firms identified and managed their conflicts of interest to avoid violating FINRA's rules (FINRA Industry Professionals 2012).

Although these efforts are helpful, conflicts of interest are inherent within the financial industry. From brokers acting on behalf of clients to credit rating agencies intertwining their revenue streams with rating methodologies, all professionals in the financial industry must give thoughtful consideration to this ethical challenge in order to adequately protect consumers.

4.5 Failure to Develop, Implement, and Comply with Internal Programs and Procedures

The current issues highlighted above demonstrate that even where internal programs and procedures may have existed, they were not properly developed and/or followed. Moreover, the financial institutions' compliance departments were either unaware or did not understand the inappropriate behavior of numerous professionals within their organizations.

Regulators make efforts to ensure that compliance programs and procedures are in place and followed. For instance, the SEC Office of Credit Rating is charged with confirming that credit rating agencies adhere to their internal policies, procedures, and methodologies for determining credit ratings (SEC 2012). In addition, FINRA Rule 3130 requires broker-dealers to have in place compliance programs that include "substantial and purposeful interaction" between business managers and compliance officers. Unfortunately, confirming adequate compliance policies and implementation of those policies can prove to be a difficult task for a variety of reasons. Regulatory examiners may not be experienced enough to identify the compliance issues, financial professionals may be working hard to hide the compliance issue from the regulators, or the financial institution's compliance officers failed to exercise their due diligence to discover the compliance violations.

An example of problematic compliance programs and procedures is highlighted by the financial institutions who invested in products managed by Bernie Madoff. Those institutions became the subject of lawsuits alleging that they failed to exercise their due diligence when determining whether to invest with Madoff. Clients alleged that the financial institutions should have known that the returns promised by Madoff were not possible and that relying on Madoff's reputation was not enough (Bryan-Low and Mollenkamp 2008). The erosion of trust as a result of the compliance failures within these financial institutions is difficult to regain.

4.6 Failure to Promote a Whistleblowing Culture

Whistleblowing among financial professionals is a tough topic given the negative perception of reporting on one's peers or supervisors, as well as the potential for retaliation for blowing the whistle. For example, at S&P, when a financial professional disagreed with the recommended approach, he was no longer invited to meetings related to the topic (*U.S. v. McGraw-Hill, et. al*).

Section 922 of the Dodd-Frank Act directed the SEC to make monetary awards to eligible individuals who voluntarily blow the whistle providing original information that leads to a successful enforcement action resulting in a monetary sanction over $1 million. The SEC is authorized to make an award to the whistleblower from 10% to 30% of the monetary sanctions collected (Dodd-Frank Act 2010; Securities Exchange Act, Regulation 21F; U.S. SEC).

In 2009, FINRA created the Office of the Whistleblower to handle high-risk tips (FINRA Industry Professionals). The Office of the Whistleblower reviews the tips submitted and ensures a rapid response and further review and investigation, if necessary (FINRA Industry Professionals).

Had those individuals who raised red flags within organizations or at HBSC with regard to the AML deficiencies been taken seriously, the problems may not have escalated to such extensive levels and the damage to the reputation of organizations would have been limited. Because a culture of reporting was apparently insufficient or non-existent, the individuals who were uncomfortable with the decisions of the financial institutions went unheard.

4.7 Failure to Acknowledge the Problems of Short-Term Excessive Risk Taking

While not directly the cause of the current issues discussed above, excessive executive compensation has become a topic of public debate and a contributing factor of society's general distrust of those leading the financial industry. The executives at the helms of the financial institutions that were "too big to fail" were generously compensated even after the causes for the 2008 financial crises were identified. For example, American International Group (AIG) paid out $165 million in bonuses to the top executives of the financial division just after U.S. government agreed to give AIG $180 billion to rescue it from bankruptcy (Hartman and DesJardins 2011). Unfortunately, this sends a message to the public that the government will turn the other cheek when it comes to ethical violations and help financial firms stay in business.

After the bailout, however, Section 951 of the Dodd-Frank Act required an amendment to the Securities and Exchange Act of 1934 adding a requirement that shareholders vote to approve the compensation of company executives. In addition, if financial reports are found to be based upon inaccurate information, companies are required to develop policies to take back executive compensation (Dodd-Frank Act 2010).

Executives who allow unethical behavior to continue in order to benefit from short-term gains diminish their company's chance for long-term credibility and sustainability. Moreover, the excessive compensation they receive in light of their actions contributes to the general erosion of trust and compromise the integrity of the market.

5. Suggestions for Change

It is apparent from the information included in this paper that legislators and regulators are trying to do their part to prevent ethical lapses in the financial industry. Unfortunately, legislators and regulators typically only have the benefit of enacting legislation, rules and regulations after some crisis has unfolded. It is generally believed that common people prefer to trust the financial industry and the financial elite to act in the public's best interest, instead of having an adversarial government watchdog (See 2012).

Financial institutions, regrettably, are often the ones, which provide incentives for professionals to behave unethically (Viana 2012). As a result, financial institutions must be part of the solution to demand ethical behavior. Higher education must play a role as well.

5.1 Act in Best Interests of Clients

Regardless of the well-established agency theory discussed repeatedly in financial ethics publications, when there is no law, rule, or code, financial professionals should act in the best interest of the *client* when engaging in activity on behalf of that client. Financial professionals should act with integrity as set forth in the standards of CFAs, CFPs and other professional organizations.

A proposed approach to encourage financial professionals to act in the best interest of the investing client is known as "targeting" (Kuriata 2012). This means that investment purchases should reflect client's ability to assess and manage risk based upon their level of financial literacy (Kuriata 2012). For example, clients should not be approved for loans or have access to margin capabilities that they cannot afford. Clients should not be sold products for which they have no ability to hedge the risk (Kuriata 2012).

Certainly, regulators have addressed this concept through suitability rules (FINRA Rule 2111). The targeting we recommend, however, encourages a conservative approach when assessing a client's ability to manage risks and would include an incentive structure within the financial institution to better target financial products (Kuriata 2012). As a result, not only would suitability presumably be accomplished, but clearer risk boundaries would be available to financial professionals and investors.

Further, it is presumably the job of the financial professional to educate the client with regard to the transactions being made. This includes ample information about the financial product being purchased, such as how the product is structured, the nature of the risk involved, disclosure of any conflicts of interest (especially among proprietary products, institutional recommendations and ratings), all fees charged, and other pertinent information. The client should understand all aspects of the product before engaging in the transaction. The integrity of the financial professional is predicated upon acting in the client's best interest which includes the financial professional being informed about the client and the client being educated about the transaction.

5.2 Finance Professionals Must Be Properly Educated

The 2008 global financial crisis has raised serious concerns about the unethical practices on Wall Street with so many types of fraud, including Ponzi schemes, identified when analyzing the causes for the crisis. The financial crisis has clearly highlighted the fallibility of the global financial system without proper behavior of business ethics. It is generally believed that education is one of the most powerful drivers of business cultural change (Fernandez 2012) because graduates are future leaders in society. To change the current pattern of financial dealings and culture, we need to change the business curriculum in business schools in the U.S. and across the globe to emphasize the importance of business ethics in practice. In fact, the AACSB International, the main accreditation bodies for business schools in the world, has mandated a business ethics component in the business school curriculum for accreditation after the debacle of Enron in 2001 and Parmalat in 2003 (AACSB International 2004).

Chan, Fung, and Yau (2010) show that U.S. academic institutions appear to lead in the business ethics research contributions globally, while Asian and European institutions have made significant progress in recent years. Business ethics research output is found to be closely linked to the missions of the institutions driven by their values or mission. At the same time, it is widely recognized that business ethics is an important component in both teaching and research at business schools across the globe (Chan, Fung, and Yau 2013). It is puzzling that ethics of finance is still underdeveloped compared to the fields of business ethics or professional ethics and that ethicists lack an understanding of the technicalities of financial management (Sifah 2012). This situation is likely due to the fact that the business ethics curriculum is sallow, focusing on the management issue instead of a broad base ethical issue (Chan, Fung, and Yau 2013). In particular, the ethics in finance research is undermined as many top-tier finance journals focus primarily on pure financial research issues, but do not attempt to publish ethical financial topics, which are more practical in nature.

Business schools around the world appear to have responded considerably to the criticism (Kaplan 2009). Some business schools around the country have a mandatory ethics and social responsibility requirement. For example, the New York University's Stern School of Business added a class on policy responses to the financial crisis. Others have exploited curriculums to make it less theoretical and less technical, and more interdisciplinary (Bender 2010). Harvard Business School now encourages their MBA students to take the "MBA Oath" to emphasize the importance of ethical promises (Chan, Fung, and Yau 2013).

Business schools, especially those accredited business schools, have started to teach with different teaching pedagogies to their both undergraduate and graduate MBA students in ethical decision makings. However, how effective this ethical course in a classroom setting can be taught to encourage ethical behavior remains to be seen. Moreover, few faculty members include in their teaching materials into the ethical teaching curriculum. More importantly, ethical curriculum is not broad based enough to cover sufficient materials in various disciplines. Particularly, the ethical financial issues are clearly insufficiently covered. The ethical issues that arose during the financial crisis clearly imply that the business ethics curriculum warrants immediate attention in the U.S. and around the world.

Ethics must be thread through higher education finance courses. Similar to business leaders who create a top-down corporate culture of ethics by making it an integral part of everyday business dealings, business schools should include ethics as part of all its course work. A code of conduct specified in a profession's handbook that is merely words on a page or an ethics officer who does her work on the side is as ineffective as a one-time ethics course that may or may not be required to graduate. Rather, business schools need to integrate ethics into all of its classes and work with companies to ensure that ethics become an integral and useful means of training employees.

In addition to educating future financial professionals about ethics in finance, industry laws, rules, and regulations should be adequately taught to financial professionals. Financial industry attorneys and compliance personnel are not the only individuals who need to know this information. All financial professionals, including brokers, investment advisors, analysts, accountants, communication specialists, traders, and regulators, must be knowledgeable about the legal implications of their work. Business schools should focus on industry laws, rules, and regulations to properly prepare their students to enter the financial industry. Without this knowledge, not only may ethical considerations be overlooked, but legal requirements as well.

Further, with regard to financial professionals working with complex financial products, such as derivatives, hedge funds, and structured products, one possible option is to treat them similarly to lawyers and doctors. In order to create, develop, rate, sell, or regulate these complex products, individuals must have completed an accredited graduate program in the field, pass a board or bar exam, maintain a certification, take continuing education classes regularly, and agree to uphold certain professional standards in order to maintain a license. After all, these transactions require specialized knowledge similar to the law and medicine (See 2012).

The downside, of course, is the cost associated with this framework. Along with these requirements come the development and maintenance of the professional structure, and possibly malpractice considerations. This type of professional framework, however, may serve as a deterrent to prevent the high-risk, highly-leveraged products with inflated ratings that appear to benefit no one but those seeking the short-term gain.

5.3 Develop a Balanced Approach for Adequate Transparency and Disclosure

Financial institutions, along with companies in most regulated industries, would likely argue that the disclosures required are already excessive. Investors may agree that while much information is disclosed (in very small print), it is difficult to discern what they actually need to know to make an investment decision. Unfortunately, the erosion of trust within the financial industry has led to these burdensome disclosure requirements.

A balance is necessary to provide investors with what they need to know, to allow financial professionals truthful and accurate information to make appropriate recommendations to the clients, and to access any information regulators need to ensure financial institutions are in compliance with current laws and regulations. The difficulty with this suggestion is that different investors need, understand, and rely upon a variety of information making it problematic for financial institutions to accommodate all investors.

Regardless, it is the ethical responsibility of the financial professional to make investment recommendations and decisions as transparent as possible. Without transparency, clients are unable to make informed, fair decisions thereby reducing their trust in the integrity of the market.

5.4 Conflicts of Interest Must Be Properly Identified, Managed, and Disclosed to Ensure Fairness for All Investors

As mentioned above, the agency relationship regularly present in financial transactions is inherently problematic. According to Araujo (2012), if an agent is offered with an option that is more opportunity for gain than one that is more profitable for the principal, the agent faces an ethical dilemma. However, if the agent fears that unethical choices may have long-term consequences on their professions, they are likely to avoid them (Araujo 2012).

As such, one suggestion would be to develop policies setting forth how long certain financial professionals could work with certain clients (Motsi-Omoijiada 2012). This suggestion may be more problematic in the retail investor relationship than in the professional investor or financial institution relationship given the more personal nature of a retail investor relationship. Such a policy, however, would reduce the investor’s reliance on one particular financial professional who may not be acting in the client’s best interest.

Beyond restructuring certain relationships, this ethical challenge requires continuing education and training. Unless financial professionals know how to identify a conflict of interest, they will not know how to manage it, much less be aware that disclosure is necessary. Presumably, most professionals would know that taking advantage of a situation for themselves at the detriment of a client constitutes a conflict of interest. Some financial professionals, however, may not be aware that fee structures, product recommendations, proprietary products, and certain business arrangements may also constitute conflicts of interest. Once aware that a conflict of interest exists, it is ethically imperative that the financial professional properly manage that conflict and/or disclose that conflict to the client. Without such action, the client cannot make an informed, fair decision thereby reducing the trust and respect the client has in the financial professional and compromising the integrity of the market generally.

5.5 Compliance Personnel Must Be Competent to Ensure Compliance

Financial institutions must be knowledgeable about law, rules, and regulations, as well as aware of the actions of their employees. Education, discussed above, is imperative if compliance programs and procedures are to be effective. It is unusual to find a course within higher education finance programs that deals directly with the regulations and self-regulatory organizations’ rules that are imposed upon financial institutions every day. Moreover, these rules and regulations change frequently. Without a basis of knowledge to understand the regulatory framework, identifying issues and properly applying the pertinent laws, rules, and regulations can become overwhelming to compliance personnel, including those who are part of the regulatory regime (investigators, examiners, etc.).

In addition, to encourage a culture of compliance within a financial institution, firms should reward those employees who act to protect their organizations (Benton 2012). Typically, compliance personnel focus on finding out what is being done wrong. While an integral part of their job, highlighting what financial professional are doing right would encourage a culture of compliance. Positive feedback only reinforces the expectations of an organization.

5.6 Whistleblowing Opportunities Must Be Available for Accountability

On the flip side, those who make unethical decisions should be penalized (Araujo 2012). They should be penalized by the organization in addition to any self-reporting to a regulatory authority that may need to be done.

Further, firms within the financial industry should encourage a culture of whistleblowing. They should communicate methods of reporting often, provide examples of ethical violations to employees frequently, and train their employees regularly. Whistleblowing should be considered an important part of business success. If an organizational whistleblowing structure does not exist, financial professionals should be educated about the governmental whistleblower offices created by the SEC and FINRA.

Organizations should also appeal to individuals' monetary side of ethical consequences explaining that unethical behavior costs money in the sense of contracts, compliance, litigation, and enforcement. Examples of SEC enforcement actions demonstrate millions of dollars in sanctions not only to the financial institutions, but to CEOs, CFOs, senior corporate officers and other licensed individuals (U.S. SEC 2013).

5.7 Compensation Structures Should Mirror Sustainable Contributions

While the Dodd-Frank Act's "say on pay" provisions will likely change the landscape of executive compensation, there is more to be done. Bonuses for short-term gains, lavish trips as a reward for "reaching the numbers", and the fact that those at the top make hundreds of times more per year than those at the bottom still exist.

Stock options are one of the bonus structures still prevalent today. Under this payment structure, executives are often incentivized to increase stock prices for personal benefit rather than for long-term company success. This is demonstrated by the fact that executive compensation has followed a similar pattern as the S&P 500 Index, but corporate profits have lagged far behind (Hartman and DesJardins 2011).

Executive compensation should be tied to long-term financial success, a clean compliance record, and a top-down ethical culture. The compensation structure should be commensurate with the financial executive's education and experience. They should be rewarded for true, transparent performance and for sustainable contribution to the organization and the industry. It would certainly be a challenge to set up this incentive structure, but one the board of directors, preferably an independent board of directors, of financial institutions should carefully consider.

6. Conclusions

If there were a clear answer to all of the questions set forth in the introduction of this paper, much of the concern about the financial industry and its professionals would not exist. In this study, we have tried to make an effort to highlight some of the existing ethical financial issues and present the current legal and regulatory landscape. In the process, we have reviewed the causes for the 2008 financial crisis, the Madoff Ponzi scheme, credit rating agency cases, and LIBOR scandal. At the same time, we have provided pros and cons for the different legal framework (such as the Dodd-Frank Act, SEC study on Advisers and Broker-Dealers, Credit Rating Agency Reform Act, Sarbanes-Oxley Act, and USA Patriot Act) that relate closely to ethical behaviors for the financial crisis. Finally, we have discussed triggers that may prompt unethical behaviors while also providing suggestions for cultural change.

Although it is important for firms and financial institutions to make profit, it is equally important that financial professionals follow ethical standards and code. On one hand, firms have to follow the legal mandates of business practice and satisfy the due diligence requirements expected of them. At the same time, financial institutions have to maintain integrity and social responsibility to build trust and credibility with their clients. Otherwise, a sound financial system cannot be sustainable. Although a profit-maximizing motive is important for financial firms, we argue here that firms have to satisfy constraints such as legal and ethical conditions while attempting to achieve the profit-maximizing objective. This is a sustainable approach for the financial institutions to survive over time. In the end, if the financial industry must serve the self-interested goal of maximizing profits, it must do so without harm to society (Cosgrove-Sacks 2012).

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