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FOREWORD

TRANSPARENCY AND ETHICS IN THE FINANCIAL SYSTEM

THOMAS E. HOLLORAN*

This issue of the *University of St. Thomas Law Journal* contains two important, well-reasoned articles drawn from the 2010 iteration of its Law Journal Lecture series.¹ Each contributes to our understanding of, and the remedial paths from, the 2008–2009 financial crisis, which among other things saw the collapse of such industry giants as Lehman Brothers and Bear Sterns.²

Essential to the well-being of the country is a transparent, ethical financial system. The function of investment banking—raising capital by underwriting and/or acting as a client’s agent in the issuance of securities—resides at the heart of that financial system. Investment banking assists companies and governments in raising capital for growth and for infrastructure, and it assists individuals by providing investments suitable for funding future goals (e.g., retirement, children’s education, purchase or start-up of a business). In this era of overspending and undersaving, an ethical source of guidance and fairly constructed investment products are indispensable.

It is elemental that the needs of the investment bank’s clients are paramount to the perceived needs of the investment bank, its officers, and its employees. The articles collected here discuss in some detail the plethora of governmental regulations intended to ensure this—yet regardless of the political hubris exhibited by Congress on the passage of each new milestone of legislation, none have proven adequate. Recognizing this insufficiency of a mere legislative or regulatory “solution,” the authors focus their efforts on exploring the proper—and necessary—role of moral and ethical values in

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1. Richard Painter, *The Moral Responsibilities of Investment Bankers*, 8 U. ST. THOMAS L.J. 5 (2010); Lyman Johnson, *Beyond the Inevitable and Inadequate Regulation of Bankers: A Comment on Painter*, 8 U. ST. THOMAS L.J. 29 (2010).

2. For a detailed analysis of the financial collapse, and discussion of financial crises in general, see Carmen M. Reinhart & Kenneth S. Rogoff, *The Aftermath of Financial Crises*, 99 AM. ECON. REV. 466 (2009).

maintaining a healthy financial system and preventing the recurrence of recent events.

Richard Painter cogently recognizes that virtue is the essential ingredient of all transactions. He reasons that regulation, while necessary to prevent another financial crisis, is not sufficient to deter irresponsible behavior.³ Rather, government action must be supplemented by individual and collective self-restraint: "Regulation can define outer limits of acceptable behavior, but an elite group—whether investment bankers or others—will not last long operating under the assumption that everything inside these limits is acceptable."⁴ The first step toward reinstating a sound and sustainable investment banking industry is to address, head-on, past and present moral shortcomings in light of religious and secular "first principles" that bear on such questions as the appropriateness of profit as a primary motivating factor and recognition of collateral consequences of bankers' conduct.⁵

Lyman Johnson questions Painter's characterization of the danger to bankers' own well-being of operating at the margins of legal limits, but concurs with and refines the larger call to effectuate a change in the ethical culture of banking. In Johnson's view, Painter has hit upon the "key prerequisite to genuine change" in his urging of bankers to engage with other bankers and society at large in a conversation about moral issues in their work and the religious and philosophical underpinnings of their own values.⁶ Johnson recalls his early training in his reminiscence of the shaping of his moral outlook. He urges, "[W]e need more of—and we need ourselves to be more like—these moral exemplars who unashamedly bring together morals and business to enrich and reform from within . . ."⁷ He then applies his rural Minnesota common sense when he concludes, "[R]eliance on law is displacing reliance on morality, in banking as elsewhere, as law increasingly is being asked to support a social load it cannot bear."⁸

Perhaps not surprisingly, concern about the inadequacy of legislation and regulation to address deep-seated problems within the financial industry is also found beyond the walls of academia.

In January 2011, subsequent to the preparation of the articles discussed above, the National Commission on the Causes of the Financial and Economic Crisis in the United States published its Financial Crisis Inquiry Report.⁹ President Obama charged the Commission "to examine the causes,

3. Painter, *supra* note 1, at 6.

4. *Id.* at 11.

5. *Id.* at 20.

6. Johnson, *supra* note 1, at 36.

7. *Id.* at 39.

8. *Id.*

9. NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS IN THE U.S., THE FINANCIAL CRISIS INQUIRY REPORT (Authorized ed. 2011) [hereinafter INQUIRY].

domestic and global, of the current financial and economic crisis in the United States.”¹⁰ In carrying out its task, the Commission reviewed millions of pages of documents, interviewed more than 700 witnesses, and held nineteen days of public hearings.¹¹

The Commission’s ten key findings and conclusions are terse and unequivocal. The first in order of presentation states, “We conclude this financial crisis was avoidable.”¹² Even more notably, in the context of the present discussion, is the Report’s sixth finding: “We conclude there was a systemic breakdown in accountability and ethics.”¹³ The Report explains as follows:

Unfortunately—as has been the case in past speculative booms and busts—we witnessed an erosion of standards of responsibility and ethics that exacerbated the financial crisis. This was not universal, but these breaches stretched from the ground level to the corporate suites. They resulted not only in significant financial consequences but also in damage to the trust of investors, businesses, and the public in the financial system.¹⁴

Although the Commission is thus in apparent agreement with the general thrust of Painter’s and Johnson’s arguments, some circumstances surrounding its Report give cause for continued concern. Of the ten Commissioners, six adopted the Report and four wrote or signed on to dissents; their division was along political party lines. Furthermore, despite the inclusion of several hundred pages of anecdotal narrative, the Report is disjointed, political in nature, and lacks critical facts supporting its conclusions. Most troubling, however, is the timing of its release relative to other responses to the subject of its inquiry: The Report that purports to explain the 2008–2009 financial crisis was rendered six months *after* passage of the intended remedial legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹⁵ This is an unsettling instance of the solution to a problem being determined prior to ascertaining its cause.

The Report’s preamble prudently encourages further review effort, as “[t]here is still much to learn, much to investigate, and much to fix.”¹⁶

10. *Id.* at 416; Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, § 5, 123 Stat. 1617 (2009).

11. *INQUIRY*, *supra* note 9, at xi.

12. *Id.* at xvii.

13. *Id.* at xxii.

14. *Id.*

15. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The Act was signed into law on July 21, 2010. It comprises sixteen titles, and required the creation of 243 new rules by regulators. Its purported purpose, among others, is the promotion of the financial stability of the United States through increased and improved accountability and transparency in the financial system. *Id.*

16. *INQUIRY*, *supra* note 9, at xxviii. On April 13, 2011, the Senate Permanent Subcommittee on Investigations released its own report on the 2008 financial crisis, which unlike the Financial Crisis Inquiry Report received bipartisan support. STAFF OF S. PERMANENT SUBCOMM. ON INVESTI-

Painter's article and Johnson's response contain wise and timely counsel. Their message should become the mantra of mission as the financial services industry searches for essential and expected conduct.

GATIONS, COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, 112TH CONG., WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (Comm. Print 2011), http://hsgac.senate.gov/public_files/Financial_Crisis/FinancialCrisisReport.pdf. This report was very critical of—among other things—investment banks' conflicts of interest in dealing with mortgage investments. *Id.* at 318–636.