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Keynote Address

The Moral Responsibilities of Investment Bankers

Richard Painter*

I. Introduction

We all know by now that the 2008–2009 financial collapse was caused by irresponsible decisions both in government and in financial institutions—investment banks, commercial banks, insurance companies, and others. Much attention has been given to the inadequacies of government regulation, as well as to the capital structure and risky investments of the financial institutions.

My topic in this article will be about the people running the financial institutions. I call these people "investment bankers" because they do what people used to do when they worked for investment banks. Today, with the 1999 repeal of the Glass-Steagall Act's separation of commercial banking from other businesses, and with more liberal state regulation of insurance companies, investment bankers work for many types of financial institutions in addition to investment banks. Indeed, some investment banks such as Goldman Sachs and Morgan Stanley recently put themselves under commercial bank holding company structures so they could meet liquidity needs by borrowing money from the Federal Reserve.[1] Despite their creative restructuring, they are still investment banks.

I will first discuss the reasons why government regulation of investment bankers, while necessary to prevent another financial crisis, is insufficient. Second, I will discuss the need for self-restraint within the investment banking industry—self-restraint that is linked to a broader sense of personal responsibility for investment bankers. Third, I will discuss some components of personal responsibility for investment bankers, and specific proposals for how investment bankers might be made more personally responsible.

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1. *See* Andrew Ross Sorkin & Vikas Bajaj, *Shift for Goldman and Morgan Marks the End of an Era*, N.Y. Times, Sept. 21, 2008, http://www.nytimes.com/2008/09/22/business/22bank.html.

Until this point, I base many of my observations on research and publications I worked on with Claire Hill, a colleague at the University of Minnesota Law School.[2] We published an article proposing that joint venture agreements or assessable stocks be used to make the most highly paid investment bankers personally liable for their firms' debts, just as they were when most investment banks were general partnerships before the 1980s.[3]

In this article, I focus on a particular aspect of this topic: investment bankers' moral values. Where do they get their moral values and how are those values relevant to their work? Can those values be changed? Can investment bankers be persuaded to incorporate moral values into their work? What is the appropriate role of religion and philosophy in this discussion?

II. Government Regulation of Investment Banking Is Necessary but Is Not Sufficient to Deter Irresponsibility

Government regulation of financial institutions and financial markets—for example, the 2010 Dodd-Frank Act[4] and the 2002 Sarbanes-Oxley Act[5]—may help prevent another financial crisis or mitigate its severity. Law, after all, sometimes does change behavior. That is one of the reasons we have laws.

Regulation, however, is not enough to protect the investment banking industry, and the rest of us, from the folly of investment bankers. Regulation is insufficient for several reasons:

a. *Regulators have difficulty keeping up with new financial instruments, new technologies, and other developments.* The explosive growth in the market for derivative securities, swap agreements, and collateralized debt obligations in the last twenty years illustrates this point. Investment bankers designed and marketed new financial instruments so rapidly that regulators could not keep up. Investment bankers may not have understood the instruments they were investing in, but regulators understood them even less.
b. *Regulation is a delayed reaction.* Regulators must decide which agency will regulate a financial instrument or practice. (There have been notorious turf battles between the Securities

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2. *See, e.g.*, Claire Hill & Richard Painter, *Compromised Fiduciaries: Conflicts of Interest in Government and Business*, 95 Minn. L. Rev. 1637 (2011). We are also working on a book that will have several other specific proposals that I will summarize in this article. The tentative title for our book is "The Personal and Professional Responsibilities of Investment Bankers."

3. Claire Hill & Richard Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 Seattle U. L. Rev. 1173, 1174 (2010) (2009 symposium on Adolf Berle).

4. Dodd-Frank Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) (codified in scattered sections of 12 and 18 U.S.C.).

5. Sarbanes-Oxley Act, Pub. L. No. 107–204, 116 Stat. 745 (2002) (codified in scattered sections of 15 and 18 U.S.C.).

and Exchange Commission ("SEC" or the "Commission") and the Commodity Futures Trading Commission ("CFTC") about this.)[6] Regulators then must deliberate over how to regulate a financial instrument or practice and draft a regulation. The notice and comment period required by the Administrative Procedures Act ("APA")[7] adds to the delay before a rule is in place. By then investment bankers may be selling a new and different financial instrument or be engaged in a new business practice that is not subject to the regulation.

c. *Regulation is a "cat and mouse game" in which investment bankers hire lawyers to help them circumvent regulations.* This problem raises concerns about the moral responsibility of corporate lawyers—the topic of my first law review article in 1994.[8] I will not dwell on those concerns, except to say that lawyers themselves are part of the reason that law is sometimes an ineffective instrument for regulating business conduct.

d. *Regulators are sometimes captured by a regulated industry and do what the industry wants at the moment.* This may be something different than what is best for the industry in the long run. "Regulatory capture"[9] occurs because of the revolving door of employees between the private sector and government, particularly at the most senior levels. I discuss the problems of the revolving door and capture in Chapter 2 of my recent book on government ethics.[10] Government is supposed to regulate Goldman Sachs and its Wall Street competitors, but often individuals who move back and forth between Wall Street and government call the shots. Hence the phrase that became popular in the media a few years ago, "Government Sachs."[11] The revolving door helps regulators understand the industry they regulate, but the revolving door also gives regulated industry more influence over the content of regulation.

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6. *See* Brendan Conway, *CBOE Chief: SEC and CFTC Still in Turf War*, WALL ST. J., Oct. 19, 2010, http://online.wsj.com/article/SB10001424052702303550904575562423972481304.html ("[T]he federal agencies that regulate the securities and futures industries still spend too much time battling each other for influence, the chairman of the Chicago Board Options Exchange said.").

7. The APA's notice and comment requirements are set forth in 5 U.S.C. § 553(b)–(c) (2006).

8. *See* Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. CAL. L. REV. 507, 511–12 (1994).

9. Economists have published extensively on industry capture of regulatory agencies. *See, e.g.*, Jean-Jacques Laffont & Jean Tirole, *The Politics of Government Decision-Making: A Theory of Regulatory Capture*, 106 Q.J. ECON. 1089, 1089 (1991).

10. RICHARD W. PAINTER, GETTING THE GOVERNMENT AMERICA DESERVES: HOW ETHICS REFORM CAN MAKE A DIFFERENCE (2009).

11. *See, e.g.*, Julie Creswell & Ben White, *The Guys from 'Government Sachs,'* N.Y. TIMES, Oct. 19, 2008, http://www.nytimes.com/2008/10/19/business/19gold.html.

e. *Regulators often lack the resources to enforce regulation.* The SEC budget is inadequate, particularly given the many challenges the Commission faces.[12] Investment banks devote a substantial amount of resources to designing new financial instruments, hiring lawyers to get around SEC regulation, and fighting SEC enforcement actions. Also, promoters other than large investment banks perpetrate many securities frauds all over the country, and the SEC may devote scarce enforcement resources toward this low-hanging fruit rather than untangle the complexities of transactions at large investment banks. Sometimes the SEC even fails to get the low-hanging fruit: for example, when it ignored warnings about Bernie Madoff.[13]

f. *Regulators must deal with Congress, and financial institutions have influence over Congress.* First, Congress makes laws that define regulators' authority. For example, Section 2A of the Securities Act of 1933[14] and a parallel provision in the Securities Exchange Act of 1934,[15] as amended in 1999, removed security-based swap agreements from the definition of a security and specifically prohibited the SEC from promulgating regulations designed to prevent fraud in these instruments. Congress thus effectively prohibited the SEC from preventing fraud in swap agreements. The political atmosphere of the 1990s made this effort, led by Senate Banking Chairman Phil Gramm, possible. Second, regulators' enforcement of existing law is under Congressional oversight. Congress puts pressure on regulators on behalf of regulated companies that also happen to be campaign contributors and political supporters. For example, former SEC Chairman Arthur Levitt in 2002 wrote a book about his tenure at the Commission and the pressure from Senator Gramm and others to back off on regulating the accounting industry.[16] The appendix to Levitt's book includes letters he received from Congress and very similarly worded letters he received from Enron CEO Kenneth Lay complaining that the SEC was interfering in Enron's relationship with its auditor Arthur Ander-

12. At least one noted expert on securities law pointed this problem out in the years leading up to the 2008 financial crisis. *See* Joel Seligman, President, Univ. of Rochester, The SEC and Politics 8 (Jan. 18, 2006) (transcript available at http://www.law.northwestern.edu/professionaled/documents/SECpolitics.pdf) ("The SEC has survived episodic litigation challenges, but throughout significant periods its effectiveness has been seriously undermined by an inadequate budget and staff.").

13. *See* Binyamin Appelbaum & David S. Hilzenrath, *SEC Ignored Credible Tips About Madoff, Chief Says*, Wash. Post, Dec. 17, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/12/16/AR2008121602926.html.

14. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2006).

15. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78oo (2006).

16. Arthur Levitt with Paula Dwyer, Take on the Street (2002).

son.[17] Levitt was expected to listen to Congress and Congress was listening to Lay.

g. *Even without pressure from Congress, regulators sometimes go in the wrong direction.* For example, when risky investment strategies became popular in the 1990s, regulators probably should have tightened up on capital requirements for broker-dealers. They did the opposite. In 2004, the SEC adopted a change to its so-called "net capital rule" that was created in 1975 for broker-dealers.[18] The 2004 rule change allowed five firms—Bear Stearns, Lehman Brothers, and Merrill Lynch, plus Goldman Sachs and Morgan Stanley—to assign higher valuations to assets on their balance sheets using mathematical models. As a result, these firms could substantially increase the leverage they were allowed to have.[19] After the debacle of 2008, three of those five firms no longer exist.[20]

h. *Regulation is a costly solution to irresponsible behavior in the financial industry.* The costs include compliance costs for regulated industry, enforcement costs for regulators, and costs of overregulation that deters productive business ventures. Government and regulated industry will save money to the extent self-restraint can be achieved through other means, whether contractual mechanisms, social norms or, most important for this discussion, better moral values.

i. *Regulation is generally confined to national boundaries.* Difficulties arise when regulating occurs across national boundaries, even within a group of countries such as the European Union ("EU"). Worldwide regulation is nearly impossible. Global investment banking, by contrast, is rapidly expanding. Opportunities for regulatory arbitrage are frequent, as illus-

17. *See id.*; Richard W. Painter, *Standing Up to Wall Street (and Congress)*, 101 MICH. L. REV. 1512, 1517 (2003) (book review) (reviewing Levitt's book and discussing the problem of Congressional influence on independent agencies).

18. *See* Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities, 69 Fed. Reg. 34428, 34428 (June 21, 2004) (to be codified at 7 C.F.R. pts. 200, 240).

19. The 1975 rule was designed to assure that broker-dealers could meet obligations to customers and other creditors. The rule requires firms to value their securities at market prices but also to discount those values—applying a so-called "haircut"—based on the risk characteristics of securities in their portfolio. The haircut values of securities held by a firm are then used to compute the "cushion" of required liquid assets for purposes of the net capital rule. The 2004 rule change permitted the largest broker-dealers with net capital of more than $5 billion to apply for exemptions from the traditional method of calculating the haircut and instead use mathematical models to compute haircuts on securities. This made it easier for these firms to meet the net capital requirement by claiming higher values for their securities. *See id.* (stating that "[t]hese amendments are intended to reduce regulatory costs for broker-dealers by allowing very highly capitalized firms that have developed robust internal risk management practices to use those risk management practices, such as mathematical risk measurement models, for regulatory purposes").

20. For a vivid description of how these firms met their demise and the financial system as a whole collapsed in 2008, see MICHAEL LEWIS, THE BIG SHORT (2010).

trated by the Lehman Brothers Repo 105 transactions that concealed debt on Lehman's balance sheet.[21] When New York lawyers refused to bless a dubious short-term sale of Lehman's bad assets to get them off its balance sheet for a few days at the end of the quarter, the deal was done in London and blessed by English solicitors who reported it back as a legitimate transaction to Lehman's accountants in New York.[22] In another example, Goldman Sachs and other New York banks assisted Greece in using derivative securities to conceal government debt from the EU and from Greece's creditors, precipitating a second financial crisis in Europe.[23] Finally, this past summer, the United States Supreme Court—correctly in my opinion[24]—recognized that United States securities laws only go so far. In *Morrison v. National Australia Bank*[25] the Court said that the Exchange Act's antifraud provisions do not apply to securities transactions that take place outside of the United States.[26] The United States is not, and cannot effectively be, the world's policeman against securities fraud. I have written about these and other problems in global securities regulation with Professor Dr. Wulf Kaal, an expert on German, as well as U.S., securities law.[27] While there is hope for more global cooperation in the future, we must recognize that worldwide government regulation of securities transactions will be very difficult.

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21. The Repo 105 accounting practice allows a bank to take liabilities off its balance sheet by selling assets to a buyer for cash used to pay down debt temporarily. The sale is coupled with an agreement to repurchase the same assets from the buyer for cash after the reporting period is over, but it is still accounted for as a true sale if the assets are worth at least 105% of the amount of cash that changes hands. *See* Report of Anton R. Valukas, Examiner at 737, *In re* Lehman Bros. Holdings, Inc., No. 08-13555 (Bankr. S.D.N.Y. Mar. 11, 2010), *available at* http://lehmanreport.jenner.com/VOLUME 3.pdf. To call a repo a true sale based on legal technicalities, however, a law firm needs to write a legal opinion. *Id.* at 783 n.3017. Lehman could not find a U.S. law firm that would provide such an opinion letter permitting the true sale accounting treatment. *Id.* Lehman transferred the securities involved to London where the transaction would take place and hired a U.K. law firm to provide the legal opinion under English law. *Id.* at 784.

22. *Id.*

23. *See* Louise Story, Landon Thomas & Nelson D. Schwartz, *Wall St. Helped to Mask Debt Fueling Europe's Crisis*, N.Y. Times, Feb. 13, 2010, http://www.nytimes.com/2010/02/14/business/global/14debt.html.

24. *See* Richard W. Painter & Wulf A. Kaal, *Extraterritorial Application of U.S. Securities Laws*, 7 Eur. Company L., no. 3, June 2010 at 90.

25. 130 S. Ct. 2869 (2010).

26. Unfortunately, there continues to be confusion about precisely what the Supreme Court said in this opinion and what Congress said in response. *See* Richard W. Painter, Douglas Dunham & Ellen Quackenbos, *When Courts and Congress Don't Say What They Mean*, 20 Minn. J. Int'l L. 1 (2010).

27. Wulf A. Kaal & Richard W. Painter, *Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States*, 40 Seton Hall L. Rev. 1433 (2010).

III. THE NEED FOR SELF-RESTRAINT

The 2009–2010 financial crisis illustrates how a civilized society depends upon self-restraint. People—particularly people in the upper reaches of society—should not do everything the law permits them to do. Our leading citizens collectively and individually need to say no to excessive greed, excessive risk, endangerment of others, and dishonesty.

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. An elite group that encourages conduct at the margins of legal limits is more likely to meet a swift demise. Perhaps a few times the elite group can plead for a government bailout from the consequences of recklessness, but this may encourage more recklessness in the future, and may also generate considerable resentment from the rest of society.

In addition to regulation, there needs to be self-restraint from within the elite group. Investment bankers need to show self-restraint by not doing some things that regulators allow them to do, and to stay clear of many things that regulators only arguably allow them to do. Professor Claire Hill and I explore this theme of self-restraint in a series of papers and the book we are writing on the personal and professional responsibility of investment bankers.[28]

Our initial inquiry is: what is responsible investment banking? Professor Hill and I have identified some components of responsible banking transactions. Not all of these components are present in all transactions, and we do not propose a specific test to define what is and is not a responsible transaction. We believe the following factors are important indicators of whether a transaction is or is not responsible.

First, is there a clearly articulated social utility to the transaction? The traditional role of investment bankers in providing access to capital markets through the underwriting process is an example where the answer to this question would probably be yes, provided the capital is to be put to good use. Some mortgage-backed securities products also are socially useful if they lower interest rates and make housing more affordable. At the other end of the spectrum are purely synthetic securities and other derivative instruments that are designed purely for speculation; the explosive growth of these securities in recent years gives Wall Street the social utility of a casino, albeit at a cost to society much greater than an ordinary casino.

Second, is the risk involved in the transaction proportionate to its expected social utility? The proportionality principle is important to many areas of law and moral philosophy,[29] and has a role in banking as well. Even

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28. *See* Hill & Painter, *supra* note 2; Hill & Painter, *supra* note 3.

29. *See, e.g.*, E. THOMAS SULLIVAN & RICHARD S. FRASE, PROPORTIONALITY PRINCIPLES IN AMERICAN LAW (2009).

if some social utility from a transaction is expected, it may not be worth the risk involved. For example, some derivative securities transactions are socially useful because they provide businesses with opportunities to hedge against certain types of losses, but the risk that these securities transactions will be misused for speculation might also be sufficiently great that, on the whole, society is better off without them. The harm from such transactions is disproportionately great compared with the benefits.

Third, who bears the risk? Does the risk taker bear the risk or are substantial social externalities involved? Do creditors, lower level employees, and the rest of society bear the consequences of the risk while the persons who make decisions about the risk get most of the upside?

Fourth, are bankers honest about the risk? Our federal securities laws were designed to address this problem, but legal prohibitions do not effectively reach all the ways in which risk can be concealed. Sometimes bankers' personal responsibility should prompt them to disclose more to counterparties, regulators, and markets as a whole than the law might require. Goldman Sachs recently settled SEC claims that it violated the law in this area in a private transaction in collateralized debt obligations; Goldman Sachs still has not admitted wrongdoing.[30] Goldman, however, never would have been in this situation if it had adhered to a higher standard of honesty than the law absolutely requires when dealing with clients and counterparties.

After articulating some of the characteristics of responsible investment banking, the next inquiry is: how can bankers be made to be more responsible? Professor Hill and I make several specific suggestions for a more professionally and personally responsible field of investment banking.

First, the most highly paid investment bankers should be personally liable for the debts of their firms, either through a joint venture agreement or assessable stock.[31] For years prior to the 1980s, many of the most prominent investment banks operated under this rule because they were general partnerships.

One example is Salomon Brothers. Partners were personally liable for the debts of the firm and took care to consult each other on trades over one or two hundred thousand dollars. William Salomon watched the firm's traders closely from his corner office off the trading floor. Partners paid themselves limited draws for personal expenses and left the rest of the money in the firm so it could grow. If the firm invested wisely and prudently, they

30. *See* Complaint at 20–21, Sec. & Exch. Comm'n v. Goldman Sachs & Co., 2010 U.S. Dist. LEXIS 119802 (S.D.N.Y. Apr. 16, 2010) (No. 10-CV-3229), *available at* http://www.sec.gov/litigation/complaints/2010/comp-pr2010-59.pdf; Settlement, Sec. & Exch. Comm'n v. Goldman Sachs & Co., 2010 U.S. Dist. LEXIS 119802 (S.D.N.Y. July 14, 2010) (No. 10-CV-3229), *available at* http://www.sec.gov/litigation/litreleases/2010/judgment-pr2010-123.pdf.

31. *See* Hill & Painter, *supra* note 3, at 1174.

each had a considerable nest egg when they retired. If it did not, they knew they would be in trouble, and the government would not bail them out.[32]

Then, in 1981, Salomon Brothers merged with Phibro Commodities and became a corporation with limited personal liability for its bankers. The firm's culture quickly changed, as it did at many other firms that made the same switch in the 1980s. Michael Lewis's book *Liar's Poker*[33] discusses the culture that took root at Salomon in the 1980s: traders ruled and the successful trader, instead of being called a "hot shot" as in former years, was now celebrated for sexual as well as financial prowess, upon the assumption that the two were inseparable. By 1991, a rogue trader had caught the firm up in a scandal that almost led the Treasury Department to shut the firm down; it merged into Smith Barney and then into Travelers Insurance and Sandy Weil's financial empire at Citicorp. The Salomon name was irreparably damaged and was retired. Almost two decades later, after several more scandals and many more risks, Citicorp itself became a colossal mess in need of a government bailout.

In view of these events, which Professor Hill and I blame in part on the shift to limited liability, we suggest going back to the liability rules that reinforced personal responsibility of investment bankers in an earlier era. Most investment banks probably will not become general partnerships again, but the government could require the most highly paid investment bankers—we suggest those making over $3 million per year—to enter into joint venture agreements with their firms in which they would be personally liable for firm debts. Alternatively, bankers' compensation in excess of $1 million could be paid in assessable stock, a security commonly issued by banks that operated under corporate charters up through the 1930s.[34] The concept here is that when the bank needs more capital, whether because of a liquidity crunch or some other reason, a mandatory capital call is made upon the holders of the assessable stock. Investment bankers, under this regime, would be personally responsible for their own firm's bailouts.

Another related proposal Professor Hill and I will explore is recalibrating bonuses and other compensation schemes to discourage excessive risk taking. Escrowing bonuses for several years until risks play themselves out

32. *See* Hill & Painter, *supra* note 3, at 1180–83 (discussing the old Salomon Brothers and comparing it with the more risk prone firm that emerged after corporate form replaced general partnership with the 1981 merger into Phibro. The latter firm is vividly depicted in Michael Lewis's book LIAR'S POKER).

33. MICHAEL LEWIS, LIAR'S POKER (1989).

34. *See* Hill & Painter, *supra* note 3, at 1175–77 (discussing assessable stock). For general commentary on relevant case law on assessable stock in the years before the Great Depression, see *Constitutional Law—Impairment of the Obligation of Contracts—Assessment to Restore Impaired Capital*, 45 HARV. L. REV. 584, 584–85 (1932). *See also* Broderick v. Rosner, 294 U.S. 629 (1935) (holding that under the full faith and credit clause of the U.S. Constitution, the New York Superintendent of Banks could bring suit for assessments against New Jersey residents holding stock in a New York bank).

is one option. Another is making stock nontransferable until a certain period after the investment bankers holding the stock retire. Yet another more radical idea is lowering the level of compensation. Lower compensation might improve the quality of investment bankers if the objective is to attract to the industry persons who prioritize stability over innovation—innovation that often has no easily identifiable social purpose. In sum, if we pay less we might actually get more.

Yet another approach is using the fault-based liability regime to more aggressively hold investment bankers liable for their conduct. Professor Lyman Johnson has correctly observed that the business judgment rule, while perhaps appropriate for shielding the business decisions of corporate directors, is often inappropriate for defining the standard of care expected of corporate officers.[35] In investment banking, corporate officers are entrusted with enormous amounts of other people's money—the firm's money as well as that of clients and other third parties. Yet the business judgment rule can be perceived as supplanting the more stringent requirements of the prudent person rule that generally applies to persons who have been entrusted with other people's property.[36] For the purposes of defining investment bankers' obligations to their firms, perhaps the business judgment rule should recede and be replaced by the prudent person rule.

Another idea is firm-wide and industry-wide standards of professional responsibility. Here the legal profession is perhaps an example of what professionals can do for themselves that external regulation by a government agency may not accomplish. Both firm-wide and industry-wide standards of conduct reach beyond national borders. They reach wherever the firms that have agreed to be bound by these standards have their offices, where the SEC or other national regulators may not go, or only go with great difficulty. Investment banks could perhaps be required to promulgate a meaningful code of business ethics, building upon the code of ethics that is already contemplated for public companies by the Sarbanes-Oxley Act.[37] The code would be one of their own choosing, but its contents would be disclosed to the banks' own investors in its securities filings. Departures from the code, thus, might in some circumstances be actionable under federal securities laws.

35. *See* Lyman Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUSINESS LAWYER 439 (2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=711122.

36. *See* BEVIS LONGSTRETH, MODERN INVESTMENT MANAGEMENT AND THE PRUDENT MAN RULE (1986).

37. Section 406 of the Sarbanes-Oxley Act requires all public companies, including foreign issuers, in their annual report, to disclose whether or not the company has adopted a written code of ethics covering the conduct of the company's principal executive officer, principal financial officer, principal accounting officer or controller, and people performing similar functions. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

IV. The Moral Underpinnings of Personal Responsibility

The specific proposals discussed above should help make investment bankers more personally responsible. Ultimately, however, personal responsibility is about the moral values of particular persons, and professional responsibility is about the collective moral values of a group of persons in a trade or profession. The driving element of responsibility is our individual and collective sense of right and wrong. Bankers, like other businesspeople, need to talk with each other and with the rest of society about morality. Leading scholars on business ethics, including Dr. Kenneth Goodpaster[38] at the University of St. Thomas, began this conversation. Bankers and other businesspeople need to be persuaded to take the conversation seriously and join in.

Where do we get our sense of right and wrong? Religion and philosophy, including secular philosophy, are the most obvious places to look. As Lyman Johnson points out in his recent article on religion and corporate law titled *Re-Enchanting the Corporation*,[39] many business leaders are religious, and their religious life influences their business activity. It is important for corporate law commentators—particularly those interested in a realist approach to behavioral economics—to understand the relationship between the two.[40] Bankers practice many different religious faiths, and those without religious faith adhere to a range of secular philosophies. Bankers, like other people, have personal moral values derived from whatever religion or philosophy they adhere to. Like other people, bankers also know what is right and what is wrong, but they sometimes do not do what is right, and are often reluctant to talk about it.

Just as lawyers and other persons in a trade or profession, bankers work within groups that have a collective ethos that sometimes runs counter to, and other times reinforces, their personal sense of right and wrong. A professional ethos runs counter to personal morality when it says that something that one ordinarily thinks of as wrong is right because one works in a certain trade or profession in which the conduct is justified.[41] (Arguably this is a variation of "situation ethics"[42] because one's professional situation

38. *See generally* KENNETH E. GOODPASTER, CONSCIENCE AND CORPORATE CULTURE (2007) [hereinafter CONSCIENCE]; Kenneth E. Goodpaster & J.B. Matthews, *Can a Corporation Have a Conscience?*, 60 HARV. BUS. REV. 132 (1982).

39. Lyman Johnson, *Re-Enchanting the Corporation*, 2010 WM. & MARY BUS. L. REV. 83, 90–93 (2010).

40. *Id.* at 103–07.

41. The goal thus is perceived to justify just about any means. *See* CONSCIENCE, *supra* note 38, at 28 (2007) (describing malaise in corporate culture that the author calls "teleopathy," combining the Greek words for "goal" and "disease").

Teleopathy is "the unbalanced pursuit of purpose in either individuals or organizations." *Id.* This can be true of investment banks, as well as other organizations, including law firms. *See* Neil Hamilton, *Does a Law Firm Have a Conscience?*, MINN. LAW., Aug. 20, 2007.

42. *See* JOSEPH FLETCHER, SITUATION ETHICS: THE NEW MORALITY 26 (1966).

determines one's ethics.) A professional ethos reinforces personal morality when it says that something which one ordinarily thinks of as wrong is also wrong in a trade or profession, and therefore certain specific conduct in that trade or profession is wrong.

An example of the former approach: an investment banker generally believes that lying and telling half-truths is wrong, but the banker also believes that sophisticated institutional investors should do their own homework when buying collateralized debt obligations or credit default swaps from an investment bank. The bank, therefore, need not affirmatively disclose everything it knows, such as the fact that the person designing the instrument is on the selling side of the same trade.[43]

An example of the latter approach: an investment banker believes that regardless of what an institutional buyer knows or should know about a financial instrument, the investment bank selling it should disclose all of the material facts it knows about the instrument as well as who has what financial interest in it. A lower level of disclosure may be legally permissible, but complete honesty is both what is morally required and what both parties to the transaction should expect from each other.

Another example of the former approach: a particular transaction such as a leveraged buyout of a successful company may lead to widespread layoffs of employees and misery for their families as well as great risk for creditors. An investment banker believes that for these reasons he would not consummate such a transaction if he owned the company. But he does not own the company, but rather, it is his client. The banker believes that his professional duty extends solely to the company and its directors, and they believe that their duties extend solely to the company's shareholders who will profit from the buyout. (The fate of creditors is presumably addressed by the "efficient" market in which they buy the company's junk bonds; the fate of senior management is well taken care of.[44]) An act that the banker ordinarily thinks of as wrong—structuring a business deal to impose substantial hardship on persons least able to bear that hardship—thus is right because an investment banker's obligations to a client are more

43. These facts are taken from the SEC's recent enforcement action against Goldman Sachs, which settled with payment of a fine but no acknowledgment of wrongdoing. Complaint at 1–2, Sec. & Exch. Comm'n v. Goldman Sachs & Co., 2010 U.S. Dist. LEXIS 119802 (S.D.N.Y. Apr. 16, 2010) (No. 10-CV-3229), *available at* http://www.sec.gov/litigation/complaints/2010/comp-pr2010-59.pdf.

44. Many leveraged buyouts—sometimes called "management LBOs"—are instigated by a firm's management, which holds a significant portion of the equity stake in the leveraged firm after it is bought from its public shareholders. The managers stand to make a lot of money if the company is successful and pays off its debt. If not, the managers lose their equity stake, but the exceptionally high debt load means that the bulk of the losses are suffered by the firm's debt holders. If the firm fails because of the excessive debt, the employees may also lose their jobs.

narrowly defined than the obligations persons are generally presumed to owe others.[45]

An example of the opposite approach to this same problem: the investment banker will not assist a client in consummating a transaction that the banker would refuse on moral grounds to consummate for his or her own company. The banker thus structures the leveraged buyout transaction, and advises the company's directors to proceed with the transaction in a way that creates wealth for shareholders while protecting employees and creditors. The appropriate balance between these competing concerns is debatable, and here is where the proportionality principle comes into play. The banker believes that he has a moral obligation to pursue a transaction that balances these competing concerns, with the scales being weighed in favor of the persons least able to protect themselves. If the client company does not like this approach, it can find another banker.

In these and other situations, there needs to be a conversation about one's personal ethics. There also needs to be a meaningful measure of right and wrong, whether from religion or from a secular philosophy. Absent a meaningful measure of right and wrong, tangible elements—profit, growth, and the year-end bonus—fill the void and provide the measures that guide bankers' behavior.

On many questions of right and wrong in economic transactions, premises derived from different religious faiths, in addition to humanist perspectives, lead to similar conclusions. Sometimes they lead to different conclusions, but only at the margins and not with respect to core concepts. Occasionally, different religious or secular philosophical traditions differ over core concepts such as the appropriateness of charging interest on loans, although close examination of the way transactions are structured reveals that the differences may not be so stark. (Religious traditions with stricter rules sometimes find ways of accommodating conduct that closely resembles that which is already accepted by traditions with more flexible rules.) What is important is that few, if any, religious traditions or secular philosophies of morality embrace an ethos that allows moral actors to do whatever the law allows them to get away with, that celebrates greed as a good characteristic, that promotes conspicuous and unnecessary consumption as a social good rather than an evil, or that encourages people to ignore the impact of their actions on other people. Yet, for whatever reason, an ethos with these characteristics is widely believed to have taken root in our financial centers.

It is possible, one might argue, to discuss conclusions about right and wrong absent discussion of the religious or secular principles from which

45. This reasoning parallels the reasoning of some lawyers who believe that their professional obligations to clients require them to do things to assist clients that they would not do for themselves.

those conclusions are derived. Perhaps in this manner conclusions can be agreed upon without the acrimony that so often accompanies discussion of broader religious or philosophical principles. Effort spent arguing over first principles can instead be expended in defining how specific agreed-upon conclusions apply to a particular field such as banking.

This approach only works, however, if people agree on their conclusions about right and wrong while agreeing not to discuss the reasons for their conclusions. They must also agree to hold steadfastly to these conclusions despite the many temptations to stray from these conclusions, temptations which are backed up by a wide range of rationalizations, and of course the money.

The problem is that conclusions about right and wrong are an unstable foundation for moral reasoning without the premises upon which they are built. Conversations about ethics are not likely to lead to unshakable conclusions if participants in the conversation do not freely think about and express their reasons for arriving at conclusions about moral action. Starting points for ethical reasoning are important, and leaving starting points out of a conversation about ethics has a cost just as does the opposite problem of refusing to acknowledge the different starting points of other participants in the conversation. More often than not different starting points lead to the same convictions about right and wrong, just as the different legs of a chair support the same seat. The philosophical support structure for conclusions about ethics—even if viewed differently by each participant in the conversation—will be stronger if it is in the open. The strength of philosophical conviction will reinforce conclusions about right and wrong so these conclusions might withstand the inevitable pressure to do differently.

Deliberating over right and wrong in a specific context—banking or any other—without looking to a system of religion or secular philosophy for first principles is, thus, like trying to build furniture without strong legs. As soon as any significant weight is applied to it, the furniture falls to the ground. In matters of commerce, pecuniary impulse is an enormous weight; principles that support any conclusion about right and wrong in the commercial context must be very strong to withstand that pressure. Half-hearted conclusions about personal morality are weak without an understanding of why we arrive at those conclusions. There need not be a single set of first principles nor a single reason why we hold them; indeed, in a diverse society we need to recognize diverse reasons for moral action. Each set of principles, however, is stronger to the extent it is internally coherent, and religion and philosophy are an important part of that coherence.

Why has this conversation been lacking in banking? In part, people do not want to have the conversation because of the enormous amounts of money involved. Bankers want that money, and having a meaningful conversation about right and wrong might lead them either to act in a manner that produces less money or causes them to suffer moral discomfort (con-

science) when they get more money. It is supposedly better not to have the conversation at all, and instead compartmentalize one's life. In this approach, what goes on in the investment bank is governed by the morals of the marketplace and not much more, with legal prohibitions setting outside limits on acceptable behavior. Relationships outside the bank—to the extent there is time for such relationships—are where meaningful concepts of morality come into play. If one's conscience needs comfort, charitable endeavors may provide that comfort along with social recognition for benevolence. Changing one's behavior within the investment bank is not considered a realistic option. After all, that is where the money is made, and making money and morality are supposedly two very different things.

Another reason belief systems may be a taboo topic of conversation in investment banking relates to the history of religious prejudice and discrimination in banking; this history made meaningful discussion of religious or even secular philosophical concepts difficult. Articulating a faith-based concept—or even a secular concept—that applies to banking can be perceived as a ploy to exclude others as "morally unfit" to share in the riches of banking simply because their moral reasoning starts at a different point. Indeed, this happened for much of our history. Smaller groups—particularly Jews—were mischaracterized by predominant groups at the time—particularly Protestant Christians—as being unfit for the high degree of trust required for banking.[46] It did not matter that Jewish bankers had a long history of honorable transactions in Europe (including bailing out governments instead of vice versa), and that Louis Brandeis was one of the first commentators on modern banking to expose the moral deficiencies of bankers in *Other People's Money and How the Bankers Use It.*[47] Nor did it matter that predominantly Protestant banks in the United States, perhaps because of their wealth and global influence, had the most prominent role in the events leading up to 1929 and the Great Depression: J.P. Morgan & Co. and National City Corporation were two of the most prominent.[48] Many people in control of leading financial institutions used anti-Semitism and other forms of prejudice, including a widespread belief in Protestantism's moral superiority over Catholicism, to justify their own position of wealth and influence.

46. Even the most prominent Jewish families had to confront anti-Jewish sentiments in the business establishment and responded by building their own social and business network. *See generally* STEPHEN BIRMINGHAM, OUR CROWD: THE GREAT JEWISH FAMILIES OF NEW YORK (1967).

47. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT (1914).

48. For a discussion of how Ferdinand Pecora led the principal Congressional inquiry into the conduct of a predominantly Protestant Wall Street after the 1929 crash, see MICHAEL PERINO, THE HELLHOUND OF WALL STREET (2010) (discussing how Pecora exposed the misdeeds of National City Chairman Charles Mitchell and other establishment bankers and how Pecora's triumph over the WASP financial elite also heralded a social transformation in American finance).

Yet another difficulty that arises with discussing religious values in the context of finance is that people sometimes use religion not only to exclude people of other faiths from lucrative economic opportunities, but also to lure persons of one's own faith into fraudulent opportunities. "Affinity fraud" is built upon the premise that common elements such as culture and religion enhance trust and cause people to let their guard down. We saw affinity fraud in the Bernie Madoff Ponzi scheme, which disproportionately victimized the Jewish community. We also saw affinity fraud in the 2001 Arizona Baptist Foundation scandal—an Arthur Andersen–approved version of the old "church bonds" ploy[49] where promoters tour the Bible Belt selling bonds for proceeds in fact used to do something other than build churches. If religion can be so easily used to mask fraud, it is easy for observers to assume—erroneously I believe—that there would be less fraud if investors gave no thought to religion and distrusted financiers who talked of religion.

Where do we go from here? We cannot let either the moral shortcomings of the past or the persistent misuses of religion in finance impede meaningful discussion of the moral shortcomings of the present. We should not banish religion and secular philosophy from our discussion of bankers and their work. Rather, we should openly and honestly discuss first principles. Should profit be the principal motivating factor for a banker's transaction? How important to the banker's decisions are collateral consequences of a transaction to persons not party to it? Are there limits to the amount of money any individual should be allowed to make with other people's money? What is the morally right attitude toward risk with other people's money? With one's own money? With respect to each of these questions, why do we reach the conclusions we do? What is the role of faith or secular philosophical systems in our moral reasoning? How are the conclusions we reach different from, or the same as, conclusions reached by persons who use different starting points for their moral reasoning?

We would probably find that Protestant, Catholic, Jewish, Islamic, humanist, and other premises in many contexts—although not all—lead to similar conclusions about what is right and wrong in economic interactions generally, and in banking in particular. Bankers and society in general, however, need to have this conversation. Participants in the conversation should not be afraid to say what they think about morality in banking and why. Participants also need to find areas of common agreement and then discuss what can be done to make things right.

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49. *See* Floyd Norris, *$217 Million New Settlement by Andersen in Baptist Case*, N.Y. Times, May 7, 2002, http://www.nytimes.com/2002/05/07/business/217-million-new-settlement-by-andersen-in-baptist-case.html (discussing how Arthur Andersen agreed to pay $217 million "to compensate investors in a fraudulent Arizona charity whose financial statements Andersen had certified, even after former employees of the charity said a fraud was involved").

Finally, what is the role in this discussion for a University committed to meaningful discussion of morality and the purpose-driven professional life? A Catholic university such as St. Thomas has a unique role to play. Catholic social teaching has given considerable thought to questions of economic justice and moral action in the economic sphere. Many of the social teachings of our Protestant churches, including my own, are derived from Catholic social teaching.[50] Also, history is not so much an impediment, at least here in the United States. The fact that Catholic bankers did not hold positions of disproportionate influence in the past in the United States—and were for the most part not in a position in this country to use religion to exclude persons of other faiths—should make it easier for people to listen to Catholic teachings about banking.

Of course, much work remains to be done. Catholic social teaching has been far reaching since the 1891 Encyclical *Rerum Novarum* of Leo XIII[51] and has focused on problems of global development since the 1960s,[52] but does not extensively address the ethical responsibilities of bankers in particular. This is partly due to a traditional focus on workers' rights, the role of the state in the economy, the role of private property, income distribution, and other issues.[53] There is also the legacy of an earlier era when Catholic finance ethics was focused on the issue of usury,[54] a losing battle that may

50. *See* Darryl M. Jordan, *He Hath Filled the Hungry with Good Things: Early Developments in Anglo-Catholic Social Theology*, ANGLO-CATHOLIC SOCIALISM, http://www.anglocatholicsocialism.org/acsocialtheology.html (May 5, 2002). *See generally* WILLIAM L. SACHS, THE TRANSFORMATION OF ANGLICANISM: FROM STATE CHURCH TO GLOBAL COMMUNION (1993).

51. *See* Leo XIII, Encyclical *Rerum Novarum: Acta Leonis XIII* (May 15, 1891): Leonis XIII P. M. Acta, XI, Romae 1892 at pages 97–144, *available at* http://www.vatican.va/holy_father/leo_xiii/encyclicals/documents/hf_l-xiii_enc_15051891_rerum-novarum_en.html, and subsequent documents on anniversaries of that first document. The Second Vatican Council proposed the creation of a Church body "to stimulate the Catholic community to promote progress in needy regions and international social justice." *Gaudium et Spes*, No. 90, *available at* http://www.vatican.va/archive/hist_councils/ii_vatican_council/documents/vat-ii_cons_19651207_gaudium-et-spes_en.html. Pope Paul VI responded by establishing the Pontifical Commission "Iustitia et Pax" in a Motu Proprio of January 6, 1967. *Catholicam Christi Ecclesiam* [*Council on the Laity–Commission for Studies in Justice and Peace*], 27 JURIST 258, 258–61 (1967).

52. *See Populorum Progressio*, Encyclical of Pope John Paul VI on the Development of Peoples (Mar. 26, 1967), *available at* http://www.vatican.va/holy_father/paul_vi/encyclicals/documents/hf_pvi_enc_26031967_populorum_en.html. This letter warns that economic development requires more than technical expertise. *See id.* § 20 ("If development calls for an ever-growing number of technical experts, even more necessary still is the deep thought and reflection of wise men in search of a new humanism, one which will enable our contemporaries to enjoy the higher values of love and friendship, of prayer and contemplation, and thus find themselves. This is what will guarantee man's authentic development—his transition from less than human conditions to truly human ones."). This lesson was apparently not heeded by the banking industry in subsequent decades as banks hired more mathematicians and other experts, financial instruments became more and more complex, and little attention was given to these instruments' ultimate purpose or their impact on the human condition. In the years leading up to 2008, wise men were lacking in the financial industry, or at least were not in a position to avert catastrophe.

53. *See* J.S. BOSWELL, F.P. MCHUGH & J. VERSTRAETEN, CATHOLIC SOCIAL THOUGHT 201 (2000).

54. *Id.* at 202.

have diverted attention from other questions such as how bankers loan money, how much, to whom, and for what purposes. Catholic social teaching advances solutions to some of the most serious problems created by the banking system, such as international debt,[55] but there is a continuing need to develop broad principles demarking the difference between banking practices that are ethical and those that are not. More specifically, what did large investment banks do in the most recent financial crisis that was unethical and why? How can people run banks in a more responsible manner?

The Catholic Church's response to the world debt crisis in the 1980s illustrates the strengths as well as the limitations of its approach to moral issues in banking. In 1986, when the indebtedness of developing countries was steadily worsening, Pope John Paul II mentioned the moral responsibilities of businessmen:

> [W]e see peace as an indivisible fruit of just and honest relations on every level—social, economic, cultural and ethical—of human life on this earth . . . . To you, business men, to you who are responsible for financial and commercial organizations, I appeal, to examine anew your responsibilities towards all your brothers and sisters.[56]

A contemporaneous 1986 Church document, *At the Service of the Human Community: An Ethical Approach to the International Debt Question* ("International Debt" document),[57] set forth the specific responsibilities of the various parties involved in the debt crisis, including world financial organizations, debtor nations, creditor nations, financial institutions, and political leaders. The document's principal criticism of financial institutions was the high interest rates they charged borrowers and their unwillingness to extend further credit to promote economic growth in developing countries.[58] The document urged banks—even at some risk to their depositors[59]—to lower interest rates and lend more money for projects that foster economic growth.[60]

55. *See* Pontifical Comm'n, Justitia Et Pax, At the Service of the Human Community: An Ethical Approach to the International Debt Question (Dec. 27, 1986), *in* Enchiridion Vaticanum 10 (hereinafter Pontifical Comm'n); *see also* David L. Gregory, *From Pope John Paul II to Bono/U2: International Debt Relief Initiatives "In the Name of Love,"* 19 B.U. Int'l L.J. 257 (2001).

56. John Paul II, *Message for the 1986 World Day of Peace* (Jan. 1, 1986), *available at* http://www.vatican.va/holy_father/john_paul_ii/messages/peace/documents/hf_jp-ii_mes_19851208_xix-world-day-for-peace_en.html.

57. Pontifical Comm'n, *supra* note 55.

58. *Id.*

59. *See id.* ("The commercial banks are direct creditors of developing countries (States and enterprises). Their duties towards their depositors are essential and must be fulfilled if confidence is to be maintained. These duties, however, are not their only ones and must be compatible with respect for their debtors whose needs are often more urgent.").

60. *See id.* ("Commercial banks have an active role to play in the efforts undertaken by creditor States and international organizations in solving the debt problem: rescheduling of debts, revision of interest rates, relaunching investments in developing countries, financing of projects on the basis of their impact on growth in preference to 'safer' projects with more immediate

The Church's 1986 International Debt document was right in many respects. In times of economic crisis, financial institutions make things worse by cutting off credit to borrowers or charging excessive interest. Politicians and economists often join religious leaders in calling upon bankers to ease credit and relieve economic hardship. Bankers' obligation to foster growth is important, particularly when growth lags behind mounting debt.

Still, the 1986 International Debt document does not address the dangers of excessive lending. In particular, the document does not address the dangers of loose loan underwriting standards, although it does observe in passing that in the boom years of the 1970s and early 1980s, lenders to developing countries incurred too much risk.[61] This is nothing new; throughout history, easy money and loose lending standards often led to overheated credit markets and to ensuing economic collapse.[62] The developed countries experienced this phenomenon often, as did the United States once again in 2008.

The Church's 1986 International Debt document needed an in-depth discussion of the morality of the financing arrangements that created the crisis in the first place. The document would have been stronger—and provided more useful guidance for avoiding future crises—had it explored whether it was wrong for the banks to have made some of the loans, whether the banks were unfairly taking advantage of unrealistic borrower ambitions, and whether individual bankers made the loans for their own professional or pecuniary motives without paying attention to whether there was a realistic prospect of the loans being repaid.[63] A strong moral—as well as economic—case can be made that some of the loans that caused the

investment returns and those of questionable usefulness (e.g., prestige investments, armaments). This approach undoubtedly goes beyond the traditional function of commercial banks in so far as it invites them to undertake a type of discernment which transcends the ordinary criteria of profitability and security for capital invested in the form of loans. Nonetheless, why would they not assume in that way part of the responsibility in the face of this major challenge of our times: promoting the united development of all peoples and thereby contributing to international peace? All persons of good will are called to this task, according to their own expertise, professional commitment, and sense of solidarity.").

61. *Id.* ("The remote causes for this phenomenon go back to the time when widely shared opinions about growth possibilities led developing countries to look for capital and commercial banks to offer credits for financial investments, sometimes at high risk. The prices for raw materials were favourable and the majority of debtor nations remained solvent. . . . The first and second oil crises of 1974 and 1979, the fall in the price of raw materials and the abundance of petrodollars in search of profitable investments, as well as the effects of over-ambitious development programmes, contributed to the massive indebtedness of many developing countries.").

62. *See generally* SIDNEY HOMER, A HISTORY OF INTEREST RATES (Rutgers University Press, 1st ed. 1963) (documenting credit conditions back to 2000 BC).

63. There is a hint in the document that the drafters were aware of unethical dealings, including fraud, when some of the loans were made, but there is little supporting information. "Except when loans have been granted at usurious rates or used to finance projects overpriced through fraudulent complicity—in which case legal proceedings could be initiated to revise the contracts—creditors have rights, acknowledged by the debtors, relative to interest rates, the conditions and schedule of reimbursement." Pontifical Comm'n, *supra* note 55.

third world debt crisis should not have been made in the first place. That crisis, like the 2008 financial crisis in the United States and the sovereign debt crisis in Europe in 2010, resulted from banks being eager to loan money heedless of the consequences. Some loans were responsible, but other loans were irresponsible for both the lenders and the borrowers.

In sum, there are good and bad consequences that ensue from the standard formula for bankers' social responsibility: lowering interest rates and easing credit conditions for borrowers. This formula can help cure a crisis and ease its pain, but this formula can also help create the next crisis unless prudent lending is also emphasized. Other aspects of the Church's proposal for resolving the world debt crisis, including direct aid from developed countries to developing countries,[64] have a firm economic footing, but using credit as a means of income redistribution has inherent dangers that should have been explored in more depth. Turning to an example in the United States, Fannie Mae and Freddie Mac both purported to fulfill a broader social mission in their lending practices in the years leading to 2008, earning them widespread support from political leaders. In retrospect, they may have done more harm than good.

In response to the present crisis, Pope Benedict XVI issued an Encyclical Letter in 2009 that addressed in general language the misuse of financial instruments by bankers and others who personally profited at the expense of society as a whole.[65] The letter called for a new—or arguably a return to a traditional—focus for finance:

> *Finance*, therefore—through the renewed structures and operating methods that have to be designed after its misuse, which wreaked such havoc on the real economy—now needs to go back to being an *instrument directed towards improved wealth creation and development*. Insofar as they are instruments, the entire economy and finance, not just certain sectors, must be used in an ethical way so as to create suitable conditions for human development and for the development of peoples. It is certainly useful, and in some circumstances imperative, to launch financial initiatives in which the humanitarian dimension predominates. However, this must not obscure the fact that the entire financial system has to be aimed at sustaining true development. Above all, the intention to do good must not be considered incompatible with the effective capacity to produce goods. Financiers must

64. *See id.* ("In particular, has the time not come for the industrialized countries to draw up a broad plan of cooperation and assistance for the good of the developing countries?").

65. See Pope Benedict XVI, *Caritas In Veritate* § 36 (June 29, 2009), which states that "[e]conomy and finance, as instruments, can be used badly when those at the helm are motivated by purely selfish ends. Instruments that are good in themselves can thereby be transformed into harmful ones. But it is man's darkened reason that produces these consequences, not the instrument *per se*. Therefore it is not the instrument that must be called to account, but individuals, their moral conscience and their personal and social responsibility."

> rediscover the genuinely ethical foundation of their activity, so as not to abuse the sophisticated instruments which can serve to betray the interests of savers. Right intention, transparency, and the search for positive results are mutually compatible and must never be detached from one another. If love is wise, it can find ways of working in accordance with provident and just expediency, as is illustrated in a significant way by much of the experience of credit unions.
>
> Both the regulation of the financial sector, so as to safeguard weaker parties and discourage scandalous speculation, and experimentation with new forms of finance, designed to support development projects, are positive experiences that should be further explored and encouraged, highlighting *the responsibility of the investor* . . . .[66]

The letter also emphasized the importance of building a morally grounded understanding of business ethics for the entire economy not just parts of it that are labeled—sometimes misleadingly—as being "ethical."[67] The letter urges a departure from the strict distinction between for-profit and non-profit businesses and urges that profits be seen as a means of achieving broader social goals.[68]

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66. *Id.* § 65.

67. *Id.* § 45 ("*The economy needs ethics in order to function correctly*—not any ethics whatsoever, but an ethics which is people-centred. Today we hear much talk of ethics in the world of economy, finance and business. . . . It would be advisable, however, to develop a sound criterion of discernment, since the adjective 'ethical' can be abused. When the word is used generically, it can lend itself to any number of interpretations, even to the point where it includes decisions and choices contrary to justice and authentic human welfare.

Much in fact depends on the underlying system of morality. On this subject the Church's social doctrine can make a specific contribution, since it is based on man's creation 'in the image of God' (Gen 1:27), a datum which gives rise to the inviolable dignity of the human person and the transcendent value of natural moral norms. When business ethics prescinds from these two pillars, it inevitably risks losing its distinctive nature and it falls prey to forms of exploitation; more specifically, it risks becoming subservient to existing economic and financial systems rather than correcting their dysfunctional aspects. Among other things, it risks being used to justify the financing of projects that are in reality unethical. The word 'ethical', then, should not be used to make ideological distinctions, as if to suggest that initiatives not formally so designated would not be ethical. Efforts are needed—and it is essential to say this—not only to create 'ethical' sectors or segments of the economy or the world of finance, but to ensure that the whole economy—the whole of finance—is ethical, not merely by virtue of an external label, but by its respect for requirements intrinsic to its very nature.").

68. *Id.* § 46 ("When we consider the issues involved in the *relationship between business and ethics*, as well as the evolution currently taking place in methods of production, it would appear that the traditionally valid distinction between profit-based companies and non-profit organizations can no longer do full justice to reality, or offer practical direction for the future. In recent decades a broad intermediate area has emerged between the two types of enterprise. It is made up of traditional companies which nonetheless subscribe to social aid agreements in support of underdeveloped countries, charitable foundations associated with individual companies, groups of companies oriented towards social welfare, and the diversified world of the so-called 'civil economy' and the 'economy of communion'. This is not merely a matter of a 'third sector', but of a broad new composite reality embracing the private and public spheres, one which does not exclude profit, but instead considers it a means for achieving human and social ends. Whether such com-

For investment bankers, the teachings of this letter support one of the points I made at the beginning of this article—banking should have a socially useful objective such as raising capital for useful enterprises.[69] Responsible bankers do not pursue speculation in financial instruments as an end in itself. The letter also addresses two other aspects of responsible banking that I mentioned earlier—attention to the impact of transactions on society as a whole, particularly on weaker parties, and honesty or transparency in financial transactions.[70]

To fulfill the calling described in this letter, bankers need to focus less on short-term profits, particularly those not linked to productive enterprise, and focus more on relationships that they build with clients, investors, and the communities that they serve. Global investment banks can fulfill this calling in part by accepting responsibility for the health of the global economy; banks that bet against the economy and profit from other people's suffering do the precise opposite. Regional investment banks can fulfill this calling by accepting responsibility for meeting the needs of the communities they serve.

Regional banks are particularly important because the bankers who lead them live in the communities affected by their activities: they and their family members are likely to have leading roles in local charitable organizations, schools, churches, and temples, and see firsthand what socially responsible banking—and socially irresponsible banking—does to people's lives. Bankers' prominent role in society (sometimes derisively referred to with a capital *S* by social commentators)[71] will not necessarily make them more responsible, but this role reminds them of the genuine needs of a world beyond their banks. Regional bankers have the added advantage that the portion of the world they learn about through charitable, religious, and social activities is the same as that which is most affected by their banks. It

panies distribute dividends or not, whether their juridical structure corresponds to one or other of the established forms, becomes secondary in relation to their willingness to view profit as a means of achieving the goal of a more humane market and society. It is to be hoped that these new kinds of enterprise will succeed in finding a suitable juridical and fiscal structure in every country. Without prejudice to the importance and the economic and social benefits of the more traditional forms of business, they steer the system towards a clearer and more complete assumption of duties on the part of economic subjects. And not only that. *The very plurality of institutional forms of business gives rise to a market which is not only more civilized but also more competitive.*").

69. *See supra* p. 11.

70. *See supra* pp. 12–13, 17.

71. Some of this criticism is justified. Participation in a Society dominated by upper income people can have "noblesse oblige" qualities but can also have negative qualities if it promotes conspicuous consumption, competition in the acquisition of money and material goods, unwillingness to expose ethical shortcomings of other people in positions of power, or racial and religious discrimination. Social activities also can have more or less impact on the ethical decision making of businesspeople—membership on the board of the Museum of the City of New York, an Ivy League university, or a prep school may not tell a businessperson as much about how business decisions impact other people's lives as participation in a local Catholic Social Services organization, a Boys or Girls Club, or a disaster relief organization.

is, therefore, important that policy makers consider whether too much financial power is now concentrated in the hands of multinational institutions headquartered in London, New York, Tokyo, and a few other world financial capitals. People and businesses in Pittsburgh, Philadelphia, and Minneapolis need financial services, and these services may be better if they originate in the communities they serve.

I am not saying that bankers in global financial institutions cannot meet the calling in the Pope's letter—they can, and it is very important to the global economy that they make every effort to do so. Their work has enormous impact, and it is their moral obligation to think about this impact. Global bankers' active participation in the life of the Church, the Council on Foreign Relations, and other organizations with a global reach should help them meet this moral obligation to the world they serve. In some respects, however, the calling set forth in the Pope's letter is easier for regional bankers to accomplish. Also, from a societal perspective, diversification—a concept familiar to investment managers—is an important means to accomplish broader objectives. Society should not allow large portions of the economy to be exposed to financial risks—and ethical risks—concentrated in the decision-making of a few individuals in faraway places. Diversifying the power base in banking, and spreading it out geographically may help make this sector of the economy conduct itself more responsibly.

I am not prepared to opine further on what specifically Catholic social teaching says or should say on what is or is not responsible banking; although, perhaps I will have an opportunity to explore these questions further with a faculty member here at the University of St. Thomas School of Law, at another leading Catholic university, or elsewhere. I am prepared to emphasize that each of us needs to examine our innermost convictions about right and wrong, and how these convictions relate to banking and other fields of economic endeavor. Economics historically was not a field that was independent of moral philosophy, sociology, and other areas of inquiry; I am not convinced that economics can be intellectually coherent—or relevant to the modern world—as an entirely independent discipline. From a practical perspective also, I doubt that economic endeavors such as banking can be successful without consideration of their morality.

If we care about preserving capitalism and its many benefits for our society, we must constrain its excesses. Regulation will play an important part, but as thousands of pages are added to the United States Code and thousands more to the Code of Federal Regulation, we cannot forget the equally important role for moral values of individual bankers and of the banking profession as a whole.

We fail in this endeavor at our peril. For decades we lived in fear of godless communism. When the iron curtain fell in the late 1980s, we turned even more vigorously to the business of making money. That business ac-

celerated in the 1990s and the early years of the present century. In 2008, we came close to being destroyed by banking conducted at the margins of the law and with little or no regard for right and wrong. Raw capitalism, freed of restraints that arise from personal and collective morality and subject only to the weak oversight of the law, almost accomplished the widespread destruction of our system that communist dictators only dreamed about. We narrowly escaped complete disaster. We are experiencing the deepest recession in seventy years. Next time it could be even worse. We should act now to address the moral as well as economic causes of our financial collapse.