Ethical standards and financial law - revision
Presentation outline

- Reasons for financial market regulation
- Role of ethical codes and standards
- Key terms
- Long-term benefits of compliance to legal regulations, standards and codes of ethics
- Consequences of violating regulations
- Influencing ethical behavior
- Different methods of regulating financial market - legal regulations versus ethical and professional standards
- National versus international level of regulation
- Regulation of the financial market - trends and perspectives
- Mock exam
Reasons for financial market regulation

- lesson from the financial crises, e.g. dot-com speculative bubble (1995-2000) and suprime crisis (2007-2010) and nowdays – Greece ...
- global interconnection and scale of consequences due to individual player’s misbehavior
- complex financial instruments - lack of transparency and amount of risk involved
- too big too fall – problem of bailouts
- asymmetry of information, problem of agency, transaction costs, moral hazard
Need of ethical codes and standards

- amorality of financial market: anonymity, greed, economical background (homo oeconomicus approach), ignorance of consequences
- low public trust when good trust is needed - ethical codes as restrictions to gain legitimacy (after financial frauds revealing)
- increase of investors confidence in financial market
- choice between ethical standard compliance and need of stronger law regulations
Key terms – standards in capsule

- misrepresentation vs misconduct – dissociation, whistle blowing
- market manipulation (through information or action)
- independence and objectivity, conflict of interests – avoidance and disclosure
- reasonable and adequate basis
- client’s interest first, front running
- public dissemination of the information
- insider trading, material nonpublic information, mosaic theory
- Chinese walls (fire walls), restricted list
- suitability, investment policy statement
- soft commissions, best prices and best execution
- solicitation of employer’s clients
Benefits of compliance

- investment market benefits
- investment professionals benefits (brokers, analysts, portfolio managers)
- investment companies benefits (investment bank, brokerage houses, investment funds)
- private investors (clients) benefits
Consequences of rules violation

- legal (prison, fine) – both for individuals and companies
- professional (loose of license) - both for individuals and companies
- social (reputation within professional community and among clients) - both for individuals and companies
- psychological (shame and guilt)
Effectiveness of codes of ethics and training in ethics

- legal window dressing?
- only making individuals aware of the litigation risk of certain actions?
- altering actual motivation?
- constrains, trade-off: profits vs ethics or change of perspective: virtues based approach (virtue ethics), excellence seeking, external vs internal goods (competition versus common interest)
Influencing ethical behavior

- punishment
- education
- training
- socializing / corporate culture
- role examples / leadership
Ethical and professional standards vs legal regulations

- Institutional frameworks
  - rules of game – constraints of player’s behavior
  - mechanism of enforcement
  - sanctions
- Interaction of standards and regulations
  - complementarities
  - substitution
Methods of regulating financial market

- acts of law
- regulations of supervision bodies
- self-regulation of investment organizations and their associations (norms and standards)
- self-regulations professionals’ associations (norms and standards)
- informal norms
National vs international level of regulation

- national level:
  - state regulators (eg. Polish Financial Supervision Authority – acts of law and recommendations)
  - self regulation of investment companies (eg. Chamber of Brokerage Houses and its Good Practice Code of Brokerage Houses)
  - self regulation of investment professionals (eg. Polish Association of Brokers and Investment Advisers and its internal rules)
  - internal organization regulation (eg. Warsaw Stock Exchange Rules, investment funds’ articles of association)
National vs international level of regulation (II)

- international level:
  - international industry self-regulation (eg. International Swaps and Derivatives Association and its Master Agreement)
  - international profession self-regulation (eg. CFA Institute and its professional and ethical standards)
EXAMPLE: Client protection

- conflict of interests avoidance and disclosure
- informational duties
- procedures and supervision
- co-existence of law regulations and ethical standards, external and internal, state protection and self-regulation, national and international, formal and informal
Trends and perspectives

- increasing level of regulation (protection of markets and clients)
- international standardization (bigger transparency)
- global regulators (global markets out of national regulators control)