



According to Plato, “Good people do not need laws to tell them to act responsibly, while bad people will find a way around the laws.” Given the current spate of financial scandals, the words of this ancient philosopher hit close to home. Rule-makers around the world are adding staff, beefing up mandates and otherwise looking to stabilize markets after an unprecedented rollercoaster ride for individual and institutional investors alike. Wall Street is girding itself for a tough regulatory climate, especially in areas such as compensation and proprietary risk-taking. The unfortunate fallout, as with any statute, is the blurring of lines between good and bad players. Companies lose the flexibility to reward prudent process and are challenged to lure new clients on the basis of transparency. After all, if everyone is forced to abide, how do buy side executives separate the wheat from the chaff?

The good news for ethicists is that integrity matters. As stated in its 2009 Midyear Special Report about trust, Edelman Public Relations reports that “profitability and performance falls behind employee well-being, transparent and honest business practices.” In “Building Customer Value and Profitability With Business Ethics,” researchers Robert C. McMurrian and Erika Matulich support the notion that good behavior adds “value for customers” and results in “increased profitability and performance for the firm.” Contrast that with the results of a February 2009 Marist poll sponsored by the Knights of Columbus which assigns a “grade of D or F in ethical matters to the financial and investment industry.”

While grossly unfair to indict an entire collection of professionals, it is surprising that Wall Street executives have been relatively silent on the topic of moral leadership. Statistics document the almost \$3 trillion allocated to “socially responsible” money managers yet there is almost nothing known about what the sell side spends on investment governance.


The truth is straightforward. Bad apples spoil the pie for everyone. It is folly to ignore the negative externalities due to misdeeds of industry peers. The costs are too high. Lost clients, fiduciary litigation, new law compliance and missed opportunities are only a few components of the rogue’s price tag, handed off to increasingly impatient shareholders, investors and taxpayers. Even if one is inclined to skimp for whatever reason, it is not smart business. With new fiduciary regulations looming over the horizon, service providers who take the time to learn more about institutional investor pain points could have a big advantage in terms of client acquisition and retention.

Institutional investors do not get a free pass. They absolutely must dig deep or risk being sued themselves, see their name in headlines, lose their job and/or incur the wrath of unhappy beneficiaries. The encouraging news is that there are lots of ways to improve due diligence. Far from exhaustive, the following list includes some suggested action steps:

- Ask to meet with the individual who is responsible for creating a standard of investment best practices for the back office,

senior traders and sales team members, respectively

- Inquire whether bonuses are tied to risk-adjusted performance that considers both qualitative and quantitative measures
- Identify whether a service provider has been sued and whether they were found culpable
- Query whether the compliance officer, if one exists, is tasked to develop investment best practices that go beyond the technical adherence to a particular statute
- Request examples as to how a service provider expended resources in implementing best practice standards even when not required to do so by law
- Ask if best practices are applied equally across business units in different countries, if applicable
- Discuss how the service provider controls for conflicts of interest
- Require information about the service provider’s fiduciary liability insurance policy (cost, scope, whether terms have ever been rescinded, etc.)
- Gain a better understanding of the mechanism by which a vendor acquires new clients

Unless Lady Luck is a close friend, scant attention paid to investment ethics is an invitation to trouble. Who wants to find themselves in a courtroom, explaining bad acts or incomplete oversight? On a positive note, conversations with buy side executives about conflicts of interest, compensation and risk management offer an opportunity to spin transparency into gold. It is better that industry participants climb the same train than be forced to bear the brunt of a “one size fits all” solution from legislators with little or no experience in capital markets. Ideally, a sufficiently large number of leaders coalesce to enforce higher standards on behalf of the millions of pension, endowment, foundation and mutual fund beneficiaries. They count on stewards and investment service providers alike to be there in more ways than one. 

Disclaimer: The information provided by this article should not be construed as financial or legal advice. The reader should consult with his or her own advisors.

Dr. Susan Mangiero is President and CEO of Investment Governance, Inc., author of Risk Management for Pensions, Endowments, and Foundations (John Wiley & Sons, 2005) and the brainchild behind www.PensionRiskmatters.com and www.FiduciaryX.com.

*Susan Mangiero, PhD, CFA, FRM
President and CEO*

Investment Governance, Inc.

(formerly known as Pension Governance, Incorporated)

One Corporate Drive, Suite 202

Shelton, CT 06468

Tel: (203) 929-0011

SMangiero@InvestmentGovernance.com

