

Putting Integrity into Finance: A Purely Positive Approach

Finance Working Paper N° 417/2014

November 2015

Werner Erhard

Harvard Business School Negotiation, Organizations and
Markets

Michael C Jensen (Deceased)

© Werner Erhard and Michael C Jensen
(Deceased) 2015. All rights reserved. Short
sections of text, not to exceed two paragraphs,
may be quoted without explicit permission
provided that full credit, including © notice, is given
to the source.

This paper can be downloaded without charge from:
<https://www.ecgi.global/publications/working-papers>

ECGI Working Paper Series in Finance

Putting Integrity into Finance: A Purely Positive Approach

Working Paper N° 417/2014
November 2015

Werner Erhard
Michael C Jensen (Deceased)

Abstract

The seemingly never ending scandals in the world of finance with their damaging effects on value and human welfare argue strongly for an addition to the current paradigm of financial economics. We summarize here our new theory of integrity that reveals integrity as a purely positive phenomenon with no normative aspects whatsoever. Adding integrity as a positive phenomenon to the paradigm of financial economics provides actionable access (rather than mere explanation with no access) to the source of the behavior that has resulted in those damaging effects on value and human welfare; thereby significantly reducing that behavior. More generally we argue that this addition to the paradigm of financial economics will create significant increases in economic efficiency, productivity, and aggregate human welfare. Because integrity has generally been treated as a virtue (a normative phenomenon) the actual cause of the damaging effects of out-of-integrity behavior are hidden, resulting in assigning false causes to those effects. This keeps the actual source of these damaging effects invisible to us. As a result, in spite of all the attempts to police the false causes of these damaging effects, the out-of-integrity actions that are the source of these effects continue to be repeated. This new model of integrity makes the actual source of the damage available for all to see, and therefore to act on. Integrity as we define it (or the lack thereof) on the part of individuals or organizations has enormous economic implications for value, productivity, and quality of life. Indeed, integrity is a factor of production as important as labor, capital, and technology. Without a clear, concise, and most importantly, an actionable definition of integrity, economics is far less powerful than it can be. So too finance and management.

Werner Erhard

Harvard Business School Negotiation, Organizations and Markets

Michael C Jensen (Deceased)

Harvard Business School Negotiation, Organizations and Markets
Research Papers

HARVARD NOM UNIT RESEARCH PAPER NO. 12-074
EUROPEAN CORPORATE GOVERNANCE INSTITUTE (ECGI) NO. 417/2014
BARBADOS GROUP WORKING PAPER NO. 12-01

**Putting Integrity Into Finance:
A Purely Positive Approach**

Forthcoming in *Capitalism & Society*

27 November 2015
(First draft: 16 December 2011)

WERNER ERHARD

Independent
werhard@ssrn.com

MICHAEL C. JENSEN

Jessie Isidor Straus Professor of Business Administration, Emeritus, Harvard Business School
mjensen@hbs.edu

FAIR USE: You may redistribute this document freely, but **DO NOT POST** the electronic file on the web. We welcome web links to this document at: <http://ssrn.com/abstract=1985594>

We revise our papers regularly, and providing the above link to the original ensures that readers will receive the most recent version. Thank you for doing so, W. Erhard and M. Jensen.

Abstract

The seemingly never ending scandals in the world of finance with their damaging effects on value and human welfare argue strongly for an addition to the current paradigm of financial economics. We summarize here our new theory of integrity that reveals integrity as a purely positive phenomenon with no normative aspects whatsoever. Adding integrity as a positive phenomenon to the paradigm of financial economics provides actionable access (rather than mere explanation with no access) to the source of the behavior that has resulted in those damaging effects on value and human welfare; thereby significantly reducing that behavior. More generally we argue that this addition to the paradigm of financial economics will create significant increases in economic efficiency, productivity, and aggregate human welfare.

Because integrity has generally been treated as a virtue (a normative phenomenon) the actual cause of the damaging effects of out-of-integrity behavior are hidden, resulting in assigning false causes to those effects. This keeps the *actual* source of these damaging effects invisible to us. As a result, in spite of all the attempts to police the false causes of these damaging effects, the out-of-integrity actions that are the source of these effects continue to be repeated. This new model of integrity makes the actual source of the damage available for all to see, and therefore to act on.

Integrity as we define it (or the lack thereof) on the part of individuals or organizations has enormous economic implications for value, productivity, and quality of life. Indeed, integrity is a factor of production as important as labor, capital, and technology. Without a clear, concise, and most importantly, an actionable definition of integrity, economics is far less powerful than it can be. So too finance and management.

Putting Integrity Into Finance: A Purely Positive Approach¹

WERNER ERHARD

Independent

werhard@ssrn.com

MICHAEL C. JENSEN

Jessie Isidor Straus Professor of Business Administration, Emeritus, Harvard Business School

mjensen@hbs.edu

1. INTRODUCTION AND SUMMARY

a. What This Paper Is About

This paper presents an extension to the prevailing economic paradigm that reveals a heretofore unrecognized critical *factor of production*. This newly revealed factor of production also creates access to effectively deal with a current failure in financial economics and economic policy

¹ We are indebted to Sandra Carr, Miriam Diesendruck, Anders Dillan, James Poterba, Allan Scherr, Christopher Gates, Sigurfreyr Jonasson, Gonneke Spits, Sue Strober, Dominic Swords, and Steve Zaffron for their willingness to share their efforts, knowledge and insights into matters relevant to this paper, and especially Kevin Murphy for his insightful challenges, questions, and comments on this paper, and his willingness to share with us his knowledge, data and exhibits relevant to executive compensation. We acknowledge our students and seminar participants for their contribution to us, in particular the critical lessons about the effectiveness of the material and the methodology for mastering it. We are also indebted to two anonymous referees for their valuable comments, criticisms, and suggestions. All errors are our responsibility.

Disclosure Statement: Jensen has received financial support from the Harvard Business School Division of Research. Both authors are associated with the non-profit Erhard-Jensen Ontological / Phenomenological Initiative (from which the authors receive no financial benefit other than reimbursement of travel expenses when dealing with the Initiative's activities). The purpose of the Initiative is to stimulate and support research into and the application of the *ontological / phenomenological perspective on human nature and human function*, and the impact of such a perspective on life, living, self, and society. Various management consulting and public program delivery firms (some from which the authors, while not being members of, derive a financial benefit) utilize some of the ideas presented in this paper in their consulting activities or programs.

(which failure we will shortly specify in [Section c.](#) below). Thomas Kuhn (1962, 2012) in his landmark book on scientific paradigms characterized such failures occurring within a discipline as “anomalies and crises” that pile up until they argue for an alteration to the existing paradigm of the discipline.

b. A Warning

Economics can, in a certain sense, be seen as a *conversational domain*. That is, economics can be seen as being constituted by a set of specialized terms (terms with a special, precise, and often technical meaning), which terms are networked together in rigorous discourse and formulae that create access to deal with aspects of life that are otherwise not scientifically accessible. We propose to extend the paradigm of economics by introducing certain new specialized terms that are not currently a part of the economics paradigm, and by networking those terms together so as to provide access to an important aspect of economic life that is not currently accessible.

Because here we are dealing with something currently outside the prevailing economic paradigm, what is presented and the way it is presented will necessarily be unfamiliar and therefore even strange to most economists. In fact, it may at first seemingly even be outside the bounds of economics. However, this should not surprise us because, as Kuhn (1962, 2012) makes clear in *The Structure of Scientific Revolutions*, the requirement for change in a scientific paradigm does not arise from even the best current practices of a given science.

They [the best current practices] were parts of normal science, an enterprise that, as we have already seen, aims to refine, extend, and articulate a paradigm that is already in existence. (p. 122)

...

But that interpretive enterprise [normal science] ... can only articulate a paradigm, not correct it. Paradigms are not corrigible [changeable] by normal science at all. ... And these [“anomalies and crises” that show up within the current paradigm] are terminated, not by deliberation and interpretation, but by a relatively sudden and unstructured event like the gestalt switch. Scientists then often speak of the ... ‘lightning flash’ that ‘inundates’ a previously obscure puzzle, enabling its components to be seen in a new way ... No ordinary sense of the term ‘interpretation’ fits these flashes of intuition through which a new paradigm is born. (p. 122, 123)

It has been said that the anomalies requiring a shift in paradigm are first explained away, and when that fails are simply ignored until someone recognizes that the anomalies have actually risen to the level of a crisis (see the following section). Kuhn warned us that the first expressions of a shift in a current paradigm are likely to confound and annoy scholars and scientists before the moment of the gestalt insight, or as Kuhn also put it, before the “lightning flash” occurs.

c. Failures in the World of Finance That Call For a Shift in the Financial Paradigm

In the world of finance there is an unrelenting, and seemingly endless stream of reports of value-destroying behavior by individuals, groups, and organizations, ranging in the current era from the savings-and-loan scandals of the 1980s to the more recent scandals involving mortgage backed securities, bank manipulation of Libor rates, and banks facilitating tax evasion by their clients. Such scandals infect non-financial organizations as well. Note Toshiba Corporation’s write off of over \$1.2 billion in mid-2015 (and it will likely incur another multi-billion dollar write-off in the

remainder of 2015.)² In addition, Volkswagen has been rocked by an emissions scandal for installing sophisticated “defeat devices” software in the control module of diesel engines produced between 2008 and 2015. The software senses when the car is being tested for pollution output and allowed the cars to pass the emissions tests even though the cars emitted 10 to 40 times the legal amount when on the road. On Sept. 25, 2015 CNNMoney reported the following: “Shares of Volkswagen have plunged nearly 30% since the news of the automaker’s Clean Air Act violations first surfaced last Friday. The stock is now more than 50% below the 52-week high that it hit in March.”³ For short, we refer to the relentless stream of these as “the scandals” (see [Appendix 1](#), p. 55 for a detailed summary of just seven of what we refer to as “the scandals”).

The fact that these scandals keep arising *in spite of the ongoing and varied attempts to curtail such behavior* amounts, if not to an outright failure in economics and finance, at least to an “obscure puzzle” in the discipline. The persistence of these scandals in spite of all of the efforts to curtail them (a perfect example of Kuhn’s “anomalies and crises” within the prevailing paradigm) is, we argue, strong evidence that the prevailing financial economics paradigm requires a transformation.

d. Integrity Revealed as a Purely Positive Phenomenon Creates Access To this Transformation

In this paper we argue that *integrity*, as it is defined and modeled in this paper, is revealed as *a purely positive phenomenon*. Revealed and dealt with in this way, integrity provides finance scholars and practitioners access to effectively dealing with the onslaught of scandals in the world of finance, and to do so in ways that lead to increased organizational performance. Moreover, from a broader perspective integrity as a purely positive phenomenon is revealed as a factor of production, a factor of production as important for example as knowledge, technology, entrepreneurship, human capital, and physical and social capital. And, from a more personal perspective, integrity as a positive phenomenon results in substantial increases in human welfare, including increased personal power and quality of life, personal well-being, quality of family and professional lives, and personal performance.

e. Our Invitation

What we will say about integrity here will stretch most of us. To start with, because in the current economic mindset integrity automatically occurs as normative, most economists will dismiss it out-of-hand. However, if you can bear with us for a few more paragraphs, you will see in the next Section that as integrity is defined and distinguished in this new model, integrity is revealed as a purely positive phenomenon with no normative aspects whatsoever. This is a result of doing no more than using the first two of the three current dictionary definitions of integrity⁴, and leaving out the third which confuses integrity with morality and sincerity. Given this new model’s radical departure from the popular *meaning* of (current *understanding* of) “integrity” – or more specifically, given the radical departure from the way in which integrity has historically *occurred* for most of us

² See Mochizukii (2015).

³ See <http://www.cnn.com/2015/09/22/what-you-need-to-know-about-the-volkswagen-scandal.html>

⁴ Webster’s New World Dictionary & Thesaurus (1998)

– we ask you, our reader, to suspend judgment of each of the elements of the model until the whole has been laid out.

Moreover, as we said earlier, because in this paper we are dealing with something currently outside the prevailing economic paradigm, and in addition outside the current worldview or mindset of most economists, what is presented and the way it is presented will necessarily be unfamiliar and therefore even strange to most economists. In fact, given the way integrity currently occurs for most people it will at first seemingly even be outside the bounds of or irrelevant to economics. Nevertheless, given what this model will provide if it turns out to be valid – access to effectively dealing with the scandals, revealing a heretofore hidden factor of production, and from a more personal perspective, a substantial increase in human welfare – we ask our readers to stay with us to the end of the paper, including staying with anything that occurs as counter-intuitive or even just strange or even irrelevant.

As is often the case in altering a paradigm, we must reach outside economics as it is generally thought of, and draw on insights from other disciplines. The roots of what we are dealing with in this paper are from the discipline of ontology (the science of the nature of being – in this case, the nature of being a person of integrity or other human entity of integrity).

While we await the results from large scale empirical tests of the impact of integrity as we define it (see the following Section) and as we model its implementation, we suggest that those who wish more immediate empirical evidence perform your own empirical tests by experimenting with putting integrity as we define and model it into your personal life, your family life, and your professional life. See if you observe the predicted effects of integrity as we define and model it, or the lack of integrity, on workability and therefore on your opportunity for performance, not to mention its impact on quality of life for you and those around you. We predict that you will see firsthand a real impact on reducing the messes in your life (no matter how inevitable they may have looked), and on increasing the quality of your personal and professional life, on the trust others place in you, on your productivity and performance, and finally on your personal well-being.

f. Integrity Defined

In our positive theory of integrity, integrity is defined as: “*the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition*” – for short, in this paper we often refer to this as “whole and complete”. This unambiguous definition (virtually word for word the first two definitions of integrity in Webster’s New World Dictionary (1998)⁵) does not define a virtue. There is nothing inherently good or bad (that is, virtuous or otherwise normative) about the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition. An object, system, person, or other human entity (such as a corporation) is just “whole and complete” in this or that aspect, or it isn’t.

Note that being whole and complete produces maximum workability⁶, which results in maximum opportunity for performance⁷ – of course, later we will fully explicate this.

⁵ See [Section 3.a](#), p. 20 for a discussion of the dictionary definition of integrity, and what of that definition we leave out of our definition, and the basis for doing so.

⁶ “Workable” as defined in Merriam-Webster’s dictionary (2015): “capable of being put into successful operation: feasible, practicable”; Synonyms: “achievable, attainable, doable, realizable, viable, possible”.

To complete the definition of integrity, we will also fully specify exactly what must be whole and complete:

- OBJECT: for an *object* to be in integrity (see [Section 3.c](#), p. 22 for this full explication)
- SYSTEM: for a *system* (e.g., a corporation when dealt with as a *system*) to be in integrity (see [Section 3.c](#), p. 22 for this full explication)
- PERSON: for an individual *human being* (a person) to be in integrity (see [Section 3.d](#), p. 22 for this full explication)
- OTHER HUMAN ENTITY: for any *other human entity* (such as a corporation when dealt with as a *human entity*) to be in integrity (see [Section 3.d](#), p. 22 for this full explication)

For now, suffice it to say that the nature of integrity for an *object* or *system* is different and distinct from the nature of integrity for an individual *human being* or *other human entity*. Of course, a human being or other human entity can be dealt with as an object or system. But in the case of integrity we will show that for a human being (person) or other human entity (such as a corporation) integrity is a matter of that person's or corporation's word, nothing more and nothing less. For a person or other human entity to be in integrity that person's or that human entity's word must be whole, complete, unbroken, unimpaired, sound, in perfect condition. We explicate what is said in this paragraph in detail in [Section 3.c](#), p. 22 and [Section 3.d](#), p. 22.

Finally, in this model a person's word or other human entity's word is whole and complete (is in integrity) when that person or other human entity's word is "kept", or when it is not kept, it is "honored" as we define *honor*. (See [Section 3.e.3](#), p. 24 where we provide a full explication of *honor*.) See [Section 3.e.1](#), p. 23 for a simple list of the six components of one's word – see [Appendix 2](#), p. 63 for a full explication of the six components of one's word.

g. Empirical Evidence

Up to now, we have not been able to run formal large-scale empirical studies of the impact of integrity on human performance. We are now in the process of formulating and funding large-scale empirical tests that began in 2014 and will run over a number of years. We look forward to the results of these empirical studies. We are currently engaged in analyzing as a case study the observable experiences of a Wall Street firm that has spent several years implementing integrity (as we model it) into their culture. We also, have our own experiences with the impact of this model of integrity on our personal and professional lives. In addition, we regularly receive feedback (solicited, unsolicited and non-random) from the instructors and attendees of seminars, programs and courses that include our positive model of integrity. From the thousands of participants in such events, ranging from students to top-level executives, consultants, and scholars we have consistently received feedback that taking on integrity as a positive phenomenon has resulted in substantial increases in their personal power and quality of life, including personal well-being, quality of their family and professional lives, and personal and organizational performance.

⁷ In whatever way you define performance.

In addition, Steve Zaffron, the CEO of the consulting firm Vanto Group and a coauthor of our more general paper on integrity, reports the following experiences with several Vanto Group clients that applied earlier versions of this positive model of integrity in their organizations. Steve reports the following:

1. Magma Copper Company in Tucson, Arizona, Vanto Group's first large client (1992-1995), took on a project to measure the company's integrity by measuring "promises made and kept" and "promises made and not kept". Using a computer program designed for this project, the employees of Magma reported each promise they made (with no distinction between "large" promises or "small" promises) – just any promise made was a data point to measure. Weekly, they reported "promises kept" and "promises not kept".

When employees did not keep a promise they acknowledged and announced that they were not keeping their promise. [When one will not be keeping one's word, this is the first step in maintaining one's integrity, which is accomplished by honoring one's word – see [Section 3.e.3](#), p. 24 below for the definition and discussion of "honoring" one's word.] This was done for the 3 years Vanto worked with them (until they were acquired by BHP, now BHP Billiton). When acquired, they were valued at 3 times what they had been valued at when Vanto first started working with them. Over the three years of this engagement the integrity statistic moved from 65% to 75% to 80% and correlated with a significant rise in productivity, and decrease in costs.

2. A large chain of petrol stations, a client in the Netherlands during the period 2006 and 2007, also measured the company's integrity by measuring "promises made", and "promises kept" and "promises not kept" as a part of the "breakthrough project" Vanto conducted with them. During this two-year period the company experienced a 58% increase in net profit (along with an increase in customer satisfaction).
3. Vanto also conducted a breakthrough project in the Netherlands in 2012 with a prime contractor for Airbus. The intended breakthrough was in delivering critical parts to Airbus on time and up to specs [in other words, being good for their word, or in short, acting with integrity] – an area in which according to Airbus our client needed an immediate breakthrough. As a part of this project our client measured promises that were kept, and actions promised and not kept but "honored" (acknowledged to their customer as not kept, along with a statement of by when it would be kept, and a clean-up to the degree possible of the damage imposed on their customer). During the year of this project this client experienced a 25% to 40% increase in productivity across various divisions of the firm. More specifically, programs that used to run 40% over planned time to build to specs a part for the new Airbus A350 (with a significant financial loss, not to mention a loss of morale) now run on time and as promised to Airbus. As a result of this on-time on-spec performance breakthrough, our client received a letter of recognition from Airbus. The client transformed themselves from a "not reliable supplier" (on the verge of being never worked with again) to one of Airbus's most reliable suppliers and partners.

In addition, for an example of the formal measurement of the statistically significant increase in performance created by integrity see the study of the effect on student performance outcomes associated with increased student integrity by Isberg, Thundiyil and Owen (2012)

<http://ssrn.com/abstract=2148783> See also the evidence on the positive relation between CEO integrity and firm performance provided by Dikolli, Keusch, Mayew and Steffen (2014) <http://ssrn.com/abstract=2131476>

Paul Fireman (former CEO of Reebok US) implemented at Reebok an early version of the integrity model discussed here. You might be interested in his assessment of the major impact of that implementation on his and Reebok's remarkable success. See his Commencement Address to the Suffolk University Sawyer Business School on May 19th, 2013, Boston, MA. <http://www.youtube.com/watch?gl=US&hl=en&client=mv-google&v=ITw0GX4nVXs&nomobile=1>

We look forward to the completion of additional formal statistical tests of the impact of integrity as defined by this positive model of integrity.

h. The Impact of Integrity As A Positive Phenomenon

As we have said, in this model we define integrity as the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition – clearly, the definition of a positive phenomenon. As is the case with any positive phenomenon – for example, gravity – there are effects caused by actions related to that phenomenon. The action of stepping off a cliff will, as a result of gravity being a positive phenomenon, cause an effect (whether one likes the effect or not). Likewise, action that is consistent or inconsistent with integrity will, as a result of integrity being a positive phenomenon, also cause an effect (again, whether one likes the effect or not).

When integrity is revealed and dealt with as a positive phenomenon as it is in our model, the relation between integrity, workability and performance is as follows:

1. *Maximum workability for an object, system, person, or other human entity (such as a partnership or corporation) is a necessary (although not sufficient) condition for maximum performance,*
2. *Integrity as we distinguish and define it (the state of being whole, complete, unbroken, sound, in perfect condition) is a necessary (and sufficient) condition for maximum workability,*
3. *It follows that for an object, system, person, or other human entity integrity is a necessary (although not sufficient) condition for maximum performance, and*
4. *It follows that as integrity declines, the opportunity for performance declines.*
5. *This leads to the empirically refutable proposition that, ceteris paribus, as integrity declines, performance declines.*

i. What Hides the Actual Source of the Damaging Effects of Out-Of-Integrity Behavior

The damaging effects of out-of-integrity behavior are inevitable and inescapable. However, the actual source of those damaging effects is almost always hidden. As a consequence, those effects are usually attributed to something other than out-of-integrity behavior – that is, the damaging effects of out-of-integrity behavior wind up being attributed to false causes. We name

what hides the actual source of the damaging effects of out-of-integrity behavior the “Veil of Invisibility”⁸, and identify the eleven factors that constitute that veil (see [Section 3.h](#), p. 25 below).

In addition to the eleven factors of the Veil of Invisibility, we note an additional obscuring factor. Explaining the behavior that results in these damaging effects as being caused by a state or trait that is a *property* (since Aristotle, a “substance”⁹) inhering in a person or an organization obscures the actual cause of the behavior. Examples of such supposed properties inside a person are: immoral, greedy, dishonest, or selfish, and the like. While such concepts may have some validity in *describing* behavior, when they are seen as properties inside a person or organization, they obscure the actual source of the behavior. In the 2500 years since Aristotle, the various attempts to reduce the behavior that causes these damaging effects by dealing with these properties supposedly inhering in people and organizations has met with little success, and surely in the world of finance. (This is widely extended into behavioral economics through such notions as “irrationality”, where irrationality is a *property* (a substance) inside some people, or inside some people at certain times or under certain conditions.)

The continuing scandals are therefore strong evidence of the dismal failure of these explanations to provide any effective access to reducing the counter-productive behavior. These spectacular failures are, in fact, strong evidence that these explanations of the behavior are in fact false causes.

While such false causes appear to provide a satisfying *explanation* for the behavior, note that they provide no effective *access* to altering the behavior. In fact, the almost universal assignment of false causes of the behavior that result in these damaging effects (exemplified by what we termed the “scandals”) (for examples see [Appendix 1](#), p. 55) actually obscures the real source of such behavior. We argue that the real source of this behavior is individuals or organizations being out of integrity (as we have said, their word not being whole, complete, unbroken, unimpaired, sound, in perfect condition). And it is one or more of the eleven factors making up the Veil of Invisibility (discussed fully in [Section 3.h](#), p. 25) that results in individuals and organizations not seeing the cost to themselves of their out-of-integrity behavior.

Consider the following key findings unearthed in the survey of more than 1,200 finance professionals regarding workplace ethics by Tenbrunsel and Thomas (2015) entitled “The Street, The Bull and the Crisis: A survey of the US & UK financial Services Industry”. These findings quoted below provide striking indications that there has been little or no progress in reducing the out-of-integrity culture in the field of finance.

- . . . our survey clearly shows that a culture of integrity has failed to take hold. Numerous individuals continue to believe that engaging in illegal or unethical activity is part and parcel of succeeding in this highly competitive field.
- 47% of respondents find it likely that their competitors have engaged in unethical or illegal activity in order to gain an edge in the market . . . a spike from the 39% who reported as such when surveyed in 2013. This figure jumps to 51% for individuals earning more than \$500,000 or more per year.

⁸ Playing on Harsanyi (1953, 1955) and Rawls (1971, 2001) “Veil of Ignorance”.

⁹ See the Stanford Encyclopedia of Philosophy, Robinson (2014)
<http://plato.stanford.edu/entries/substance/>

- More than one-third (34%) of those earning \$500,000 or more annually have witnessed or have first-hand knowledge of wrongdoing in the workplace.
- 23% of respondents believe it is likely that fellow employees have engaged in illegal or unethical activity in order to gain an edge, nearly double the 12% that reported as such in 2012.
- 25% would likely use non-public information to make a guaranteed \$10 million if there was no chance of getting arrested for insider trading. Employees with less than 10 years experience are more than two times as likely as those with over 20 years experience, reporting 32% and 14% respectively.
- In the UK 32% of individuals said they would likely engage in insider trading to earn \$10 million if there was no chance of getting arrested, compared to 24% of respondents from the US.
- Nearly one in five respondents feel financial services professionals must at least sometimes engage in illegal or unethical activity to be successful.
- 27% of those surveyed disagree that the financial services industry puts the best interests of clients first. This figure rises to 38% for those earning \$500,000 or more per year.
- Nearly one-third of respondents (32%) believe compensation structures or bonus plans in place at their company could incentivize employees to compromise ethics or violate the law.
- 33% of financial service professionals feel the industry hasn't changed for the better since the financial crisis.

The continuing scandals are therefore strong evidence of the dismal failure of these explanations to provide any effective access to reducing the counter-productive behavior. These spectacular failures are, in fact, strong evidence that these explanations of the behavior are in fact false causes.

While such false causes appear to provide a satisfying *explanation* for the behavior, note that they provide no effective *access* to altering the behavior. In fact, the almost universal assignment of false causes of the behavior that result in these damaging effects (exemplified by what we termed the “scandals”) (for examples see [Appendix 1](#), p. 55) actually obscures the real source of such behavior. We argue that the real source of this behavior is individuals or organizations being out of integrity (as we have said, their word not being whole, complete, unbroken, unimpaired, sound, in perfect condition). And it is one or more of the eleven factors making up the Veil of Invisibility (discussed fully in [Section 3.h](#), p. 25) that results in individuals and organizations not seeing the cost to themselves of their out-of-integrity behavior.

2. DIFFICULTIES WITH THE CURRENT PARADIGM OF FINANCIAL ECONOMICS

a. The “Obscure Puzzle” in Finance that Calls for a New Paradigm

In the world of finance there is a continuous and seemingly unending stream of reports of value-destroying behavior by individuals, groups, and organizations. For short, we refer to these as “the scandals” (see [Appendix 1](#), p. 55 for a summary of just seven of what we refer to as “the scandals”). The fact that these scandals keep arising *in spite of the ongoing and varied attempts to curtail such behavior* amounts to what Thomas Kuhn (1962, 2012) referred to as an “obscure puzzle”. The persistence of these scandals in spite of all of the efforts to curtail them (a perfect example of what Kuhn (1962, 2012) also terms “anomalies and crises” within the prevailing paradigm) is, we argue, strong evidence that the prevailing paradigm of financial economics requires a critical addition.

However, as Kuhn (1962, 2012) points out in *The Structure of Scientific Revolutions*,

Paradigms are not corrigible [changeable] by normal science at all. ... normal science ultimately leads only to the recognition of anomalies and to crises [within the prevailing paradigm]. (p. 122)

To resolve the “anomalies and crises” of the seemingly unstoppable scandals in the financial world, we propose an addition to the generally accepted financial economics paradigm. This addition to the prevailing paradigm opens up a perspective that reveals the *actual source* of these scandals. Moreover, from this perspective one can see clearly why the best efforts of regulatory agencies, the legal authorities, the media, etc. have so far failed to stem the tide. Our proposed addition to the financial economics paradigm reveals actionable opportunities for effectively dealing with the actual source of the continuing stream of value-destroying behavior by individuals, groups, and organizations in the world of finance.

Given that we are proposing a change to a prevailing paradigm, much of what we present in this paper is outside the accepted boundaries of the current paradigm of financial economics. For example, to start with, finance and economics scholars tend to avoid discussions or considerations of “integrity” because integrity is for them *normative* (occurs for them as normative). That normative presumption makes it challenging to even begin to consider integrity constituted as a *purely positive* phenomenon, as integrity is revealed to be in this paper. Kuhn (1996, 2012) comments on the challenge of introducing a new paradigm (and we would argue that his comment also applies to adding to an established paradigm):

... normal science, an enterprise that, as we have already seen, aims to refine, extend, and articulate a paradigm that is already in existence. ... But that interpretive enterprise [normal science] ... can only articulate a paradigm, not correct it. Paradigms are not corrigible by normal science at all. (p. 122)

By the way, should you begin to see some value in our model, because it is simply impossible to be complete in one paper on the huge topic dealt with here, you will certainly have questions and challenges regarding certain specifics that we will not have addressed or at least have not fully addressed.¹⁰ By the same token, we will have established a new perspective from which to

¹⁰ We are in the process of drafting a more complete treatment of our positive theory of integrity in our book, with the working title “A Positive Theory of the Normative Virtues”, to be published by Cambridge University Press.

view the source of these scandals. When these scandals are viewed from this new perspective one sees possibilities for effectively dealing with them – possibilities that were not apparent from the current perspective on these scandals.

In any case, we ask our readers to keep an open mind – that is, willingly suspend the immediate need to accept or reject what is presented until the entire model has been presented – and then to fully “try on” this new perspective to determine if from *within* this perspective there is a new possibility that promotes value-enhancing behavior by individuals, groups, and organizations. We rely on Thomas Kuhn (1962, 2012) as follows for the foundation for making this request. Kuhn, speaking about what is possible from within a new perspective, concludes,

... these [“anomalies and crises”] are terminated, not by deliberation and interpretation, but by a relatively sudden and unstructured event like the gestalt switch. (p. 122)

In Kuhn’s attempt to make clear what he means by “gestalt switch”, he says,

Scientists then often speak of the ‘scales falling from the eyes’ or of the ‘lightning flash’ that ‘inundates’ a previously *obscure puzzle*, enabling its components to be seen in a new way that for the first time permits its solution. [italics and underlining added] (p. 122)

The basis for 1) our proposal to add to the generally accepted financial economics paradigm, and the basis for 2) our request to our readers to try on seeing a problem and therefore its solution in an unfamiliar new way is our desire to (quoting Kuhn) “inundate a previously obscure puzzle, enabling its components to be seen in a new way that for the first time permits its solution”.

b. Behavioral Economics and Behavioral Finance, an example of Providing Explanations For Rather Than Providing Access To Altering Human Behavior

The progress in economics and finance over the last two-plus decades – founded on the paradigm-altering insights from psychology about human behavior by scholars such as Kahneman, Tversky, Thaler, Sunstein and others – has been huge. This paradigmatic revolution has allowed the profession to focus on the existence and significant impact of widespread counter-to-self-interest behavior that was heretofore unnoticed, ignored, or dismissed. Until Kahneman and Tversky’s (1979) *Econometrica* paper “Prospect Theory: An Analysis of Decision under Risk”, such counter-to-self-interest behavior was in a sense invisible when viewed through the lens of the prevailing rational/self-interest theory/paradigm. Or, that behavior was simply dismissed as irrational and therefore an irrelevant anomaly (consistent with what Kuhn (1962, pp. 111-135) termed “theory-dependence of observation”¹¹ in his chapter “Revolutions as Changes of World View”). Indeed, behavioral economics and behavioral finance have now become major areas of research on their own. The insights in these areas flow from our finally recognizing that there is something about us human beings such that we quite often behave in ways that are contrary to our self-interest.

The contributions from behavioral economics and behavioral finance, particularly Kahneman and Tversky’s biases and simplifying heuristics, have been extraordinarily powerful in providing *explanations* for the widespread existence of counter-to-self-interest behavior. However,

¹¹ See Bird (2011) Stanford Encyclopedia of Philosophy entry “4.2 Perception, Observational incommensurability, and World-Change”: <http://plato.stanford.edu/archives/win2011/entries/thomas-kuhn/>

as powerful as these contributions have been in *explaining* this behavior, they have been much less successful in providing *access to altering such behavior*.

We note that such contrary-to-self-interest behavior is still generally *dismissed* as simply “irrational behavior”. Unfortunately, dismissing contrary-to-self-interest behavior as merely irrational behavior beclouds or muddles the attempt to discover the actual source of the counter-to-self-interest behavior.¹²

Whatever the behavior, explaining it by biases and simplifying heuristics provides *no access to altering* such behavior.

Here we are pointing to the contrast between a model that completely *explains* a category of behavior, and a model of that same category of behavior that provides *actionable access to altering* the behavior. Our model of integrity as explicated in this paper provides actionable access to altering the pervasive and persistent damaging behavior we have termed “the scandals”.

Kahneman (2011) himself acknowledges that even clear *explanations* for a certain category of behavior *do not lead to altering* that behavior. In this case, the explanations are “biases” and the category of behavior is so-called “irrational behavior”. As Kahneman says:

“What can be done about biases? ... The short answer is that little can be achieved without a considerable investment of effort.” (p. 417)

Speaking about his own personal experience of the lack of impact of even considerable *knowledge* about what *explains* our so-called “irrational behavior”, Kahneman continues:

“Except for some effects that I attribute mostly to age, my intuitive thinking is just as prone to overconfidence, extreme predictions, and the planning fallacy as it was before I made a study of these issues.”¹³ (p. 417)

Kahneman’s statements, and the need to resort to the work-around of nudging (see directly below), lead one to conclude that powerful *explanations* for behavior do not as a matter of course provide any powerful *access to altering* that behavior. At least this is the case with irrationality, the biases of intuition, and simplifying heuristics that do such a good job *explaining* counter-to-self-interest behavior.

To deal with the problem that *explanations* do not alter behavior, Thaler and Sunstein (2008) in their book *Nudge* provide a workaround for this problem. Also see Goldstein, Martin and Cialdini (2007) *Yes! 50 Secrets From The Science Of Persuasion* for extensive discussions of ways to nudge people into acting in a certain way. Thaler and Sunstein argue persuasively that people can be directed (nudged) into acting in their own self-interest. Nudging accomplishes this by eliminating the requirement to choose between the alternatives. Eliminating the requirement to choose (to make

¹² Interestingly in his 2011 book “Thinking Fast and Slow” Kahneman acknowledges that the “irrational behavior” confusion with “counter-to-self-interest behavior” was probably a mistake. (See Kahneman (2011), p. 411). Yet most of the world continues to explain counter-to-self-interest behavior as “irrational behavior” (for example see Jim Holt’s (2011) *New York Times* review of Kahneman’s book in which he writes “Human irrationality is Kahneman’s great theme.”)

¹³ In his review of Kahneman’s book *Thinking, Fast and Slow*, theoretical physicist and mathematician Freeman Dyson (2011) reflecting on Kahneman’s thinking about this phenomenon says: “We also know that, even when we become aware of the bias and the illusions, the illusions do not disappear. What use is it to know that we are deluded, if the knowledge does not dispel the delusions?”

a decision) is a way to work around people's so-called irrationality provoked by the biases of intuition and simplifying heuristics that are triggered when one must make a choice. For the most part, nudging avoids the requirement for people to choose (decide) between alternatives by presenting the alternatives with a default condition. Nudging nudges people into acting in the way *those who structure* what is being dealt with *decide* is in the person's, group's, or organization's own self-interest.

As Thaler and Sunstein acknowledge (see Chapter 17, p. 235), nudging is paternalistic (in their words, "libertarian paternalism"). However, as they also acknowledge, when employed by the unscrupulous, nudging can be downright manipulative and used to exploit people.

In any case, while perhaps an effective workaround, nudging is not a *resolution* of the problem of altering the counter-to-self-interest behavior explained by biases and heuristics.

By contrast, as we will show (starting in [Section 2.d](#) below, p. 16), un-concealing the actual nature of the impact of integrity on performance (which happens as the result of the new way we model integrity) makes present in *real time* **both** the relation between acting with integrity or not and the consequences of such behavior on workability, wellbeing, and the opportunity for performance. In other words, this new model of integrity not only reveals the counter-to-self-interest impact on an individual, group, or organization that results from out-of-integrity behavior, it does so such that acting without integrity *occurs* (shows up) for a person *along with* the undesirable impact on value and performance.

In short, acting with integrity or the lack of it, and the resulting desirable or undesirable impact on value and performance, arise together. It is critical to note that when an out-of-integrity action occurs to (shows up for) an individual, group, or organization (or even for you or me) at the same time as counter to its self-interest, the likelihood of acting in that way is significantly diminished. In addition, our new model of integrity reveals exactly what constitutes out-of-integrity behavior. This contrasts dramatically with the way in which integrity currently occurs for people (as a normative phenomenon) wherein a great deal of out-of-integrity behavior does not even occur as out-of-integrity, and certainly the present and future consequences of such behavior do not show up along with the behavior.

While we will explicate more fully what we mean by "occur", an oversimplified example of what we mean by "occur" shows up in the following: The way something is understood by us or seems to be for us is a *result* of the way we frame it. Consequently, change your frame for something and the way you understand it and the way it seems to be for you will change – that is, the way in which it *occurs* for you will change.

This is in sharp contrast with the way biases of intuition and simplifying heuristics function, where at the time of the behavior that results from these biases and heuristics the *damaging impact on one's self-interest is invisible*. In fact, at the time, it actually appears to the person *that the behavior is in their self-interest*. It is only from a third-person perspective that the behavior that results from biases and heuristics is seen as counter to one's self-interest. And this includes the person, group, or organization themselves when later they have the distance for a third-person perspective on their earlier behavior. It is important to keep in mind, that even the *knowledge* that biases of intuition and simplifying heuristics will result in actions that are counter to self-interest *does not impact* people's behavior. And, this includes even people with the knowledge and experience of Daniel Kahneman (as he himself acknowledges in the above quotes).

Rather than an *explanation* for the behavior, this new model of integrity *makes present* the consequences of the behavior at the time of deciding how to behave. And, when the consequences of this or that behavior are palpably *present* in making a decision about how to behave, one is more likely to behave in one's actual self-interest. This shift in the way out-of-integrity behavior *occurs* to an individual, group, or organization – occurring both as out-of-integrity behavior *and* as counter to its own self-interest – is the access this new model of integrity provides to altering behavior.

c. The Counterproductive Effects of the Term “Irrational Behavior”

There is no doubt that the twenty or so biases of intuition and simplifying heuristics described by Kahneman and Tversky cogently *explain* what is termed “irrational behavior”. While we have no argument with the accuracy of the explanations, we argue that the counter-to-self-interest behavior is identified by default as “*irrational* behavior” because it was researched within the context of the rational-mind paradigm of psychology, and within the utility-maximizing individuals acting in perfect markets (people acting in their own self-interest) paradigm of economics. Unfortunately, labeling the behavior as *irrational*, while *explaining* the behavior perfectly, says nothing about the *source* of that behavior. Moreover, using *irrational* to counter or contrast with *rational* elicits an attempt to explain the presumed irrationality, rather than to gain access to the *source* of the observed behavior in a way that allows one to alter that behavior.

In fact, explaining the behavior associated with the biases and heuristics identified by Kahneman and Tversky as *irrational* obscures something critically important about the impact of those biases and heuristics. A person with a normal brain acts in what *appears* to that person – to that person's brain – to be in his or her self-interest.

We are saying that a person acts in what appears to be their self-interest ***given the way in which what-they-are-dealing-with occurs or shows up for them.***¹⁴ In other words, we argue that the biases and heuristics identified by Kahneman and Tversky actually alter *the way in which* what-a-person-or-entity-is-dealing-with *occurs* for that person or entity. And, the biases and heuristics do so such that counter-to-self-interest behavior appears to be in the person's or group's self-interest.

Saying the same thing in another way, *given the way* what-we-are-dealing-with *occurs* for us, we make what appear to be rational choices given that occurring. While as we said above, from a third-person perspective (and even for the person themselves when later they have the distance for a third-person perspective on their earlier action), the action that at the time appeared to be in a person's self-interest may in fact prove to be counter to their self-interest.

A person's behavior will be consistent with (will be a fit for) the *way in which* what-the-person-is-dealing-with *occurs* for that person. We argue that the biases and heuristics described by Kahneman and Tversky would actually provide *access* to self-interested behavior if they were treated as *impacting* the way in which what-a-person-is-dealing-with *occurs* for that person. If one is aware of the biases and heuristics described by Kahneman and Tversky, *and* aware that those biases and heuristics are altering the appearance of what one is dealing with so that what appears to

¹⁴ For an extended discussion of the proposition that action is a correlate of the way in which what one is dealing with or is confronted with, see Erhard, Jensen, and Barbados Group, “A New Paradigm of Individual, Group, and Organizational Performance” (2010). Available at SSRN: <http://ssrn.com/abstract=1437027>

be rational (in one's self-interest) is in fact not, one would take a second look at the situation. In the occurring impacted by those biases and heuristics, the action that *subjectively* appears to be in one's self-interest is in fact *objectively* counter to one's self-interest. From the perspective of the rational/irrational interpretation, given the way in which what the person is dealing with occurs (shows up) for that person, the choice *appears* rational.

As a consequence of the foregoing, we strongly prefer "counter-to-self-interest behavior" over "irrational behavior". As Kahneman himself declares:

"Like most protagonists in debates, I have few memories of having changed my mind under adversarial pressure, but I have certainly learned more than I know. For example, I am now quick to reject any description of our work as demonstrating human irrationality. When the occasion arises, I carefully explain that research on heuristics and biases only refutes *an unrealistic conception of rationality*, which identifies it as comprehensive coherence. Was I always so careful? Probably not."¹⁵ [italics added]

Carefully examining every dumb act in our own lives it is clear that each seemed like "a good idea at the time", i.e., desirable and perfectly rational in that the costs were less than the benefits *given the way what we were dealing with occurred for us at the time*. What made the act dumb was not irrationality, rather it was *the way in which* what we were dealing with *occurred* or showed up for us.

By labeling the behavior "irrational", we scholars end up skewing our research to find the *source of irrationality*, rather than to find the *source of the behavior*. If what we have to explain is irrational behavior, we are now not looking for what *causes the behavior*, we are looking for what *causes the irrationality*. When biases and heuristics are accepted as "the explanation" for counter-to-self-interest-behavior, that stops the inquiry. As explanations, biases and heuristics leave one with no actual access to transforming the counter-to-self-interest-behavior.

As we said, Kahneman himself says,

"What can be done about biases? ... Except for some effects that I attribute mostly to age, my intuitive thinking is just as prone to overconfidence, extreme predictions, and the planning fallacy as it was before I made a study of these issues."¹⁶ (p. 417)

The lack of impact of these biases and heuristics as explanations leaves one with little more than looking for a way around the biases or heuristics. By contrast, if I am aware that the bias or heuristic leads me to see that what-I-am-dealing-with occurs for me such that I would normally (or even, automatically) act contrary to my self-interest, that awareness alters the way what I am dealing with occurs for me, and consequently results in altering my behavior.

¹⁵ Kahneman, Daniel, "Nobel Prize Autobiography", accessed March 4, 2012 http://www.nobelprize.org/nobel_prizes/economics/laureates/2002/kahneman-autobio.html

¹⁶ In his review of Kahneman's book *Thinking, Fast and Slow*, theoretical physicist and mathematician Freeman Dyson (2011) reflecting on Kahneman's thinking about this phenomenon says: "We also know that, even when we become aware of the bias and the illusions, the illusions do not disappear. What use is it to know that we are deluded, if the knowledge does not dispel the delusions?"

d. **Out-of-Integrity Behavior: The Unnoticed Elephant in the Living Room of Behavioral Puzzles**

Our focus in this paper is integrity – that is, what is discovered when integrity is *revealed* as a positive (rather than a normative) phenomenon (as it is in our new model of integrity).

What integrity actually is, and the way integrity functions, and the consequences of the way integrity functions, is *misidentified* by virtually all people. As a result people, groups and organizations generally do not identify out-of-integrity behavior *as* out-of-integrity behavior. Additionally, people, groups and organizations are unaware that out-of-integrity behavior actually diminishes the opportunity for performance, and vice versa, as their integrity increases, their opportunity for performance increases (see [Section 1.h](#) (p. 7) and [Section 3.g](#) (p. 24)). Moreover, people, groups and organizations generally ascribe the consequences of out-of-integrity behavior as coming from some cause other than out-of-integrity behavior; in other words, they describe the source of many disruptions to performance (including the lack of opportunity for increases in performance) as being a product of something other than out-of-integrity behavior. As a consequence of these misidentifications, just what integrity is, as well as what it is to act with integrity or act without integrity, and the personal, group or organizational consequences of either type of action, is for all practical purposes *invisible*.

Given the pervasive understanding of integrity as a normative phenomenon – which makes seeing the actual function and consequences of integrity as a positive phenomenon very difficult – in this Section we ask forgiveness for being a bit laborious in our explication of the function and consequences of integrity as a positive phenomenon.

In spite of the enormous damaging impact on human welfare from out-of-integrity behavior, the universal prevalence of out-of-integrity behavior has gone unnoticed in the behavioral literature that has evolved in the last 30 years. This, even though out-of-integrity behavior – while generally not recognized as such – is in fact a significant portion of all counter-to-self-interest behavior. By the way, the damage from such behavior that makes the headlines is a small portion of the actual total damage from out-of-integrity behavior – much of which damage is misidentified as being the product of something other than out-of-integrity behavior.

The widespread damage to human welfare caused by out-of-integrity behavior is *not* identified as being caused by out-of-integrity behavior. This is a product of misidentifying the actual nature of integrity which results in most out-of-integrity behavior not being recognized as being out of integrity. Consequently, a good deal of the enormous costs to individuals, groups, and organizations that actually result from out-of-integrity behavior are mistakenly attributed to causes other than out-of-integrity behavior. Thus, all of us engaging in this explanatory behavior short-circuit the search for the actual source of the damage.

In addition, even when an individual, group, or organization's out-of-integrity behavior shows up for them as out-of-integrity behavior, it often occurs as damaging to others and not to the individual, group, or organization that is engaging in such behavior – at least not damaging to them as long as they “don't get caught” or if caught will “get away with it”.¹⁷ No matter how great or

¹⁷ What is in this paragraph is consistent with what we mentioned above from “A Survey of the US & UK Financial Services Industry”, “Nearly one-third of employees with less than two decades in the industry say they would likely engage in insider trading to make 10 million dollars if there was no chance of being

small the damage to others from one's out-of-integrity behavior, one's out-of-integrity behavior is as we will show *always* damaging to oneself. In speaking about the "enormous costs" resulting from out-of-integrity behavior we are not speaking merely about the consequences of getting caught. As we will show, even when we "don't get caught" or we "get away with it", the costs to ourselves of out-of-integrity behavior are enormous.

We demonstrate that a *powerful opportunity* to support people, groups and organizations to actually act in their own self-interest *begins* (but only begins) with the *recognition* that each of us (individuals, groups, and organizations) inflict enormous damage both on ourselves and others as a result of our own widespread and systematic out-of-integrity behavior. However, as a consequence of *the way integrity is currently understood* (currently *occurs*, *shows up*, or *exists* for people), as we have said, much out-of-integrity behavior is not recognized by people, groups, and organizations as being out of integrity. As a consequence, for the most part people, groups, and organizations do not recognize that the damage inflicted on themselves and others from their out-of-integrity behavior is *in fact* a result of their own out-of-integrity behavior.

Summarizing the foregoing: dealing effectively with out-of-integrity behavior *begins* with confronting the following four facts regarding integrity that are revealed by our positive model of integrity:

1. Just how widespread out-of-integrity behavior actually is.
2. The enormity of the cost to people, groups, and organizations of out-of-integrity behavior.
3. Given the way integrity is currently understood (exists for people), our out-of-integrity behavior does not occur for us as out-of-integrity behavior.
4. We ascribe the damage of out-of-integrity behavior as coming from some cause other than out-of-integrity behavior.

These four facts are only a *beginning* because, as is the case with the counter-to-self-interest behavior explained by the biases and heuristics identified by Kahneman, Tversky and others, the *knowledge* of such information by itself does little to alter behavior. What else is required to provide a powerful opportunity for people, groups and organizations to act in their own self-interest with regard to integrity?

Integrity must *occur* for people, groups and organizations – show up, be seen, be understood, in fact *exist* for people – in a radical new way. Integrity must occur for people, groups and organizations such that:

arrested. That's more than two times the figure for employees with more than two decades in the financial services sector." Tenbrunsel and Thomas. (2015, p. 4)

1. Out-of-integrity behavior actually shows up for them as being out-of-integrity, and
2. The damaging consequences of that behavior, whether immediate or long term, show up for them in present time right along with the behavior, and
3. Those damaging consequences show up for them as being actually caused by the out-of-integrity behavior, rather than by some merely plausible explanation.

When people, groups and organizations see integrity through the lens of this new model, 1), 2), and 3) are realized naturally. To be clear, from within this new model of integrity, integrity occurs for people (is seen by people, in fact *exists* for people) such that 1) out-of-integrity behavior actually shows up for people *as* out-of-integrity behavior, but most importantly, 2) the damaging consequences of that behavior, whether immediate or long term, begin to show up in present time right *along with* the behavior, and finally 3) the damaging consequences of that behavior show up as being *caused* by the behavior.

As we said above in [Section 2.c](#), p. 14, people with normal brains act in what *appears* to them to be in their self-interest, but appears in their self-interest *given the way in which* what-they-are-dealing-with *occurs* or *shows up* for them. The way in which integrity is currently understood (exists for people) often makes what one is dealing with *occur* such that out-of-integrity behavior actually appears to be in one's self-interest (or the behavior is not even recognized as, does not show up for them as, being out of integrity). Speaking about this in another way, our brains evolved to generate reward-resulting behavior and avoid punishment-resulting behavior. But the behavior the brain does generate, it generates based on the way what we are dealing with *is represented in our brain*.

In short, if out-of-integrity behavior shows up for me (is seen by me) as *actually being* out-of-integrity, *and* if the inescapable damaging consequences of out-of-integrity behavior show up for me *in present time right along with the behavior*, and if those damaging consequences show up as being *caused* by out-of-integrity behavior, it is obvious that I am less likely to behave out-of-integrity.

Summarizing fully what we have said in this section: Just what acting *with* integrity and acting *without* integrity actually is depends on the way integrity as a phenomenon *occurs* or *exists* for people. The actual source of people, groups, and organizations acting out of integrity and ascribing the resultant damage to causes other than acting out of integrity is a product of the way in which integrity is currently “understood” by people – that is, is a product of the way in which integrity occurs or exists for people. What we mean by people's “understanding” is what for an object, system, person, or other human entity 1) constitutes integrity, 2) the way being in or out of integrity functions to expand or diminish the opportunity for performance, and 3) the actual performance consequences that result from being in or out of integrity. Finally, our awareness of what the real damage is from out-of-integrity behavior and what the benefits are from acting with integrity also depends on the way integrity as a phenomenon *occurs* for people.

In the next Section we summarize our purely positive model of integrity (not to be confused or conflated with the normative phenomena of morality, ethics, sincerity, or character). This forms the foundation for our main task in this paper: analyze the many ways in which finance can be dramatically improved by putting a model of integrity as a positive phenomenon into the theory and practice of finance (and more generally, into the theory and practice of economics).

We first reveal integrity as a positive phenomenon. We go on to discuss what integrity is for *objects and systems*, and what integrity is for *persons and other human entities* (for example, corporations, partnerships, and governmental entities). We then discuss the consequences for objects and systems, and for persons and other human entities, of functioning or behaving consistent with and inconsistent with integrity. Finally, we discuss what blinds us from seeing all this (what we call the “veil of invisibility”), and the impact of this blindness on human welfare.

3. A PURELY POSITIVE MODEL OF INTEGRITY

It took economics over 100 years to wake up to the fact that the presumption of self-interest was flawed, even though the counter-to-self-interest behavior was right in front of us all those years. The breakthrough in behavioral economics in large measure rewrites the economic script for analyzing human behavior. In this paper we argue that the longstanding naive presumption of self-interest is parallel to the total lack of recognition that integrity when revealed as a positive phenomenon is a factor of production that is as important to success in all aspects of life as knowledge, technology, entrepreneurship, human capital, and physical and social capital – and that importance has been invisible to us even though it is in plain sight. Integrity as a factor of production is undistinguished and therefore unmanaged – and as we said, its actual impact on life is huge. We have been involved in this research into a purely positive theory of integrity since 2004 and the work is as yet incomplete.¹⁸

The way *integrity* has been historically framed and as a consequence the way in which integrity occurs for people obscures the powerful impact of integrity on the functioning of the world and life, for every human being and human entity. Resolving this issue so that the impact of integrity becomes easily visible has required us to establish a new *conversational domain* for integrity, morality, ethics, and legality. This conversational domain retains the primal and fundamental meaning of each of these concepts as expressed in their dictionary definitions, but

¹⁸ See the following for extended discussions of this work, much of which deal with the modeling issues in more detail than we have room for in this paper. Some chapters from our forthcoming book to be published by Cambridge University Press are contained in, Erhard, Werner and Jensen, Michael C., *A Positive Theory of the Normative Virtues* (December 7, 2011). Harvard Business School NOM Unit Working Paper No. 12-007; Barbados Group Working Paper No. 11-06. Available at SSRN: <http://ssrn.com/abstract=1906328> and our earlier papers: Erhard, Werner, Jensen, Michael C. and Zaffron, Steve, *Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics and Legality* (March 23, 2009). Harvard Business School NOM Working Paper No. 06-11; Barbados Group Working Paper No. 06-03; Simon School Working Paper No. FR 08-05. Available at SSRN: <http://ssrn.com/abstract=920625> or Erhard, Werner, Jensen, Michael C. and Zaffron, Steve, *Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics, and Legality - Abridged (English Language Version)* (March 7, 2010). Harvard Business School NOM Unit Working Paper No. 10-061; Barbados Group Working Paper No. 10-01; Simon School Working Paper No. 10-07. Available at SSRN: <http://ssrn.com/abstract=1542759> or Erhard, Werner and Jensen, Michael C., *The Hidden and Heretofore Inaccessible Power of Integrity: A New Model (PDF of Keynote Slides)* (May 21, 2014). Harvard Business School NOM Unit Working Paper No. 10-068. Available at SSRN: <http://ssrn.com/abstract=2439838> and Jensen, Michael C. and Erhard, Werner, *A 'Value-Free' Approach to Values (PDF File of Powerpoint Slides)* (April 11, 2011). Harvard Business School NOM Unit Working Paper No. 11-010; Barbados Group Working Paper No. 10-06; Simon School Working Paper No. FR10-26. Available at SSRN: <http://ssrn.com/abstract=1640302>

clarifies the definitions and makes each term distinct from the other by eliminating the mischief of the ambiguity and confounding of their overlapping definitions.¹⁹

Unfortunately most people resist the creation of a new conversational domain because by definition it is unfamiliar to them, and the reaction often is “Don’t use all these new words and concepts, just use the plain English of the domain I am an expert in (say economics)”. This is equivalent to a first-year-student of mathematics saying to the teacher: “Don’t use all these strange terms to communicate mathematics to me (like calculus or number theory), just use plain English”, and similarly with someone dealing with medicine, engineering or physics. Obviously that will not work because it is the conversational domain of each of these areas that provides access to being a master of the discipline.

Our purpose here is to summarize our new model of integrity, introduce its required new terminology, and deal with the actual effects of integrity in life, with particular focus on corporate, market, personal and policy issues in finance, governance and compensation.

a. Integrity: Definition

We start with the dictionary definition of integrity using Webster’s New World Dictionary (1998):

1. the quality or state of being complete; unbroken condition; wholeness; entirety
2. the quality or state of being unimpaired; perfect condition; soundness
3. the quality or state of being of sound moral principle; uprightness, honesty, and sincerity

We use the word “integrity” in this work relying on Webster’s definitions 1 and 2. Note that those two definitions define a purely positive phenomenon with no normative content. As we distinguish and use the word “integrity”, we do not include Webster’s definition 3. That is, we do not use “integrity” to refer to the normative concepts of “being of sound moral principle; uprightness, honesty, and sincerity”, or to refer to an ethical or moral code or standard, or to denote anything about right vs. wrong, good vs. bad, or desirable vs. undesirable. Note that using “moral” in the definition of integrity confuses and confounds the meaning of each.

What follows is 1) the rigorous definition of integrity as a positive phenomenon, 2) the relation between integrity and workability, 3) the relation between workability and performance. We go on to define: 1) the relation between integrity and performance, 2) the law of integrity, and 3) the relation between integrity and value, derived in our in-process book “A Positive Theory of the Normative Virtues” Erhard and Jensen (2011, Chs. 1, 2 and 3). These are some of the fundamental terms that make up this new conversational domain that gives us access to integrity and its impact on the world.

- **Integrity Defined:** For an object, system, person, or other human entity or practice, the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition.
- **The Relation between Integrity and Workability:** Integrity (the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition) is the necessary

¹⁹ See Erhard and Jensen (2011, Chapter 1) <http://ssrn.com/abstract=1906328>

and sufficient condition for maximum workability (capable of producing the desired effect or result).²⁰

- **The Relation between Workability and Performance:** Workability (capable of producing the desired effect or result) is a necessary but not sufficient condition for performance (however one wishes to define performance).
- **The Relation between Integrity and Performance:** Integrity (the state of being whole, complete, unbroken, unimpaired, sound, in perfect condition) is thus a necessary but not sufficient condition for performance.
- **The Law of Integrity:** As the integrity (the state of being whole and complete, etc.) of an object, system, person, or other human entity or practice declines, workability declines, and as workability declines the opportunity for performance declines.
- **The Relation between Integrity and Value:** Integrity is therefore a necessary but not sufficient condition for long-run value maximization.

b. The Long-Neglected Positive Role of Integrity in Finance and Economics

As we have said, finance and economics scholars tend to avoid discussions or considerations of integrity because it has occurred to them as “normative”. However, integrity as we have defined it in this new model is a purely positive phenomenon. For any object, system, human entity, or human practice, integrity (as we distinguish it for each of these four) is observable. That is, an object, system, human entity, or human practice is either observably whole, complete, unbroken, unimpaired, sound, in perfect condition, or it is not. Furthermore, it is an inescapable conclusion that as whole and complete, etc. declines, workability declines. And, as workability (capable of producing the desired effect or result) declines the opportunity for performance declines (however one wishes to define performance). Hence, the *effect* of integrity on the opportunity for performance, including value, productivity, quality of life (and the like), is a purely *positive* proposition.

Our posited link between integrity and workability (and consequently, value) is no more normative than the posited link between the traditional net present value rule for investment decisions and corporate value. “Long-run value maximization requires integrity” is a positive proposition that is testable and potentially refutable. And the empirical effects of integrity or its absence have too long been ignored in finance and economics.

In our framework, as we have said, integrity is a necessary but not sufficient condition for long-run value maximization. For example, if you have integrity and thus a large opportunity for performance, but you are committed to only a small game in life (for example: I will wake up in the morning) then you are not likely to create anything of value, in spite of having integrity. In fact for

²⁰ The *New Oxford American Dictionary* (2010) defines *workable* as “capable of producing the desired effect or result ...” *Workability* (the noun form of workable, the definition of which is derived from the adjectival form of the word) denotes the degree to which something is capable of producing the desired effect or result, ranging from no opportunity for producing the desired effect or result to the maximum opportunity for producing the desired effect or result.

an organization to create maximum value, it must also create and execute brilliant competitive, organizational, technological, and human strategies in addition to integrity.

c. Integrity for an Object or System

An *object or system* has integrity when it is whole and complete. An *object* without integrity doesn't work. Think of a wheel with missing spokes, it is not whole and complete, and therefore is not stable. It will become out-of-round, work less well and eventually stop working entirely.

For an *object or system* to be in integrity it must satisfy the following conditions:

1. The **Design** must be in integrity – that is, the design must be whole, complete, unbroken, sound, in perfect condition consistent with its intended purpose. Specifically, the design when executed must be capable of producing the intended result or performance²¹).
2. The **Implementation** of the design must be in integrity – that is, the implementation of the design must be whole, complete, unbroken, sound, in perfect condition consistent with the design itself. Specifically, the implementation of the design must in fact realize the object or system as designed.
3. The **Use** of the implemented object or system must be in integrity – that is, the use of it must be whole, complete, unbroken, sound, in perfect condition consistent with the intended purpose of the design. Specifically, the use of the object or system must be allowed by its design and be consistent with its designed purpose.
 - For example, a 200-pound man using a life vest designed for a 50-pound child will drown unless he can swim.

By the way, the foregoing also applies to the integrity of a human system as a system, such as a partnership or corporation taken as a system.

d. Integrity for a Person or other Human Entity (family, group, organization, society, and nation)

Integrity for a person or other human entity is a matter of that person's or entity's *word* – nothing more and nothing less.

In the matter of integrity (being whole, complete, etc.) it is not too much to say that a person or other human entity *is* their word – that is, is constituted by their word. It follows that when a person's or other human entity's *word* is less than whole, complete, unbroken, sound, in perfect condition, that person **as a person** or that entity **as a human entity** is less than whole, complete,

²¹ "Intended result or performance" includes all aspects of the results or performance of an object or system, including all relevant concerns in the design, implementation, and use of that object or system; for a few obvious examples consider: construction, operating, and maintenance costs, as well as durability and all relevant aesthetic requirements.

unbroken, sound, in perfect condition. This results in the person or entity as less workable, and therefore with a diminished *opportunity* for performance. Conversely, it also follows that when a person's or other human entity's word *is* whole, complete, unbroken, sound, in perfect condition, that person **as a person** and that entity **as a human entity** is whole, complete, unbroken, sound, in perfect condition. This results in the person **as a person** or human entity **as a human entity** being fully workable, and therefore with a maximum opportunity for performance.

For a person or other human entity to be in integrity they must satisfy the following conditions:

1. The person's or other human entity's word must be whole, complete, unbroken, sound, in perfect condition.
2. For the word of a person or other human entity to be whole, complete, unbroken, sound, in perfect condition, they must keep their word, or when they will not be keeping their word, they must maintain their word as whole, complete, etc. by honoring their word.

e. Integrity: What Constitutes One's Word

Briefly summarized, a person's or other human entity's word includes the following (see, [Appendix 2: One's Word – Definitions and Clarifications](#) (p. 63) for a precise and complete definition of what we mean by each of the following six aspects of one's word):

- Word-1: What you *said* you would do or not do
- Word-2: What you *know* to do or not to do
- Word-3: What is *expected* of you by those with whom you desire a workable relationship (that is, their expectations that are in fact unexpressed requests of you), unless you have specifically declined this or that of those expectations
- Word-4: What you *say is so* (your evidence for what you say is so, would satisfy your listener)
- Word-5: What you *stand for*
- Word-6: Moral, Ethical and Legal Standards
 - The *social* moral standards, the *group* ethical standards and the *governmental* legal standards of right and wrong, good and bad behavior, in the society, groups and state in which one enjoys the benefits of membership are also part of one's word (what one is expected to do) unless a) one has explicitly and publicly expressed an intention to not keep one or more of these standards, and b) one is willing to bear the costs of refusing to conform to these standards (the rules of the game one is in).

f. Integrity: Keeping or Honoring One's Word

1. For a person or other human entity, keeping your word means you fulfill your word in full and on time.

However, if you always fulfill *all of your word*, you are undoubtedly not playing a big enough game in life. For example, as we suggested above, you might give your word to nothing more than that you will wake up each morning. While you will only fail at that once, you will certainly be playing a small game in life.

2. For a person or other human entity, *honoring* your word means that you either:
 - Fulfill your word, and on time, or
 - When you have failed (or expect to fail) to fulfill your word, and on time, you *honor* your word by:
 - Acknowledging that failure as soon as you realize it, and saying by when you will now keep that word, or that you never will keep that word, and
 - Cleaning up any mess you created for those who were counting on you to keep your word (fulfill your word), and to do so on time.

For a person or other human entity, *honoring* your word means that you are honest and straightforward: This means nothing is hidden, no deception, no untruths, no violation of contracts or property rights, etc. And (as explained above) because your word also includes conforming to the rules of the games you are in (for example, ethical standards of the profession or organization you are in, and the moral standards of the society and legal standards of the government entity you are in). If you refuse to play by any of the rules of the games you are in, integrity requires you to make this refusal clear to all others and to willingly bear the costs of doing so. (Gandhi is an example.)

As we have indicated, all this applies not only to a person, but to a human organization (such as a university, partnership or corporation) as well. As we define integrity, an *organization* or any other *human entity* is in integrity when its word is whole and complete. This means it honors its word, both to its employees and to its customers, suppliers and other stakeholders. Again, this means nothing is hidden, no deception, no untruths, no violation of contracts or property rights, etc. And if the organization or other human entity refuses to play by any of the rules of the game it is in, integrity requires it to make this clear to all others and to willingly bear the costs of not playing by one or more of the rules of the game.

g. Workability: The Bridge between Integrity and Value Creation

The more a person or other human entity is out of integrity (the less whole, complete, etc. their word is), the smaller their opportunity for performance. This is a result of the decline in workability. Put simply (and somewhat overstated):

- “Without integrity nothing works.”

We use this as a heuristic. Put more rigorously:

As *integrity* (whole and complete) declines, *workability* (capable of producing the desired effect or result) declines, and as workability declines, the opportunity for performance declines (however one chooses to define performance). Thus, value maximization requires integrity.

h. An Example of the foregoing: Results from Applying these Principles of Integrity at SSRN

The above definitions of integrity (including the three simple aspects of the definition of integrity for objects and systems) have provided enormous power at SSRN (the Social Science Research Network <http://ssrn.com>) where Michael (a co-author of this paper and Integrity Officer at SSRN²²) has used them in bringing about a culture of integrity that has produced major increases in productivity. Bringing about increases in the integrity of SSRN's staff as individuals (including himself) and in the integrity of SSRN both as an organizational system and as a human entity enabled increases in productivity at SSRN of 300% over the first three years of SSRN's efforts in this domain. Interestingly those productivity increases have also been associated with substantial increases in the satisfaction and happiness of SSRN's staff. SSRN has also experienced large increases in productivity as ITX (<http://www.itx.com/>), SSRN's outside vendor of web technology services, learned about integrity through its interaction with SSRN and adopted integrity (as distinguished in this paper) as a major element of its own organizational strategy.

It is worth contemplating how it could have been that such huge increases in productivity were lying around without being noticed – another important example of counter-to-self-interest behavior that was invisible in the way the world occurred to the relevant parties at both SSRN and ITX. The size of the increases in productivity reported here may tempt some of our readers to dismiss them. However, you should know that SSRN's productivity has continued to increase subsequent to these first three years.

i. The “Veil of Invisibility”

Given the significant contribution to performance and quality-of-life that we authors discovered from acting consistent with the Law of Integrity, and conversely the devastating impact on performance from attempting to violate the Law of Integrity,²³ we were dumbfounded that the actual source of these benefits and costs has remained invisible. Faced with that puzzle, we spent two years focused on determining what created that invisibility.

We discovered eleven distinct factors that create what we call the Veil of Invisibility that for human beings and other human entities makes *invisible* the impact of integrity on their opportunity for performance. Each of these eleven factors contributes to obscuring for human beings and other human entities the negative impact on performance when their actions are *inconsistent* with the Law of Integrity, and conversely obscures the positive impact on performance when their actions are *consistent* with the Law of Integrity.

Ignorance of the Law of Integrity, kept in place by the eleven factors of the Veil of Invisibility, prevents us from seeing the actual source of the devastating impact that out-of-integrity behavior has on our lives, and the lives of our families, groups, organizations, societies, and nations. Furthermore, ignorance of the Law of Integrity and of its relation to performance leads to explanations for poor performance that, while seemingly valid, hide the actual cause of that

²² In the spirit of full disclosure, Michael is also cofounder and Chairman of the Board of SSRN.

²³ “As the integrity (the state of being whole and complete, etc.) of an object, system, person, or other human entity or practice declines, workability declines, and as workability declines the opportunity for performance declines.”

performance. Diagnosis of less than desirable performance and prescriptions for addressing that diagnosis that are not informed by the Law of Integrity are generally unreliable and often downright ineffective in providing an effective pathway for resolving performance issues. Some evidence for this is the media reports of the unrelenting “scandals” we have mentioned earlier and discuss more fully in [Appendix 1](#) (p. 55).

For now we provide a brief listing and description of the eleven factors of the veil of invisibility that prevent us human beings from seeing and therefore accessing the power that acting consistent with the Law of Integrity actually adds to performance and quality-of-life for us as individuals, and for our families, groups, organizations, societies, and nations. It is important to note that mastering these eleven factors will give you access to vast increases in integrity and performance.

1. Not seeing that who you are as a person is your word

That is, thinking that who you are as a person is anything other than your word. For example, thinking that who you are is your body, or what is going on with you internally (your mental/emotional state, your thoughts/thought processes and your bodily sensations), or anything else you identify with such as your title or position in life, or your possessions, etc. Seeing yourself as anything other than your word leaves you unable to see that when your word is less than whole and complete you are diminished as a person.

As we have said, a person as a person is constituted in language. As such, when a person's word is less than whole and complete that person is diminished as a person. Attempting to violate the Law of Integrity, that is, not honoring your word to yourself and others, results in self-disintegration. And self-disintegration limits what you can be. Said another way, each out-of-integrity act reduces your opportunity for performance, thus reducing what it is possible for you to be. From another perspective the loss of power resulting from the diminution of self often leads to the use of force.

2. Living as if my word is only what I said (Word 1) and what I assert is true (Word 4)

Even if we are clear that in the matter of integrity our word exists in six distinct ways, most of us actually function as if our word consists only of what I *said* I would do or not do (Word-1) or what I *assert* is true (Word-4). This guarantees that we cannot be men, women or organizations of integrity. For us, Words 2, 3, 5, and 6 are invisible as our word:

- Word-2: What You *Know* to do or not to do
- Word-3: What Is *Expected* of you by those with whom you wish to have a workable relationship (unless you have explicitly declined those unexpressed requests)
- Word-5: What You *Stand For*

- Word-6: Moral, Ethical and Legal *Standards* of each society, group, and governmental entity of which one is a member

When we live (function in life) as though our word is limited to Word 1: What I said I would do or not do, and Word 4: What I say is so, we are virtually certain to be out of integrity with regard to our word as constituted in Words 2, 3, 5 and 6. In such cases, all the instances of our word as individuals or organizations that are not spoken or otherwise communicated explicitly are simply invisible to us. In our lives, all the instances of our Words 2, 3, 5 and 6 simply do not show up (occur) for us as our having given our word.

3. **Seeing integrity as a virtue**

For most people and organizations, integrity exists as a *virtue* rather than as a *necessary condition for performance*. When held as a virtue rather than as a factor of production, integrity is easily sacrificed when it “appears” that a person or organization must do so to “succeed”. For many people, virtue is valued only to the degree that it engenders the admiration of others, and as such it is easily sacrificed especially when it would not be noticed or can be rationalized. Sacrificing integrity as a virtue seems no different than sacrificing courteousness, or new sinks in the men’s room.

4. **Self-deception about being out-of-integrity**

People and organizations generally do not see when they are out of integrity. In fact we are mostly unaware that we have not kept and not honored our word. All we see is the ‘reason’, rationalization or excuse for not keeping our word. In fact, people systematically deceive (lie to) themselves about who they have been and what they have done. As Chris Argyris after years of studying human nature concluded: “Put simply, people consistently act inconsistently, unaware of the contradiction between their espoused theory and their theory-in-use, between the way they think they are acting and the way they really act.”²⁴

And if you think this is not you, you are fooling yourself about fooling yourself.

Because people cannot see their out-of-integrity behavior, it is impossible for them to see the cause of the unworkability in their lives and organizations – the direct result of their own attempts to violate the Law of Integrity.

5. **Seeing integrity as only keeping one’s word**

The belief that integrity is keeping one’s word – period – leaves no way to maintain integrity when this is not possible, or when it is inappropriate, or when one simply chooses not to keep one’s word. This leads to concealing not keeping one’s word (inauthenticity), which adds to the veil of invisibility about the impact of attempts to violate the Law of Integrity.

24 Argyris, Chris. 1991. Teaching Smart People How to Learn. Harvard Business Review: May-June.

6. **Fear of acknowledging that you have not or are not going to keep your word**

When maintaining your integrity (i.e., acknowledging that you are not going to keep your word and cleaning up the mess that results) appears to you as a threat to be avoided (like it was when you were a child) rather than simply a challenge to be dealt with, you will find it difficult to maintain your integrity. When not keeping their word, most people choose the apparent short-term gain of hiding that they will not keep their word. Thus out of fear we are blinded to (and therefore mistakenly forfeit) the power and respect that accrues from acknowledging that one will not keep one's word or that one has not kept one's word.

7. **Not seeing that integrity is a factor of production**

This leads people to make up false causes and unfounded rationalizations as the source(s) of failure, which in turn conceals the attempts to violate the Law of Integrity as the source of the reduction of the opportunity for performance that results in ineffectiveness and failure.

8. **Not doing a cost/benefit analysis on giving one's word**

When giving their word, most people do not consider fully what it will take to *keep* that word. That is, people do not do a cost/benefit analysis on giving their word.

In effect, when giving their word, most people are merely sincere (well-meaning) or placating someone, and don't even think about what it will take to keep their word. (How often do we all say something like "let's have lunch sometime" without actually intending to set a date and place.) Simply put, this failure to do a cost/benefit analysis on giving one's word is irresponsible, and irresponsible giving of one's word is a major source of the mess left in the lives of people and organizations. Indeed, people often do not even know that they have given their word.

People do not see the giving of their word as: "*I am going to make this happen*". If you are not doing this and doing a cost/benefit analysis *before* giving your word you will be out-of-integrity. Generally people give their word *intending* to keep it. That is, they are merely sincere. If anything makes it difficult or even inconvenient to deliver, they then provide *reasons* instead of *results*.

9. **Doing a cost/benefit analysis on honoring one's word**

People almost universally apply cost/benefit analysis to *honoring* their word. Treating integrity as a matter of cost/ benefit analysis guarantees you will not be a trustworthy person, or with a small exception, a person of integrity.

If I apply cost/benefit analysis to honoring my word, I am either out of integrity to start with because I have not stated the cost/benefit contingency that is in fact part of my word (I lied), or to have integrity when I give my word, I must say something like the following:

"I will honor my word when it comes time for me to honor my word if the costs of doing so are less than the benefits."

Such a statement, while leaving me with integrity will not engender trust. In fact that statement fundamentally says that my word is meaningless. In fact I just told you that I am an unmitigated opportunist and my word means nothing. I have given you my word that you cannot trust me to honor my word. At best you are left guessing what costs and benefits I will be facing when it comes time for me to honor my word. And if the costs are greater than the benefits (as I see them) I will not honor my word. That is, I have just told you my word is meaningless. Therefore I would be for you an untrustworthy person.

The bottom line is the following: If you choose to be a person of integrity, you have *no choice* when it comes time to honor your word.

In summary: to be in integrity you must apply cost/benefit analysis to giving your word and you must never apply cost/benefit analysis to honoring your word.

10. Not seeing that integrity is a “mountain with no top”

To the extent that people are aware of integrity and the costs of out-of-integrity behavior they systematically believe that they are in integrity or, if not in integrity at any moment, they believe they can put themselves back into integrity and be a person of complete integrity.

Unfortunately we will never get to the place of 100% integrity because integrity is a “mountain with no top”.

However, the combination of 1) generally not seeing our own out-of-integrity behavior, 2) believing that we are persons of integrity, and 3) even when we get a glimpse of our own out-of-integrity behavior, assuaging ourselves with the notion that we will soon restore ourselves to being a person of integrity keeps us from seeing that in fact integrity is a mountain with no top.

Getting that integrity is a mountain with no top (and therefore we had better learn to enjoy climbing) leaves us as individuals 1) with power and 2) with the ability to be authentic about our out-of-integrity inauthenticities, and 3) better able to relate to those around us who also are dealing with the fact that integrity is a mountain with no top.

11. Not having your word in existence when it comes time to keep your word

People say “Talk is cheap” because most people do not 1) keep their word when it comes time to keep their word, or do not 2) honor their word when they do not keep their word.

A major source of people not keeping or honoring their word, is that when it comes time for them to do so, their word does not exist for them in a way that gives them a reliable opportunity to keep or honor their word. This is a major cause of out-of-integrity behavior for individuals, groups and organizations.

Most people have never given any thought to putting their word into effective existence so that when it comes time for them to keep their word there is a reliable opportunity for them to either keep or honor their word.

To reliably keep or honor your word, you will need an extraordinarily powerful answer to the question, “Where Is My Word When It Comes Time For Me To Keep My Word?” If you don’t have a way for your word to be powerfully present for you in the moment or moments that it is time for you to take action to keep or honor your word, then you can forget about being a person of integrity (and you can forget about being a leader). To accomplish this you must provide answers to the following questions:

- What is the first step (next action) you are going to take after you have given your word?
- By when will you take this first action (or the next action)?
- Create a “now” (that is an interval of time in your calendar) in which to do it.
- And finally you must ensure the “now” exists for you in such a way that you will reliably take that first step.²⁵

In Erhard, Jensen and Zaffron (2009, pp. 70-87) we distinguish each of these eleven factors in a way that gives one access to integrity, that is, in a way that enables one to do the work required to pierce the Veil of Invisibility, and by doing so be left in the presence of the power that integrity confers on human beings and on human entities. In our experience individuals and organizations that master the eleven factors of the Veil of Invisibility provide themselves with access to a life of integrity with the power and peace that integrity confers.

Thus in this work we go beyond “nudging” to actually give human beings and human entities access to eliminating or at least significantly reducing their out-of-integrity behavior. We must emphasize, however, that as we said above, integrity is a mountain with no top. Therefore those who set off on this task must learn to enjoy climbing because there is no end to the process. And as the climb continues life continues to get better.

In a very real sense being a person of integrity starts with me giving my word to myself – that is, my word to myself that I am a person of integrity.

And, as a person of integrity, when I give my word to anything, it is as though I have said to myself:

“**I am** going to make this happen.” And, being a person of integrity, it is a part of who I am that when I do not keep my word, without question I honor my word.

I never say to myself:

²⁵ For more about effectively managing one’s word, see Mission Control Productivity: www.missioncontrol.com and questions@missioncontrol.com © Copyright 2001-10. Mission Control Productivity, LLC. All rights reserved.

“I am going to **try** to make this happen” or “I **hope** this will happen” or even “I will **do my best** to make this happen”.

j. A Picture of What It Looks Like To Be In Integrity

We do not have the space here (nor is it appropriate in this paper) to do what is necessary to provide our readers with a complete exposition required for full *access* to integrity. Nevertheless, we have provided some access so that you can, if you choose to, experiment with living with integrity in your personal and professional life. You can then directly gather empirical evidence from your own life to test the model. To aid in that experimenting, here is a picture that provides a sense of what it is like to live a life of integrity.

Since it is my word through which I define and express myself, both for myself and for others, it is not too much to say that **who I am is my word**, both who I am for myself and who I am for others. In any case, for a human being or other human entity integrity is a matter of one's word, nothing more and nothing less.

A Picture of Integrity. Illustrating with one's self what it means for a person, group, or entity to have integrity, picture what your life would be like, and what your performance would be, if it were true that:

- **You have done what you said you would do**, and you did it on time.
- **You have done what you know to do**, you did it the way it was meant to be done, and you did it on time.
- **You have done what those with whom you desire a workable relationship expect you to do** (even if they never asked you to do it and you never said you would do it), and you did it on time. Or, you have informed them in this or that case that you will not meet their expectation of you.
- Conversely, **you have informed others of your expectations of them and have made explicit requests to those others.**
- Whenever you have given your word as to the existence of some thing or some state of the world (assert something), **you are willing to be held accountable that your evidence for what you are asserting would satisfy your listener(s) that your assertion is valid.**
- And, whenever you realized that you were not going to do any of the foregoing, or not going to do it on time:
 - **You have said so to everyone who might be impacted**, and you did so just as soon as you realized that you wouldn't be doing it, or wouldn't be doing it on time, and
 - **If you are going to do it in the future you have said by when you would do it**, or if you are not going to do it at all, you have said so, and
 - **You have dealt with the consequences of your not doing it on time, or not doing it at all**, for all those who are impacted by your not doing it on time, or not doing it at all.

Putting the foregoing all together: **You have done what you said you would do, what you know to do, and what others expect you to do, or you have said you are not doing it, or not doing it on time, and you have cleaned up the mess you have caused by not doing it at all or**

not doing it on time. You have expressed your expectations of others through explicit requests. You are willing to be held accountable that your evidence for what you assert would satisfy the others. Finally, if you are not going to obey the rules of the game you are playing in, you have informed all others playing with you of that fact, and you willingly bear the consequences. In short, you have nothing hidden; you are truthful, forthright, straight, and honest.

And, almost unimaginable: What would it be like if others operated in this way with you?

It follows then, **that in order to be whole and complete as a person, my word to myself and to others must be whole and complete. What then is it like to be whole and complete as a person?** When you keep or honor your word to yourself and others:

- You are at peace with yourself, and therefore you act from a place where you are at peace with others and the world, even those who disagree with you or might otherwise have threatened you.
- You live without fear for who you are as a person.
- You have no fear of losing the admiration of others.
- You do not have to be right; you act with humility.
- Everything or anything that someone else might say is ok for consideration. There is no need to defend or explain yourself, or rationalize yourself, you are able to learn.
- This state is often mistaken as mere self-confidence rather than the true courage that comes from being whole and complete, that is, being a man or woman of integrity.

4. A BRIEF LOOK AT SOME AREAS IN FINANCE THEORY AND PRACTICE WHERE INTEGRITY IS LACKING

We turn now to a discussion of the application of this purely positive theory of integrity to finance. We start with some common beliefs, recommended practices, and theory in finance that are inconsistent with being a person or a firm or a system of integrity. We list here some of these propositions and provide a detailed analysis below. Consider the following:

The long history in finance (not the law) of implicitly defining the fiduciary duty of managers to be to current shareholders only, and therefore ignoring future shareholders and current and future bondholders and other claimants on the firm.

- As an example of this we point to the common recommendation for managers with an overvalued stock to issue new stock at the current high price (or make acquisitions using overvalued shares as payment) to benefit current shareholders at the expense of future shareholders, and (implicitly) to hide what they are doing.
- Common budgeting practices and target-based compensation plans that pay people according to how close they meet their targets.
- “Managing relations” with capital markets in a way that views financial reporting choices as strategic and must be made to both manage what the “street” expects and to give the street what it expects (basically manipulation of the “street”).

Each of these recommended practices is out of integrity and leaves the entity being out of integrity – that is, not whole and complete as to its word. These practices thus create unworkability and destroy value.

Consider, for example, the common recommendation (noted above) for firms whose equity or debt is overvalued to sell stock or bonds at those overvalued prices. That out-of-integrity recommendation (not whole and complete as to its word) is bound to lead to value destruction. The same is true of advice to use that over-valued equity to acquire a less-overvalued firm for stock (implicitly hiding what is being done). In both of these cases the management of the overvalued firm is violating the firm's implicit word to its financial claimants that it will not intentionally take actions that harm them. This is an example of the situation where an individual or an organization is out of integrity if that individual or organization does not either 1) comply with the expectations of their financial claimants that are unexpressed requests (expectations based on the firm's implicit word to its financial claimants, and even what it simply allows those claimants to expect), or 2) explicitly and clearly decline those expectations. (See the definition of [Word-3](#) (p. 23) and [Word-4](#) (p. 23) discussed above in Section 2 and more completely in [Appendix 2 One's Word Defined](#) (p. 65)).

When new shareholders discover that they were duped, workability will decrease and value will be destroyed. Even if the lack of integrity is never recognized, the executives involved in the unacknowledged manipulation will have diminished themselves as persons, and the firm will have diminished itself as a human entity.

Note however that the law does provide some obligation of the firm to future bondholders and shareholders through disclosure rules and regulations. But consider the attitudes of sellers of new issues and the investment bankers who counsel them. Few CEOs and few investment bankers who advise them seem to take seriously any obligation of the firm to future bondholders and shareholders when pricing a new issue.

When a CEO takes a firm public by selling shares or bonds to the public, he or she is creating a fiduciary relationship between himself and his or her company, and the holders of those securities. The word he or she gives implicitly and explicitly to those purchasers regarding the value of those securities is an important part of that relationship. That word must be given with the same standards as that of the fiduciary relationship the sale creates. If the CEO or investment bankers speaking for the firm misrepresent, withhold information, or otherwise mislead those purchasing the securities, the firm is out of integrity and the fiduciary relationship the transaction creates is sullied. Therefore the ongoing workability of that relationship is damaged.

5. THE PUZZLING STATE OF LOW-INTEGRITY BEHAVIORAL STANDARDS IN CORPORATIONS AND CAPITAL MARKETS

Here is a list (albeit incomplete) of common actions and activities that result in the word of executives and firms being less than whole, complete, unbroken, unimpaired, sound, in perfect condition. In short, these common actions and activities leave those executives and those firms "out-of-integrity". Out-of-integrity behavior results in reduced workability and a reduced opportunity for performance, and therefore destroys value. The remainder of this paper is focused on surveying from the integrity perspective examples of these practices so that we begin to focus on the value that can be created by putting the system back in integrity and correcting the apparent non-value maximizing equilibrium that exists in financial markets.

a. Financial Reporting

Managers regularly choose to treat the firm's relations with the capital markets as a game where financial reporting is not driven by creating long-term value but is little more than a strategy for managing and meeting analyst expectations (often referred to as "guidance"). Managing earnings, income smoothing, and manipulating financial analysts does not leave the word of executives or the word of the firm whole and complete. These practices invariably leave executives and firms out-of-integrity with respect to Word-4 (p. 65) ("one's word as to the existence of some thing or some state of the world includes being accountable that the other would find valid for themselves the evidence that one has for asserting something to be the case").²⁶

Until recently it was generally considered part of every top manager's job to "manage earnings" – that is, to report earnings other than as they actually are (and while somewhat less so now, this still tends to be true). When managers give their word to something other than what is actually so (in this case, their word as to the accuracy of the firm's reported financial statements), this leaves them less than whole and complete, and diminishes the opportunity for performance. That is, such fudging undermines the opportunity for maximizing firm value. For too long we in finance have implicitly condoned or even collaborated in these activities. Specifically we are referring to "managing earnings", "income smoothing", etc. These issues are not merely one of deciding on a strategy – they directly involve integrity and the generally unappreciated, negative long-run value effects of such out-of-integrity behavior.

Making organizational operating decisions other than those that maximize long-term firm value so as to manage reported earnings is a violation of Word-4. If the markets had the evidence that we managers had when making such "earnings management decisions" the markets would come to a different conclusion about the meaning of those managed earnings. That, incidentally, is the reason the various manipulations of accounting and real operating decisions are not fully disclosed to the markets. In everyday language violating Word-4 is "lying". When we use terms other than lying to describe a violation of Word-4 we inadvertently encourage the sacrifice of integrity. We have observed perfectly honest upstanding people in their roles as board members condone manipulation of financial reports because it does not occur (show up) to them as lying—it occurs to them as just part of what it means to "manage". Such language effectively disables even the normal social sanctions that would limit such behavior in boardrooms and among managers as they openly discuss how to "manage earnings". As we've previously discussed, the cost of this out-of-integrity behavior will be attributed to something other than this out-of-integrity behavior (i.e., managerial lying about earnings).

As we said above, language affects the way in which what is being dealt with occurs to people. And the way what is being dealt with occurs to people affects their behavior.²⁷ When

²⁶ See Fuller, Joseph and Michael C. Jensen, "Just Say No to Wall Street: Putting a Stop to the Earnings Game" (April 5, 2010). *Journal of Applied Corporate Finance*, Vol. 22, No. 1, Winter 2010; Harvard Business School NOM Unit Working Paper No. 10-090. Available at SSRN: <http://ssrn.com/abstract=1583563>

²⁷ See Erhard, Werner, Michael C. Jensen, and Barbados Group, "A New Paradigm of Individual, Group, and Organizational Performance" (November 17, 2010). Harvard Business School NOM Unit Working Paper No. 11-006; Barbados Group Working Paper No. 09-02. Available at SSRN: <http://ssrn.com/abstract=1437027>

executives and firms give their word to something other than what is actually so (that is, manage earnings), it shifts the way in which the firm occurs to its executives. Their focus shifts away from maximizing value to how to win the short-term gains from manipulating analysts and the expectations of the market.

b. Investment Banks Defrauding Clients

Banks and investment banks misleading clients with misleading investment recommendations that clients have been led to believe are intended to serve the client is not whole and complete with regard to their word. Goldman Sachs, for example, was accused of misleading its clients in the Abacus mortgage backed securities that were intentionally structured to fail (for which Goldman paid a \$550 million settlement to the SEC in 2010, at the time the largest ever in the history of the SEC).^{28 29} In addition, Goldman Sachs' trader, Fabrice Tourre, was found guilty on six counts of fraud for his role in the Abacus debacle. (See Gustin (2013 and [Appendix 1 "A Continuing Series of Scandals in Finance"](#) below, p. 55) for a more detailed discussion of this fraud.)

Also consistent with the dramatic decline in organizational integrity at Goldman Sachs in recent years, Greg Smith resigned as executive director and head of Goldman's United States equity derivatives business in Europe, the Middle East and Africa on March 14, 2012 with his *New York Times* Op Ed article entitled "Why I am Leaving Goldman Sachs". Quoting Smith (2012a):

After almost 12 years [at Goldman Sachs] . . . I believe I have worked here long enough to understand the trajectory of its culture, its people and its identity. And I can honestly say that the environment now is as toxic and destructive as I have ever seen it. To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money. . . . culture was always a vital part of Goldman Sachs's success. It revolved around teamwork, integrity, a spirit of humility, and always doing right by our clients. The culture was the secret sauce that made this place great and allowed us to earn our clients' trust for 143 years. It wasn't just about making money; this alone will not sustain a firm for so long. . . .

. . . Today, if you make enough money for the firm (and are not currently an ax murderer) you will be promoted into a position of influence.

What are three quick ways to become a leader [at Goldman]? a) Execute on the firm's "axes," which is Goldman-speak for persuading your clients to invest in the stocks or other products that we are trying to get rid of because they are not seen as having a lot of potential profit. b) "Hunt Elephants." In English: get your clients — some of whom are sophisticated, and some of whom aren't — to trade whatever will bring the biggest profit to Goldman. Call me old-fashioned, but I don't like selling my clients a product that is wrong for them. . . .

. . . I attend derivatives sales meetings where not one single minute is spent asking questions about how we can help clients. It's purely about how we can make the most possible money off of them.

²⁸ See Dealbook (2010), and the Appendix (starting on slide 32) to Jensen, Michael C. and Werner Erhard, "A 'Value-Free' Approach to Values" (PDF File of Powerpoint Slides) (April 11, 2011). Harvard Business School NOM Unit Working Paper No. 11-010; Barbados Group Working Paper No. 10-06; Simon School Working Paper No. FR10-26. Available at SSRN: <http://ssrn.com/abstract=1640302>

²⁹ Securities and Exchange Commission, "Goldman Sachs to Pay Record \$550 Million to Settle SEC Charges Related to Subprime Mortgage CDO", July 15, 2010. <http://www.sec.gov/news/press/2010/2010-123.htm>

...It makes me ill how callously people talk about ripping their clients off. Over the last 12 months I have seen five different managing directors refer to their own clients as “muppets,” sometimes over internal e-mail. ... No humility? I mean, come on. Integrity? It is eroding. I don’t know of any illegal behavior, but will people push the envelope and pitch lucrative and complicated products to clients even if they are not the simplest investments or the ones most directly aligned with the client’s goals? Absolutely. Every day, in fact.

It astounds me how little senior management gets a basic truth: If clients don’t trust you they will eventually stop doing business with you. It doesn’t matter how smart you are.

... People who care only about making money will not sustain this firm — or the trust of its clients — for very much longer.

Based on the evidence on the Goldman Culture summarized by Smith, the conversation within Goldman Sachs about its relation to clients (or stated as a matter of integrity, “the firm’s word to itself about its relation to clients”) is obviously inimical to the interests of its clients.

What is clearly invisible to Goldman Sachs’ management is that such behavior, because it is out-of-integrity, is also contrary to Goldman’s own interests.

Goldman’s out-of-integrity behavior is evidenced in the conflict between the firm’s word *to itself* about its relation to clients, and its word *to its clients*. And as Smith says about the resulting damage to the firm from such behavior, “If clients don’t trust you they will eventually stop doing business with you”.

On its website, Goldman Sachs represents itself and gives its word to the world (including its clients) in the statement of its “Business Principles and Standards: Goldman Sachs Business Principles”.³⁰ The first and last of Goldman’s 13 business principles state:

Our clients’ interests always come first. Our experience shows that if we serve our clients well, our own success will follow.

Integrity and honesty are at the heart of our business.

Given what Smith reveals about the conversation within Goldman Sachs about the firm’s relation to clients (the firm’s word to itself), Goldman Sachs’ word to its clients is clearly not whole, and is incomplete and broken – the very definition of out-of-integrity. The *obvious* cost to Goldman Sachs and other firms of not seeing the impact of out-of-integrity behavior is the cost of lawsuits, penalties, and settlements. But the non-obvious costs of such behavior is the impact on clients’ behavior, and the extent of the reduced reputation and morale of the firm, all of which are much less obvious, and sometimes dismissed as just the cost of doing business. Such out-of-integrity behavior in the financial world is not limited to Goldman Sachs.

Smith is dumbfounded at Goldman not seeing the self-inflicted damage from its out-of-integrity behavior, “... *how little senior management gets a basic truth*: If clients don’t trust you they will eventually stop doing business with you.” [emphasis added] The source of what dumbfounds Smith (and what hides the damage from out-of-integrity behavior) is discussed above in [Section 3.i](#) on page 25, “The Veil of Invisibility”. In that Section we argue that mastering the eleven factors that constitute the Veil of Invisibility creates actionable access to eliminating the

³⁰ See <http://www.goldmansachs.com/who-we-are/business-standards/business-principles/index.html>

damage done by out-of-integrity behavior, or at least unconceals the behaviors that are generating the damage.

Interestingly, Smith's (2012b) book, *Why I Left Goldman Sachs: A Wall Street Story*, and his resignation letter has been criticized by figures in the financial press and members of the financial community. For examples see Blankfein and Cohen (2012), Stewart (2012), Roose (2012), Schatzker and Ruhle (2012). We conjecture that many in the Wall Street community considered the Smith book's accusations unimportant because they expected and did not find documentation of rampant outright *illegal* behavior in the book. The book contains considerable discussion of out-of-integrity behavior and the damage it is likely to cause, although Smith does not use that specific integrity language. This failure of the financial community to recognize the lack of integrity at Goldman described by Smith and the financial community's failure to see its importance says something noteworthy about the culture of the Wall Street community and the press that covers it.

Smith's book clearly indicates a serious lack of integrity in the culture at Goldman. And the book is consistent with the out-of-integrity actions that Goldman has taken in such deals as the Abacus 2007-AC1 mortgage backed securities issue (in which Goldman intentionally structured that issue to *fail* and misrepresented those securities to its purchasers). Goldman's clients lost over a billion dollars within months of their purchase of Abacus and Goldman paid a fine of \$550 million to the SEC. For a more detailed discussion of Goldman's integrity or lack thereof see [Appendix 1 a.](#), p. 55 below. See also the Appendix starting on slide 32 in Jensen and Erhard (2011) for a more detailed discussion of Goldman's violation of 7 of Goldman Sachs's 13 Business Principles stated on its web site.

Michael Lewis (2013) had the following to say about the Smith - Goldman events:

Either way, you had to admire Greg Smith's nerve. Still, his piece raised a couple of questions that I hoped his book might answer. The first is, why now? Goldman was helping the Greek government deceive the European Union about its indebtedness back in 2001; by 2004 the firm was busy manipulating the ratings agencies and the investing public to help expand the market for subprime mortgage bonds; by 2006 it was designing securities to fail (the infamous Abacus program) so that its own traders could bet against them, and make profits at the expense of their own customers by, in effect, pumping vast amounts of trust-reducing pollution into the financial system. For a very long time now the firm has been famous for being more frightening than helpful to its customers. Smith first worked for Goldman as an intern in the summer of 2000, near the peak of an Internet bubble that was inflated with the help of Goldman's analysts.

Consistent with Smith's judgments regarding Goldman Sachs' out-of-integrity behavior, Bodnaruk, et al (2007), in their empirical study of "The Dark Role of Investment Banks in the Market for Corporate Control" find that out-of-integrity behavior (our words not theirs) goes far beyond Goldman Sachs. As they conclude (p. 1):

We argue that advisors are privy to information about the deal that they directly exploit in the market by investing in the target. We show that the banks' advisors to the bidders tend to have positions in the target before the deal. The existence of a direct stake of the advisor to the bidder increases the probability of the bid and the target premium. Advisory banks profit from such a position. A trading strategy that conditions on the stake of the advisors delivers a net-of-risk performance of 4.08% per month. This cannot be replicated with available information. We also show that advisors not only take positions in the deals they advise on, but also directly affect the outcome of the deal and its probability of success. This has negative implications for the viability of the new entity.

c. Money Managers Defrauding Clients

Money managers have allowed certain favored investors to engage in market-timing operations (for example, after-hours trading at stale prices) that allowed these favored investors to sell or purchase shares at prices above or below the actual value of those shares. Such practices allow those favored investors to transfer wealth from non-favored fund investors to themselves. Well-known fund organizations that were accused of allowing such behavior (and fired employees as a result of the investigations and/or paid penalties to settle the charges) include Putnam Investments, Strong Capital Management, Morgan Stanley, Janus Capital Group, Bear Stearns, Bank of America and Invesco.³¹ In some cases the *managers* of the funds (for example, Strong Capital Management) engaged in such trading themselves in personal violation of their fiduciary duties to fund investors.³²

6. CORPORATE GOVERNANCE: PUTTING INTEGRITY INTO THE ORGANIZATION AS A SYSTEM AND AS A HUMAN ENTITY

a. Put Integrity Into Boards of Directors

Boards of directors are ultimately accountable for the performance of the organization as a whole. This accountability for performance includes the performance of 1) the organization as a system, and 2) the organization as a human entity. The logic chain to the ultimate outcome is as follows:

- The organization as a system is constituted as follows: the *design* of the system, the *implementation* of the design, and the *use* of the system.
- The organization as a human entity is constituted as follows: the word of the entity itself (includes those individuals who are taken to speak for the entity), and the word of the individuals who make up the entity.
- An organization is out of integrity when the organization as a system or as a human entity (or both) is less than whole, complete, unbroken, unimpaired, sound, in perfect condition.
- When an organization as a system or as a human entity is less than whole, complete, unbroken, unimpaired, sound, in perfect condition, the workability of the organization as a system or as a human entity (or both) is diminished.
- When the workability of an organization as a system or as a human entity is diminished, the organization's opportunity for performance is diminished.

³¹ See Burton (2003), Smith and Lauricella, 2006. "Moving the Market: Bear Stearns to Pay \$250 Million Fine; Net Rises 36%," *Wall Street Journal*, and Anand, 2006. "Harmed Investor? Just Wait – Brokerage Firms Pay \$255 Million, but Getting It Takes Time," *Wall Street Journal*.

³² See Lauricella and Oster, 2004 "Strong Funds And Regulators To Settle Case – Agreement Would Clear the Way For Possible Sale to Wells Fargo; Considerable Challenges Ahead," *Wall Street Journal*, Lauricella and Oster, 2003. "Second Strong Executive Snagged in Probe – Anthony D'Amato of CEO's Office Was Involved in a Deal to Allow Canary to Rapidly Trade Shares," *Wall Street Journal*, and Lauricella, 2003. "Strong Steps Down From Board But Stays On as Head of Firm," *Wall Street Journal*.

Given that boards of directors are ultimately accountable for organizational performance, and given that out-of-integrity behavior of the organization as a system or as a human entity diminishes the organization's opportunity for performance, this necessarily leaves boards of directors accountable for the integrity of the organization – the organization both as a system and as a human entity.

An organization's executive compensation plan is an example of the organization as a system. The board of directors is ultimately accountable for the workability and performance of that system. The board of directors is therefore necessarily accountable for the integrity of 1) the *design* of the organization's executive compensation plan, 2) the *implementation* of that design, and 3) the *use* of the implemented plan. An example of an out-of-integrity design of an organization's executive compensation plan is the budget or target-based executive compensation plan that most companies use.³³

In addition, what gets said and what is unsaid in an organization's boardroom is an example of the organization as a human entity. Integrity for a human entity is a matter of that entity's word, nothing more and nothing less. When what is said in the organization's boardroom is less than whole, complete, unbroken, unimpaired, sound, in perfect condition, such out-of-integrity behavior diminishes the workability of the board. When workability is diminished, the opportunity for performance is diminished.

An example of out-of-integrity behavior in boards of directors (or for that matter, executive teams) is the existence of "undiscussables" in the board room – that is, what the firm may be getting by with, but is so questionable that if it is put up on the table it probably has to cease. Anything that is undiscussable leaves the board as a human entity less than whole, complete, unbroken, unimpaired, sound, in perfect condition. As a result, workability and value are sacrificed. No human entity in which there are issues that are undiscussable can be whole and complete.

If you doubt that there are undiscussables in the background of most board meetings and indeed most executive committees just try raising the issue of one or more undiscussables. You will quickly discover that it is undiscussable that there are undiscussables. These undiscussables are always trouble waiting to happen and there is no way to head off the trouble as long as the issues are undiscussable.

b. Indicators of the Lack of Integrity In the Governance and Management of Financial Firms and their Advisors

These indicators of a lack of integrity include those professional firms who serve both the supply and demand side of financial services. Specifically this includes, law firms, banks, investment banks, brokerage firms, accounting firms, and consulting firms (especially compensation consultants) as well as other financial service firms including mutual funds, hedge funds, and private equity funds.

³³ See Murphy, Kevin J. and Michael C. Jensen, 2011. CEO Bonus Plans: And How to Fix Them (November 19). Harvard Business School NOM Unit Working Paper 12-022; Marshall School of Business Working Paper No. FBE 02-11. Available at SSRN: <http://ssrn.com/abstract=1935654>

For managers and directors of financial firms and their advisors Forstmoser (2006), in his speech “Integrity in Finance” given to the Swiss Banking Institute, offers some all-too-common explicit indicators of the existence of out-of-integrity behavior in their organizations:

“Everyone else is doing it.”
 “We’ve always done it.”
 “This is the way this business works.”
 “If we don’t do it, somebody else will.”
 “Nobody’s hurt by it.”
 “It doesn’t matter how it gets done, as long as it gets done.”
 “It works, so let’s not ask too many questions.”
 “No one’s going to notice and besides we will fix it before they do.”
 “It’s legal, but . . .”
 “It’s too expensive.”
 “It has to be done to save the organization, and by the way a lot of jobs.”

Because the widespread lack of integrity in organizations reduces long-term value, it raises the question: How can it persist if it destroys long-run value? We address this issue in the next section.

7. THE GENERAL LACK OF INTEGRITY IN RELATIONS WITH CAPITAL MARKETS

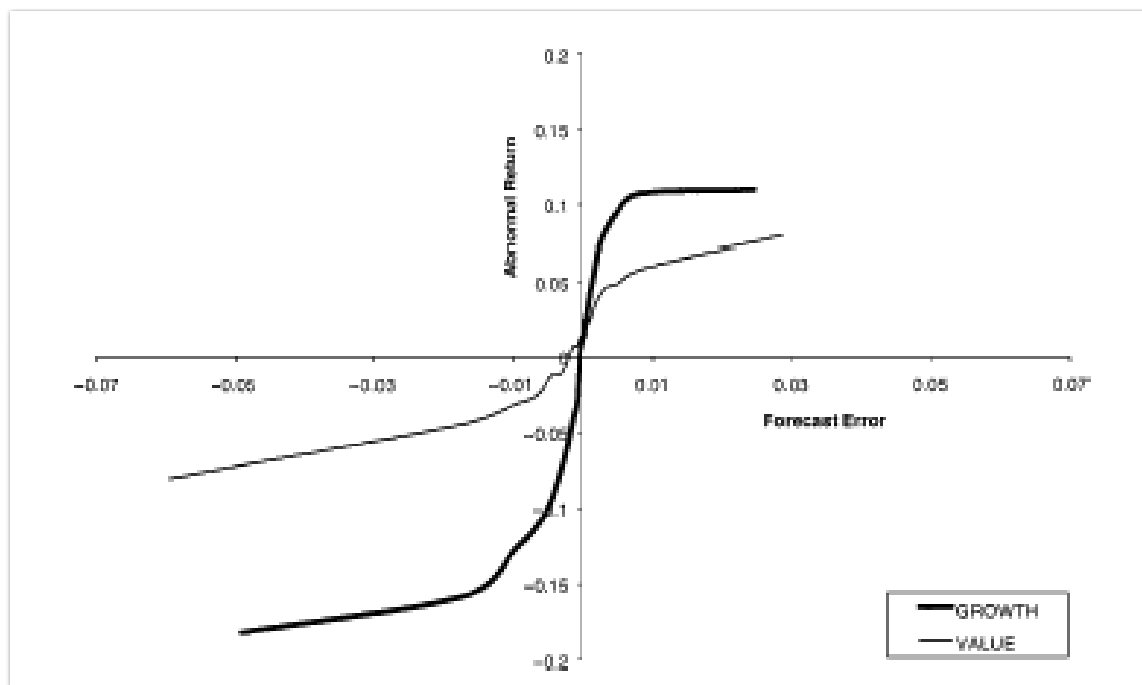
There are many reasons for the lack of integrity in the relations between firms and capital markets, but a major contributor to this situation is that markets reward and punish managers in ways very similar to those budget-based compensation systems that “pay people to lie” – that is, systems that pay people to “under promise and over deliver”. Indeed, many readers have undoubtedly heard managers and executives explicitly announce “*under promise and over deliver*” as both a personal and management philosophy. It is certainly out of integrity.

Stripping away the politeness, a management or behavioral philosophy of “under promise and over deliver” actually means in many situations: “lie and lie”. I lie to you about what I *can* deliver (a low profit), and I lie to you about what is *actually* delivered (a high profit) – another example of violations of Word-4. Put this way it is obvious what happens to integrity, trust and reliability in cultures where such behavior becomes generally accepted. We now turn to an analysis of one of the market forces that encourage managers to engage in gaming behavior such as under promise and over deliver.

Figure 1 below from Skinner and Sloan (2002, p. 209) illustrates vividly how markets reward and punish managers for meeting or beating the analysts’ consensus quarterly earnings forecast over the period 1984-1996. The graph plots quarterly abnormal returns for growth firms and value firms as a function of earnings surprise at the end of the quarter. Forecast error is measured as the earnings surprise relative to the quarter-end stock price. Growth firms are those with high market value to book value ratios, and Value firms are those with low market value to book value ratios. Data is from I/B/E/S database for the final month of the fiscal quarter for which earnings is being forecast. Sample size is 103,274 firm-quarter observations in the period 1984-1996.

A 1% positive earnings surprise results on average in a 10% abnormal stock return for growth firms and approximately a -15% abnormal stock return for missing the quarterly earnings forecast by 1%. For value firms (non-growth firms) the comparable abnormal returns are 6% and -3% respectively. Managers of a firm facing these sorts of rewards and punishments from the capital markets have incentives to take long-run value-destroying actions to satisfy the market's short-run expectations.

Figure 1: How Markets Reward and Punish Managers for Meeting or Beating Consensus Forecasts



Source: Skinner & Sloan (2002, p. 209)

Interestingly, the relation between a firm's top-management team and the capital markets has resulted in an equilibrium that replicates many counterproductive aspects of corporate internal budget or target-based bonus systems. Thus, the capital markets provide further short-run incentives for manager's to take out-of-integrity actions to meet market expectations.³⁴

For corporate executives holding large quantities of restricted stock and stock options, Figure 1 portrays the pay-performance relation that defines how meeting, beating or missing analyst forecasts affects the value of their equity-based holdings. Figure 1 has the same general shape as a smoothed version of the typical non-linear managerial bonus pay-performance relation depicted in

³⁴ See, for example, Murphy and Jensen (2011) "CEO Bonus Plans and How to Fix Them," and Jensen (2001), "Corporate Budgeting Is Broken: Let's Fix It", and Jensen, Michael C., Paying People to Lie: The Truth About the Budgeting Process (Revised September, 2001).

Fig. 2 below and discussed in Murphy and Jensen (2011), and produces the same counterproductive incentives. Therefore we discuss in some detail the incentives managers face under the bonus plans represented in Fig. 2.³⁵

Figure 2: How Typical Management Bonus Plans Reward and Punish Managers for Meeting or Beating Internal Performance Targets³⁶

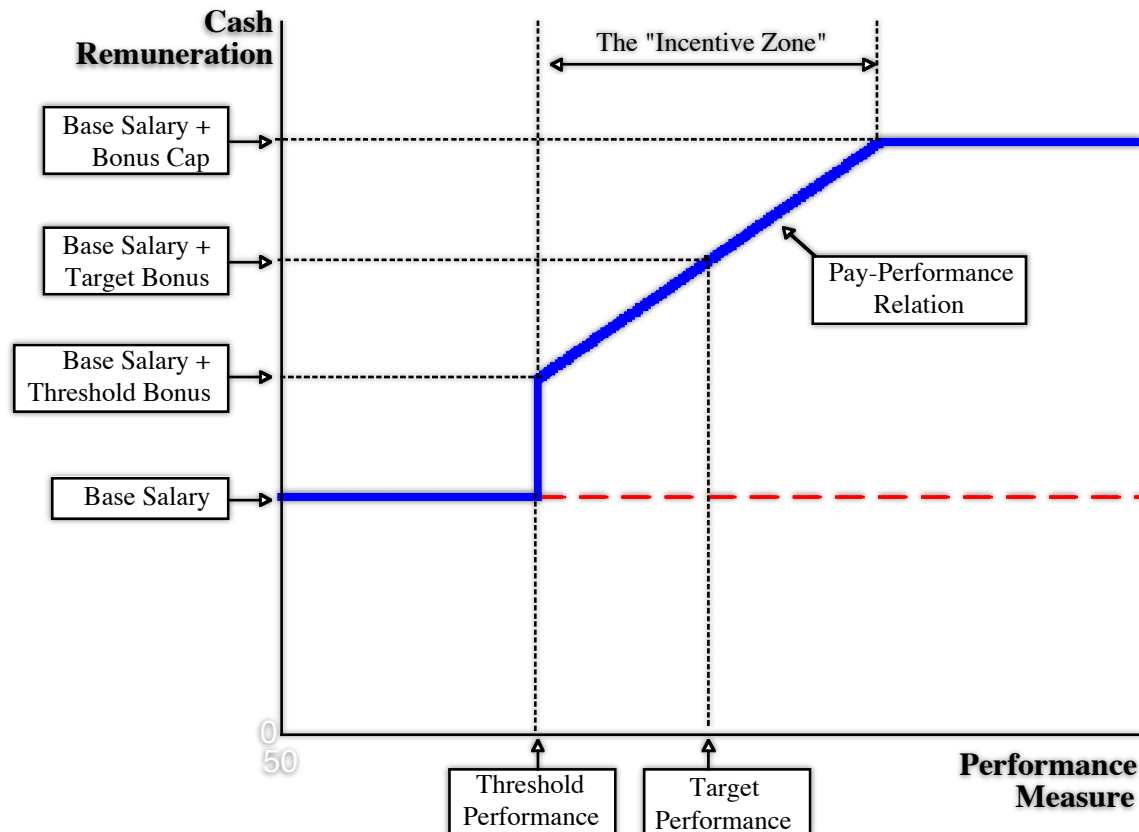


Figure 2 illustrates the common management compensation practice in which a manager's salary plus bonus is constant until a minimum "threshold performance" is reached – commonly 80% of the "target" or budgeted performance level. At 80% of the target performance the manager receives a bonus for making the threshold performance target. This bonus is often substantial, and

³⁵ For an excellent article on the history and structure of CEO pay see: Murphy (2013) "Executive Compensation: Where We Are, and How We Got There", <http://ssrn.com/abstract=2041679>

³⁶ Source: Jensen (2001) "Paying People to Lie: The Truth About the Budgeting Process", <http://ssrn.com/abstract=267651> and Murphy and Jensen (2011), "CEO Bonus Plans and How to Fix Them" <http://ssrn.com/abstract=1935654>

as performance increases above this hurdle the bonus increases until it is capped at some maximum (120% of the target performance is common). Performance above this upper limit generates no additional bonus.

Consider managers' incentives when they are struggling to reach the minimum hurdle. In this situation as long as they believe they can make the threshold performance, managers will engage in actions to increase their performance, and this can be done by legitimate or illegitimate means. When the measure is profits, or some variation of profits, managers have incentives to increase this year's profits at the expense of future year's profits by moving expenses from this year to the future (by delaying purchases, for example) or by moving revenues from future years into this year by booking orders early, by announcing future price increases, by giving special discounts this year, or by guaranteeing to repurchase goods in the future, and so on). When these actions simply move profits from one year to another the adverse impact on firm value is probably small. But, it can pay managers today to engage in actions that reduce the total value of firm cash flows by moving profits to the current period even when future profits are dramatically reduced.

When managers conclude that they cannot make the minimum threshold hurdle, their incentives shift dramatically because if the manager is going to miss the bonus this year, there is no further reduction in compensation from performance that is even farther away from the lower threshold amount (subject always to the condition that the manager is not fired). In this situation managers have incentives to do the opposite of what we just described, that is they now have incentives to move profits (if that is the performance measure) from the present to the future. They can do this by moving expenses from the future to the present period (by prepaying expenses, taking write-offs for restructuring, etc.), and by moving revenues from the present to the future.³⁷ This is the "big bath theory", and the phenomenon is regularly observed when firms faced with missing analyst expectations take a "big bath" to improve their ability to meet analyst expectations in the future.

Finally, managers who are within reach of the bonus cap have incentives to not exceed the cap because they get no rewards beyond that point (and these perverse incentives are even stronger if this year's performance is used in setting next year's targets). In this situation managers have incentives to move expenses from the future to the present and revenues from the present to the future to avoid exceeding the bonus cap this year and to increase bonuses in future years. And again, managers have incentives to do this even if it imposes real costs on the company.

Suffice it to say that all of the behavior described above is a violation of Word-4 and is therefore out of integrity and leads to unworkability and value destruction. And note that all this destructive behavior by the human beings in the organization is motivated by the fact that this common bonus plan is out-of-integrity in *its design as a system*. Eliminating this counterproductive behavior must start by eliminating the lack of integrity in the design of the compensation system. Asking the human beings operating in this badly designed system to change their behavior will fail unless and until the compensation system itself is redesigned to put it into integrity.

Popular recommendations to solve these incentive problems in the banking and financial industry as a whole tend to focus on eliminating bonuses, often motivated by the perception that the way the bonus plan works leaves top people paid "too much" rather than that the bonus plan

³⁷ Healy (1985) provides an excellent study of the effects of bonus schemes on managers' choice of accounting policies.

rewards people in the wrong way and for the wrong things. This approach addresses nothing about the design of these plans and ignores the potentially huge damaging effects associated with a mass exodus of highly qualified people from the banking and financial industry.

8. FURTHER EVIDENCE ON MANAGEMENT MANIPULATION OF EARNINGS

a. Evidence from a survey of 401 CFOs reveals a fundamental lack of integrity

Graham, Harvey & Rajgopal's survey³⁸ of 401 CFOs find that 78% of surveyed executives are willing to knowingly sacrifice value to smooth earnings. While it seems that recent scandals have made CFOs less willing to use accounting manipulations to manage earnings, this survey indicates that to meet short-run earnings targets CFOs are willing to change the real operating decisions of the firm and thereby destroy long run value. When smoothing earnings, it is true that a CFO could maintain his/her integrity (their word, and their firm's word, being whole, complete, etc.) by making something like the following public announcement each time they make such value-destroying decisions, "Given how I am paid, I am rejecting or delaying a firm-value-increasing project in order to meet analysts' consensus earnings forecast so as to increase my own pay." We would guess that relatively few CEOs and CFOs would actually make such announcements to their board of directors, analysts, and the public.

b. Aggregate evidence on the manipulation of corporate earnings.

Figure 3 displays the aggregate evidence from the DeGorge, Patel and Zeckhauser (1999, p. 20) study of the errors (measured in cents per share of corporate earnings) between actual earnings and analyst's consensus earnings forecast for over 100,000 quarterly observations on over 5,000 firms in the 1974-1996 period. The distribution is not symmetrically distributed around zero. In fact, there are far too many observations at exactly 0 as indicated by the center tall bar. It is interesting that lost from view in Fig 1 is that the stock-price response from hitting *exactly* zero (i.e., exactly hitting expectations) is significantly negative and lower than the response for missing expectations by, say, .01%. The explanation seems to be that the zeros are most likely the result of CEOs manipulating earnings upward to get exactly to zero and the market understands that and sees it as negative information.³⁹

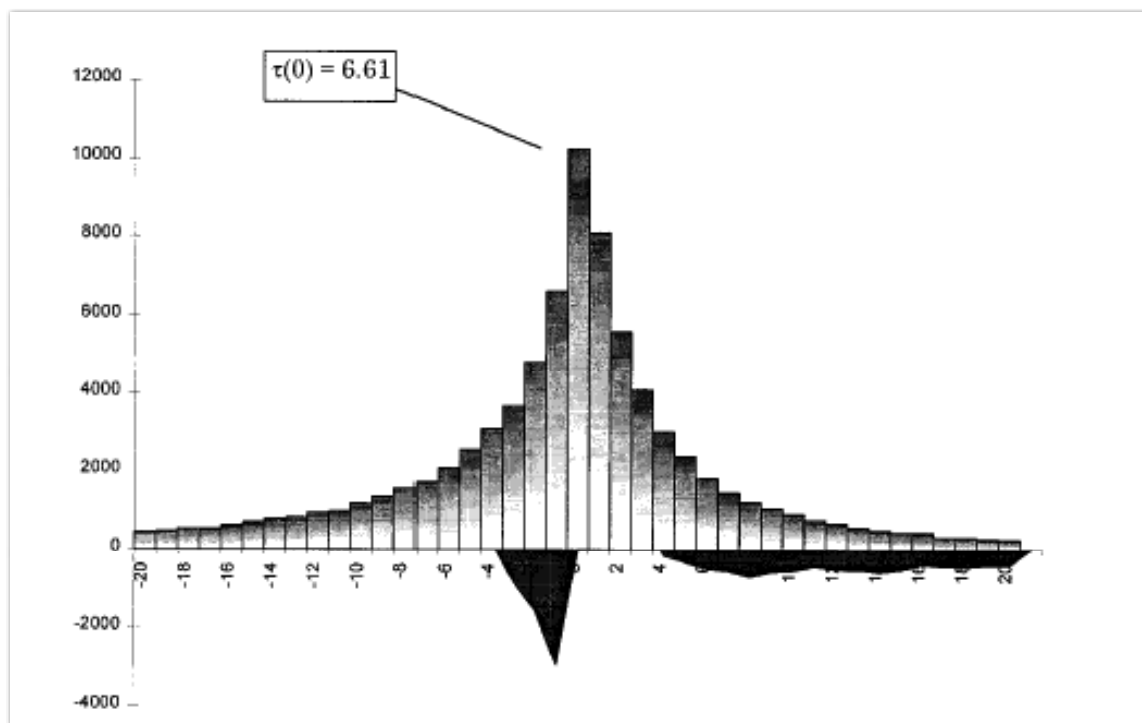
Indeed, the black areas below the X-axis denote the deficiency in frequency of observations in the intervals of the distribution that would be expected if the true underlying distribution were symmetrical around zero. There are far too few observations in the intervals between -4 cents per share and -1 cent per share (where firms have missed analysts' consensus earnings forecast by a small amount) and far too few observations in the intervals greater than +4 cents per share (where firms significantly exceeded the analyst forecasts).

³⁸ Graham, John R., Harvey, Campbell R. and Rajgopal, Shivaram, The Economic Implications of Corporate Financial Reporting (January 11, 2005). Available at SSRN: <http://ssrn.com/abstract=491627>

³⁹ Private correspondence with Kevin Murphy, 2013.

These results are consistent with the hypothesis that management is manipulating earnings to show far too *many* instances of quarterly earnings reports that exactly meet or just beat analysts' expected earnings and far too *few* instances of quarterly earnings reports in the interval of -1 and -4 cents per share below analysts' expected earnings. This is accomplished by reporting lower than actual earnings when earnings would be substantially above analysts' expectations and "storing" the hidden earnings so that the firm could report just meeting or beating analysts' expectations when the firm's earnings actually would have come in below those expectations.

Figure 3: Aggregate Evidence on the Manipulation of Earnings



Source: DeGorge, Patel and Zeckhauser (1999)

Figure 3 displays the frequency distribution of the the aggregate evidence from the DeGorge, Patel and Zeckhauser (1999, p. 20) study of the errors between actual earnings and analysts' consensus earnings forecast (measured in cents per share of corporate earnings) for over 100,000 quarterly observations on over 5,000 firms in the 1974-1996 period. The distribution is not symmetrically distributed around zero. In fact, there are far too many observations at exactly 0 as indicated by the center tall bar. The black areas below the X axis denote the deficiency in frequency of observations in the intervals of the distribution that would be expected if the true underlying distribution were symmetrical around zero. There are far too few observations in the intervals between -4 cents per share and -1 cent per share (where firms have missed analysts' consensus earnings forecast by a small amount) and far too few observations in the intervals greater than +4 cents per share (where firms significantly exceeded the analyst forecasts).

c. And the manipulation of earnings extends to the reporting of hedge fund returns

It appears that hedge funds regularly report smooth month-to-month returns. This apparently results from the fact that being able to say: “We have only had X months of negative returns” (X being a very small number) has a big impact on attracting investors to the fund. This means that reporting a return of +.01% rather than -.01% in any month leads to a large advantage in recruiting and retaining investors. And consistent with this, the evidence indicates that the distribution of returns for “hard to value” hedge funds shows way too many monthly returns just above zero and way too few just below zero.⁴⁰ This is consistent with the hypothesis that hedge funds systematically underprice the value of the fund during the year so that they can smooth out the returns from month to month and avoid reporting negative returns in any month.

Consistent with this hypothesis that hedge funds manipulate the month-to-month value of their funds to serve their own interest, the contractual features of hedge funds provide them strong incentives to inflate returns in December of each year. And the evidence indicates they do so. Hedge funds earn incentive fees if they beat their contractual benchmarks and better performance increases investor contributions to the fund. Agarwal, Daniel and Naik (2010) provide strong evidence documenting this phenomenon. They find that the average December return is more than twice as high as the average returns for the entire 11 months January through November (Table II). In the authors’ words (p. 37):

“In this paper, we provide strong evidence of hedge funds inflating their returns in an opportunistic fashion to increase their compensation. Specifically, we find funds that stand to gain the most from good performance, the funds that stand to lose the most from poor performance, and the funds that have greater opportunities to engage in return inflation exhibit the greatest spike in December returns. ... We also provide evidence on two potential mechanisms employed by hedge funds to manage returns. [The] first method involves funds underreporting their returns in the early part of the year in order to create reserves for possible poor performance later in the year (saving for the rainy day). In case some of these reserves are left unutilized, they get added to the December returns resulting in the spike. [The] second mechanism involves funds borrowing from their January returns of the subsequent year to improve their December returns. This can be achieved by funds pushing up the security prices at December-end by last-minute buying, which is followed by price reversals in January.”

d. And This Violation of Word-4 (“the other would find the evidence for my assertion also valid for themselves”) Extends to the Reporting of Analyst Recommendations

Ljungqvist, Malloy, and Marston (2007) in their paper “Rewriting History” study the major historical database of financial analyst stock recommendations and find substantial evidence that the historical record, as reported in the widely used I/B/E/S database produced by Thomson Financial, does not represent the recommendations that were actually made by many of the analysts. They conclude:⁴¹

⁴⁰ See Pool, Bollen, Nicolas P.B., “Do Hedge Fund Managers Misreport Returns? Evidence from the Pooled Distribution” (2007) and Abdulali, “The Bias Ratio™: Measuring the Shape of Fraud” (2006).

⁴¹ Note: We apologize to the reader for the long quotation summarizing Ljungqvist, Malloy, and Marston’s results rather than simply summarizing them. Thomson has been quite litigious regarding the issues researched and discussed by Ljungqvist, et al.

Comparing two snapshots of the entire historical I/B/E/S database of research analyst stock recommendations, taken in 2002 and 2004 but each covering the same time period 1993-2002, we identify tens of thousands of changes which collectively call into question the principle of replicability of empirical research. The changes are of four types: 1) The non-random removal of 19,904 analyst names from historic recommendations (“anonymizations”); 2) the addition of 19,204 new records that were not previously part of the database; 3) the removal of 4,923 records that had been in the data; and 4) alterations to 10,698 historical recommendation levels. In total, we document 54,729 ex post changes to a database originally containing 280,463 observations. (p. 1).

As of February 2007, Thomson Financial’s position is that “changes to Recommendation History have occurred as part of necessary processes and maintenance.” Previously, Thomson had indicated that the anonymizations were the result of three software glitches. The first produced incorrect start and end dates for some analysts’ employment histories. The second caused selective ticker histories for certain analysts to be anonymized, in connection with attempts to consolidate duplicate analyst identifiers. The third, which can still occur, results in recommendations being attributed to an analyst who has departed; subsequent corrections involve anonymizing such recommendations. (fnt. 1 p. 2)

Ljungqvist, Malloy, and Marston (2007) continue:

At the recommendation level, the collective effect of the changes is to make the overall distribution of historic recommendations issued for U.S. companies between October 1993 and July 2002 appear more conservative in 2004 than it did in 2002, with considerably fewer strong buys and buys, and more holds, sells, and strong sells. (p. 2)

Broker-level [data], which can be used to predict the profitability of stock recommendations (Barber et al. (2006)) change even more dramatically. One reason why these findings are important is that the apparently optimistic bias in the historical distribution of recommendations was a frequently cited impetus to the regulatory proceedings that culminated in the Global Research Analyst Settlement of 2003 between New York attorney general Eliot Spitzer, the SEC, NASD, NYSE, North American Securities Administrators Association, state regulators, and twelve brokerage firms. (p. 3) . . .

Similarly, the changes impact the implementation of popular trading strategies based on analyst consensus recommendations . . . A simple trading strategy that buys stocks in the top consensus change quintile and shorts stocks in the lowest quintile each month performs 15.9% to 42.4% better on the 2004 tape than on the 2002 tape, suggesting that the changes to the I/B/E/S database have resulted in the appearance of more profitable analyst research.

Track records of individual analysts are also affected . . . Among the group of analysts with anonymized recommendations, we find that abnormal returns following subsequently anonymized upgrades-to-buy are significantly lower than are abnormal returns following upgrades by the same analysts that remained untouched. The return differential is large, ranging from 3.6% to 4.0% p.a. over the 1993-2002 period. It is even larger in the most recent, post-bubble period (as high as 7.4% p.a.), and for the sub-sample of bolder recommendations (5.2% and 9.1% p.a. in the full-sample and post-bubble periods, respectively).

Analysts whose track records are affected are associated with more favorable career outcomes over the 2003-2005 period than their track records and abilities would otherwise warrant. Following the career path modeling in Hong, Kubik, and Solomon (2000) closely, we find that analysts associated with anonymizations experience a more than 60% increase in the likelihood of subsequently moving from a low-status to a high-status brokerage firm. This effect is much larger than any other in our career outcome models. The magnitude of the effect of additions on career outcomes is also large, boosting the likelihood by more than 40%. Similarly, analysts are more likely to be rated the top stock picker in their sectors by the Wall Street Journal, which relies on Thomson Financial data, if some of their recommendations have been dropped or added.

Collectively, our findings raise serious doubts about the replicability of past, current, and future studies using the I/B/E/S historical recommendations database. (pp. 3-5)

9. COLLUSION BETWEEN ANALYSTS AND FIRMS?

Hutton's (2004) study of firms' audits of analysts' spreadsheet earnings models result in the following:

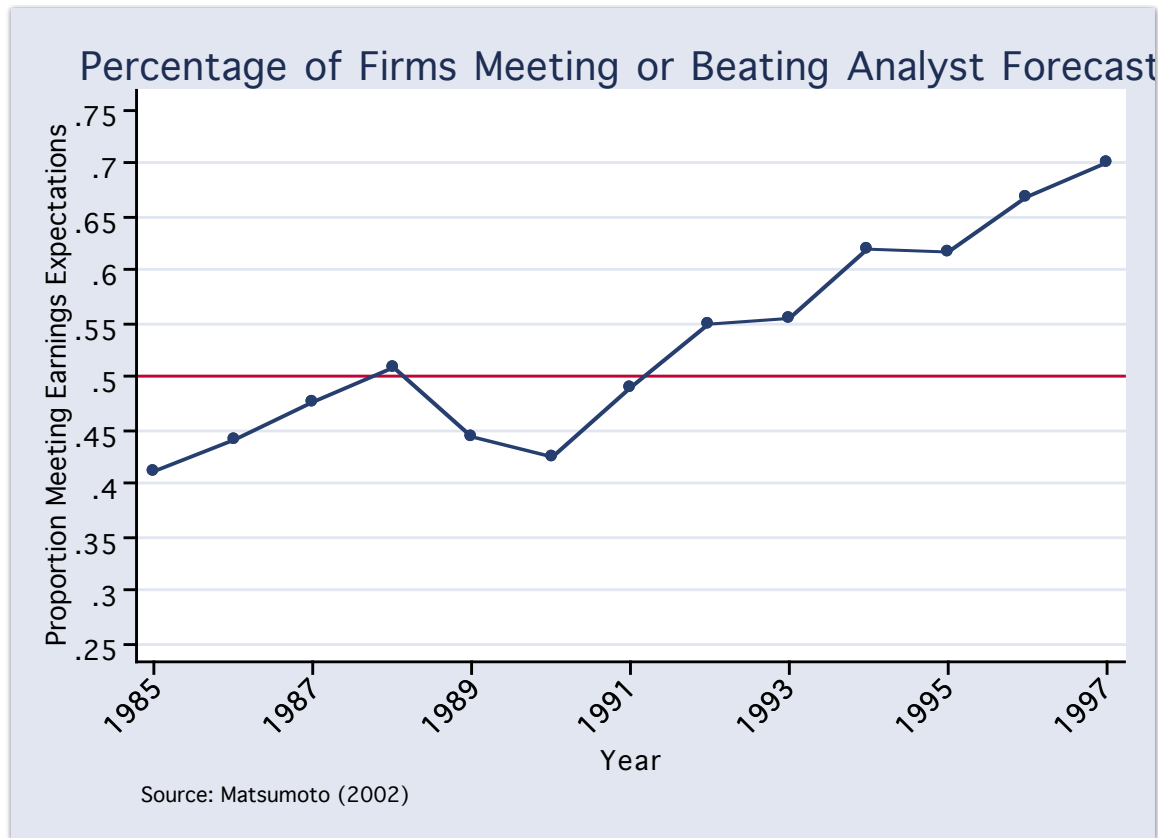
Of 421 firms responding to the NIRI 2001 survey, 85.5% reviewed analysts' models (she labeled these "guidance firms"). These analysts showed more accurate forecasts in the sense of lower mean squared errors. But, these analysts' forecasts were systematically downward biased therefore yielding systematic positive earnings surprises.

Analysts of the no-guidance firms walk down their estimated earnings in response to negative earnings surprises (47% with 3 to 4 quarters of negative earnings news) during the year.

However, analysts of the guidance firms walk down their earnings estimates even though 49% of the firms have 3 to 4 quarters of positive earnings news. This walk-down gives management a year-end boost and indicates a positive beginning-of-year bias. The walk-down practice is consistent with the hypothesis that these analysts ended up issuing forecasts that resulted in systematically positive earnings surprises so as to incur favor with the management team. If this hypothesis is correct, then in return for such positive earnings surprises, analysts receive favors from management that enable them to make more "accurate" (although more biased) forecasts.

Matsumoto (2002) (see [Fig. 4](#) below) and Bartov, Givoly and Hayn (2002) document that the managing earnings game seems to have arisen in the mid-1990s. They find that over the period from 1983-93 to the period 1994-97, the proportion of:

- Negative end-of-quarter earnings surprises fall from 48% to 31%
- Positive end-of-quarter earnings surprises increase from 40% to 50%
- Zero earnings surprises increase from 12% to 19%
- The upward bias in the 1-quarter ahead forecast increased
- A 3% premium return arose for meeting or beating analyst forecasts at the end of quarter
- A small penalty for negative revisions of forecast during quarter arose

Fig. 4: The Managing Earnings Game Seems To Have Arisen in the Mid 1990's

10. THE PECULIAR EQUILIBRIUM BETWEEN ANALYSTS AND FIRMS

Analysts' long-run (12-month ahead) forecasts are systematically biased high. These forecasts are then walked down so that at the realization date they are systematically low. See Figure 5. In this situation investors appear to get taken (fooled) in both cases (as indicated by the positively biased forecasts at the beginning of the period and the walk down to the negatively biased forecasts at the end of the period). On the face of it this seems highly inconsistent.

One potential hypothesis to explain this inconsistency is that analysts appear to be colluding with managers to allow those managers to have the benefits of excessively high long-term forecasts while also allowing the managers to meet or beat the short-run forecasts at the end of the quarter. But it seems impossible for effective collusion to take place amongst so many players.

Fig. 5: Analysts issue optimistic earnings forecasts and then “walk down” these estimates to a level firms can beat at the official earnings announcement

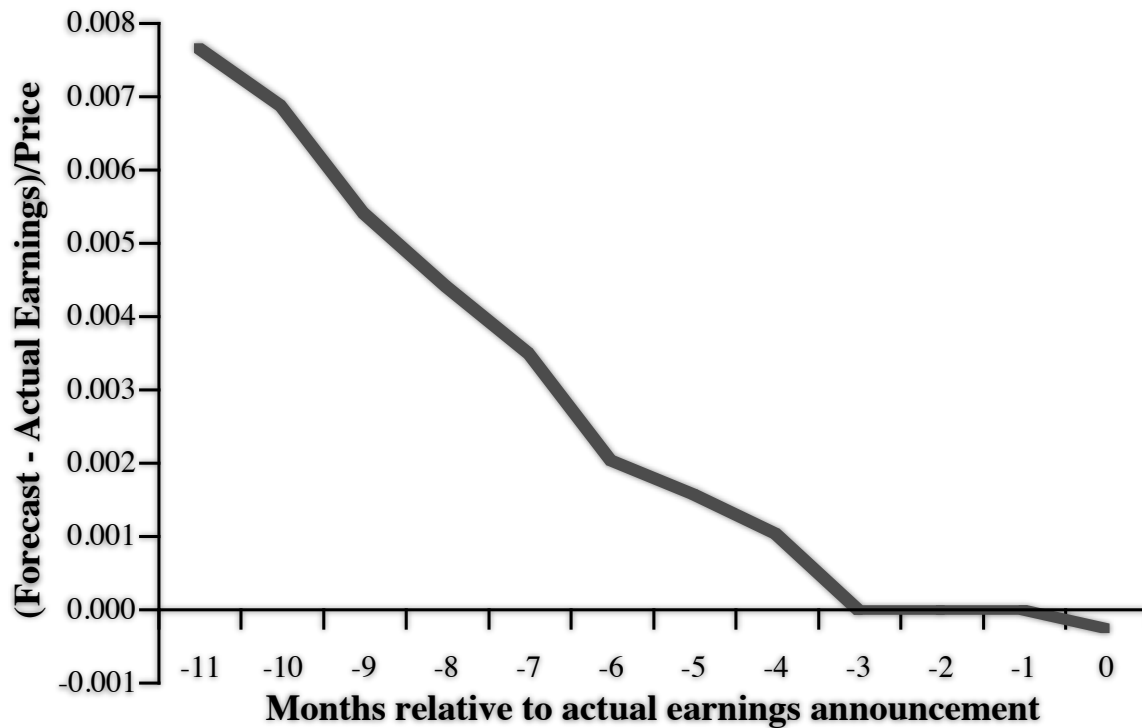


Figure 5 is based on aggregate 1984-2001 data from Richardson, Teoh, and Wysocki (2004) (provided by the authors), and shows the median difference of the forecast earnings per share and actual earnings per share, scaled by the prior-year share price. The sample consists of all individual analyst forecasts for firms with data on both I/B/E/S and Compustat, and shows that the median consensus analyst forecast is initially positively biased, but that analysts walk down these forecasts each month. By the month of the actual earnings announcement, the median consensus forecast is negatively (and statistically significantly) biased; that is, the median company reports earnings slightly exceeding the year-end analyst forecast.

a. The Walk Down Results from Management Pressure and Analyst Self Selection

One explanation of this peculiar phenomenon is as follows: Suppose management imposes costs on analysts who are pessimistic (or not sufficiently optimistic) about the future results of the firm. Suppose such analysts opt out of reporting their bad news on companies (without announcing why they opt out), or perhaps they drop their coverage of the firm completely. McNichols and O'Brien (1997) provide an intuitively appealing explanation of this hypothesis and present evidence that the observed phenomenon is not due to analysts making systematically biased estimates but rather due to analysts that self-select out of reporting bad news on companies.

If there is a range of analyst opinions about a company in any given month, and the analysts with the most negative opinions or information systematically choose not to offer a report, the

resulting consensus opinion (consisting only of analysts who actually report) will be upward biased, even if each reporting analyst is unbiased in his or her opinion.

Analysts with the negative opinions may well opt out of, or delay issuing a recommendation until late in the period (and may drop their coverage of a stock entirely) to avoid the negative repercussions from management and others who are long the stock of the company. It is well known, for example, that analysts seldom issue sell recommendations and frequently delay issuance of reports downgrading a firm. The fact that analysts seldom issue sell recommendations and often delay downgrades of a firm is consistent with this hypothesis that analysts with negative opinions delay issuing their forecasts (or do not issue them at all) to avoid offending management. The resulting consensus forecast is then biased upward.⁴² Consistent with this hypothesis, Skinner & Sloan (2002) conclude: “Analysts’ long run EPS forecasts are systematically overoptimistic for growth firms, and . . . [this] is systematically related to the inferior stock price performance of growth firms”). See also Dechow, Hutton and Sloan (1999, Abstract) who conclude:

“ . . . sell-side analysts’ long-term growth forecasts are systematically overly optimistic around equity offerings and that analysts employed by the lead managers of the offerings make the most optimistic growth forecasts. Additionally, we find a positive relation between the fees paid to the affiliated analysts’ employers and the level of the affiliated analysts’ growth forecasts. We also document that the post-offering under performance is most pronounced for firms with the highest growth forecasts made by affiliated analysts.”

These facts are consistent with a system that is out of integrity and thereby destroys value. In this case the managers that punish analysts who publish accurate but negative (or less positive) forecasts or recommendations are out of integrity because the actions of such managers are not consistent with the expectation (unexpressed request) of holders of the firm’s securities that management provide the market with accurate and unbiased financial reports on the firm’s performance.

11. MORE EVIDENCE THAT BOTH MANAGERS AND ANALYSTS MANIPULATE EARNINGS

- Marquardt and Wiedman (2002) find that managers use accruals to manage earnings either up or down in situations to fit their own interests. At times of equity issues firms use accruals to increase earnings and therefore stock price. On the other hand in management buyout situations firms use accruals to *decrease* earnings and therefore stock price.
- The frequency of small quarterly profits is unusually large and the frequency of small losses is unusually small. And so too for small increases and decreases in profits. Burgstahler and Dichev (1997)
- Managers change real operating decisions such as reducing research and development or advertising expenditures to meet benchmarks. See Dechow and Sloan (1991), Bushee, (1998), Graham, Harvey, and Rajgopal (2005), and Rowchowdhury (2004)

⁴² See McNichols & O’Brien (1997)

- Managers manipulate earnings upward around new equity offerings. Teoh, Welch & Wong (1998), and Rangan (1998), Darrough & Rangan (2005)
- Systematically overly optimistic analyst long-term growth forecasts around equity offerings are associated with the largest post IPO under performance. Rajan & Servaes (1997)
- Myers, Myers and Skinner (2005) find huge numbers of firms with consecutive strings of quarterly EPS non-decreases relative to the expected number. They “find evidence consistent with the hypothesis that managers of sample firms take actions to (i) increase reported EPS when EPS would otherwise decline, and (ii) decrease reported EPS when EPS would otherwise increase by more than necessary to record an increase”. Their evidence indicates this is done by strategically reporting special items, strategically timing stock repurchases, and exercising discretion over accounting for taxes to smooth changes in EPS. They conclude: “. . . of all Compustat firms with at least 40 quarters of available data, 811 firms report earnings strings of at least 20 quarters; the corresponding expected [number of firms] varies between 28 and 71, again depending on the [assumed time series] model [generating quarterly earnings]. (p. 16)

12. IN CONCLUSION

We argue that the financial economics paradigm is incomplete. The evidence for *any* paradigm being incomplete is the presence of a significant continuing breakdown in the discipline, along with the discipline’s continuing ineffectiveness in dealing with that breakdown (what Kuhn (1962, 2012) termed “crises and anomalies” in a discipline). In the world of finance, the combination of 1) the extent of out-of-integrity behavior and its consequent impact on value, coupled with 2) the financial economics discipline having provided little or nothing that has been effective in stemming this out-of-integrity behavior, is evidence for our argument that the financial economics paradigm is incomplete.

The out-of-integrity behavior we termed the “scandals” in Section 2 and the various examples of out-of-integrity behavior discussed in Sections 3 through 11 (mostly unrecognized as out-of-integrity behavior) are important examples of what contributes to the general atmosphere of low integrity in the world of finance (albeit not identified as such and certainly not spoken of). Out-of-integrity behavior has become virtually institutionalized. The environment of low integrity is so pervasive it seems to be nothing more than business as usual, or just a part of the nature of finance. Forstmoser’s (2006) first three indicators of the lack of integrity (listed in [Section 6.b](#), p. 39) “Everyone else is doing it.”, “We’ve always done it.”, and “This is the way this business works.” illustrate this environment.

When we speak of “integrity”, in the case of a system (or object) we mean nothing more than but nothing less than that the design, the implementation of the design, and the use of the system (or object) are whole, complete, unbroken, sound, in perfect condition with respect to its intended purpose. When we speak of integrity for a person or other human entity, we mean nothing more than but nothing less than that the word (as defined earlier) of the person or other human entity is whole, complete, unbroken, sound, in perfect condition. We have shown that integrity dealt with in this way is an important factor of production.

However, integrity as it is currently understood has been undistinguished as a factor of production, with the result that its impact on workability, and therefore productivity and value (by its presence or absence) has been wrongfully assigned to other causes. Integrity, as we define it, matters. Not because it is virtuous, but because it creates *workability*. And workability increases the *opportunity for performance*, and maximum workability is necessary for realizing maximum *value*.

Note that describing the effects of integrity is not normative. In addition, we make no admonition to act with integrity; it doesn't work to tell people what they should do. People act in what they *perceive* to be in their self-interest in the way it *shows up for them* in the circumstances they are dealing with or are confronted by. We don't tell people what to do, rather we give a picture of reality (in this case a picture of the reality of integrity revealed as a positive phenomenon) that naturally alters their correlated behavior.

As the Law of Integrity states: As the integrity (the state of being whole and complete, etc.) of an object, system, person, or other human entity or practice declines, workability declines, and as workability declines the opportunity for performance declines. Note however that when the behavior is not recognized as out of integrity, the decline in the opportunity for performance will be *explained* in some other way.

The model of integrity introduced in this paper makes clear just how widespread out-of-integrity behavior actually is, and the enormity of the cost of out-of-integrity behavior. The model also makes clear that given the way integrity is currently understood, our out-of-integrity behavior does not occur for us as such, and as a result we ascribe the cause of the damage of out-of-integrity behavior to something other than our out-of-integrity behavior. But the recognition of the foregoing is only a *beginning* for persons, groups, and organizations to have access to acting with integrity.

From within our new model of integrity when it is fully understood, integrity occurs for people (is understood by people, shows up for people) such that:

- 1) out-of-integrity behavior actually shows up for people *as* out-of-integrity behavior, but most importantly,
- 2) the damaging consequences of that behavior, whether immediate or long term, show up in present time right *along with* the out-of-integrity behavior, and
- 3) the damaging consequences show up as being *caused* by the out-of-integrity behavior.

This shift in the showing up profoundly alters the way out-of-integrity behavior occurs or shows up for people. As we have said, people with normal brains act in what appears to them to be in their self-interest, but in their self-interest given the way in which what they are dealing with occurs or shows up for them.

Our purpose here has been to show that including integrity as a purely positive phenomenon, and as such an important factor of production in the paradigm of financial economics, would allow financial economics scholars to develop the tools to effectively deal with the "crises and anomalies" of the value destroying out-of-integrity behavior in the world of finance, and ultimately to transform the culture of finance to be one of integrity.

What makes this addition to the current financial economics paradigm challenging for most professionals is that the "proof" of a paradigm is the "testing" of it in practice, rather than in the a priori theoretical proof of it. While the proposition that "as integrity (whole and complete)

decreases, workability decreases” is unmistakably valid, the proposition that “any diminution in the integrity (wholeness and completeness) of an individual’s or other human entity’s word results in a diminution of workability for that individual or entity” is a heuristic. It just works. When *that it actually works in practice* becomes a clear-cut personal discovery, that naturally alters future behavior.

13. APPENDIX 1: A CONTINUING SERIES OF SCANDALS IN FINANCE

There has been a continuing stream of scandals in the financial sector in the last 10 years (all involving out-of-integrity behavior) that has imposed huge costs on the entities that have been the source of the out-of-integrity behavior as well as other organizations and individuals who were merely customers, associates, or bystanders in these events. These continuing scandals have played a non-trivial role in the world-wide decline in business conditions, steep financial losses in the private sector, massive government bailouts of financial institutions and continuing high unemployment or underemployment in many areas of the world. What follows is an incomplete listing and brief description of some of the major recent scandals.

a. The Goldman Sachs Abacus 2007-AC1 Mortgage Backed Securities

In 2007 Goldman Sachs created its Abacus 2007-AC1 \$2 billion Synthetic CDS (credit default swap) issue of mortgage backed securities product in which the actual mortgage securities incorporated in Abacus were selected by Paulson and Company who intended to short the Abacus securities. The pitch book indicated the securities in the vehicle were selected by ACA Capital which had contracted to manage the vehicle. Paulson and Company paid millions of dollars to Goldman to create the vehicle so Paulson could sell it short. See also Section 5.b page 35 for a discussion of Goldman's actions in the Abacus deal in the context of Gregg Smith's highly controversial NY Times Op Ed letter of resignation.

The majority of the mortgages in the deal defaulted within six months of its issue, leading to losses of more than a billion dollars to clients that Goldman knowingly sold the deal to. On July 15, 2010 Goldman paid a then record \$550 million to settle SEC charges related to the Abacus subprime mortgage CDS and acknowledged that Goldman should have revealed Paulson's role in selecting the securities in the deal. See Securities and Exchange Commission (2011) for details on the settlement. Importantly, Goldman's actions in this case violated 7 of Goldman's 13 business principles as they are published on Goldman's web site.⁴³ Note these principles are formally Goldman's *word* to its clients, employees and others. As *Time Magazine* [Gustin(2013)] summarized the case on the conviction of the Goldman Sachs bond trader: "Not So 'Fabulous' Fab: Ex-Goldman Sachs Trader Fabrice Tourre Found Liable for Fraud": Tourre became a symbol of Wall Street hubris after boasting that he sold toxic mortgage assets to 'widows and orphans':

"Fabrice Tourre, a former Goldman Sachs bond trader known for his colorful nickname 'Fabulous Fab,' was found liable for fraud . . . for his role in a failed mortgage deal that cost investors \$1 billion in a debacle that foreshadowed the financial crisis. The verdict represents the most high-profile court victory related to the subprime mortgage meltdown for the Securities and Exchange Commission, which has faced criticism for failing to hold Wall Street bankers accountable for their role in creating the complex financial products that helped plunge the U.S. into the worst recession in decades.

Tourre was found liable on six of seven SEC fraud charges after a nine-member jury deliberated for two days at the conclusion of a civil trial in Manhattan federal court. In the case, U.S. regulators portrayed the French-born Tourre as a poster-boy for Wall Street greed and bad

⁴³ See the Appendix to the following presentation (Erhard and Jensen 2011, "A Value-Free' Approach to Values" at <http://ssrn.com/abstract=1640302>) for a discussion of the Goldman Sachs Abacus 2007-AC1 CDS mortgage backed securities fiasco.

behavior. Tourre's attorneys, meanwhile, insisted that their client was little more than an innocent scapegoat."

b. JP Morgan Chase & Co. Sued on Mortgage Backed Securities

The New York attorney general filed suit in NY state court alleging widespread fraud in the packaging and sale of mortgage backed securities that failed and generated \$22.5 billions of losses to the investors in those securities issued by Bear Stearns & Company in 2006 and 2007 before Bear Stearns nearly collapsed and was taken over by JP Morgan.

"The lawsuit quotes from emails and messages purportedly sent within Bear Stearns that it says showed the bank was aware it was selling poor quality investments. In one, a Bear Stearns employee described one securitization in an internal email as a "sack of s***," according to the lawsuit."⁴⁴

The suit argues that Bear Stearns knew these mortgage backed securities would fail and indeed, the losses on the mortgage-backed securities were "astounding", totaling more than 25% of the original principal balance. The suit asks that the company be made to pay damages "caused, directly or indirectly, by the fraudulent and deceptive acts." This conflict is remarkably similar to the difficulties created by Goldman Sachs in the structuring and sale of the Abacus mortgage backed securities discussed directly above in Section 4.a in the text.

c. Mortgage Backed Securities: Summary

On August 22, Scannell and Hall (2014) reported in the *Financial Times* the largest bank settlements with the U. S. Government related to "mis-selling mortgage securities", foreclosure abuses, and repurchases of loans sold to the government.

Bank of America (Aug. 2014) \$16.7 billion,

JP Morgan (Nov. 2013) \$13.0 billion

Bank of America (Feb. 2012) \$11.8 billion

Bank of America (Jan. 2013) \$11.6 billion

Bank of America (Mar. 2014) \$9.3 billion

The record speaks for itself on the lack of integrity. Bank of America "... admitted to 'repeated failures in its duty to disclose to investors the poor quality of mortgages that were packaged and sold in securities by BofA, and Countrywide and Merrill Lynch, both of which it acquired in 2008 during the financial crisis.'⁴⁵

⁴⁴ Eaglesham and Fitzpatrick (2012)

⁴⁵ Scannell and Hall (2014, p. 1)

d. The Bernard Madoff Ponzi Scheme

On Dec. 10, 2008 Bernard Madoff admitted to his sons that the asset management arm of his firm was a Ponzi Scheme. "On March 12, 2009, Madoff plead guilty to 11 federal crimes, including securities fraud, wire fraud, mail fraud, money laundering, perjury, and falsifying files with the SEC. Refusing to name accomplices, he claimed sole responsibility for the Ponzi scheme and defrauding his clients of \$65 billion. ... Former SEC Chairman Harvey Pitt estimated the actual net fraud to be between \$10 and \$17 billion. (Note this calculation does not include the fictional returns Madoff credited to his customer accounts.) Prosecutors identified \$13.2 billion in losses in accounts opened since 1996."⁴⁶ He was sentenced to 150 years in prison. It is noteworthy that Madoff was Chairman of the Board of Directors and on the Board of Governors of the National Association of Securities Dealers (NASD). That indicates something about the integrity of those organizations.

e. Mathew Martoma Sentenced to Nine Years in Prison

On December 8, 2014, Mathews (2014) reported the following for the *Wall Street Journal*:

Mathew Martoma, who worked for hedge-fund billionaire Steven A. Cohen, was sentenced to nine years in prison Monday for taking part in what prosecutors said was one of the largest insider-trading schemes ever. ... U.S. District Judge Paul Gardephe handed down the sentence, saying Mr. Martoma's crime was as brazen as it was lucrative and that there is a "darker side to his character. ...

Mr. Martoma is the eighth SAC employee convicted of insider trading. Most have chosen to plead guilty rather than contest the charges. SAC itself pleaded guilty in November to criminal insider-trading charges and agreed to pay about \$1.2 billion in new penalties. As part of the settlement, the firm said it would stop managing outside money. SAC has since changed its name to Point72 Asset Management. ...

The past decade has seen a burst of insider-trading prosecutions. The surge is largely the product of a crackdown by the office of Manhattan U.S. Attorney Preet Bharara, who has charged 89 people with insider trading since 2009 and secured 81 convictions or guilty pleas. A handful of cases remain unresolved. The uptick has also coincided with a sharp increase in the length of jail terms for those convicted. In New York federal courts, which handle the bulk of such prosecutions, the average length of a prison sentence for insider trading is up 135% in the past decade.

Mr. Martoma, who worked at SAC for four years until he was fired in 2010, was accused of using inside information provided by two doctors about results of a trial of an Alzheimer's drug being developed by Elan Corp. and Wyeth Pharmaceuticals. Both doctors testified they passed inside tips on drug tests to Mr. Martoma. Elan is now part of Perrigo Co., and Wyeth is part of Pfizer Inc.

Mr. Martoma opted to go to trial even after prosecutors sought his cooperation against Mr. Cohen, who was involved in some of the trades Mr. Martoma was ultimately charged for, according to people familiar with the matter. The move could potentially have earned him leniency.

The jury convicted Mr. Martoma of two counts of securities fraud and one count of conspiracy in February.

⁴⁶ Source: Jewish Virtual Library: Bernard Madoff.
https://www.jewishvirtuallibrary.org/jsource/biography/Bernard_Madoff.html Accessed Feb 26, 2013.

For those interested in more about SAC (now renamed Point72 Asset Management) and Steven Cohen see “Why SAC Capital’s Steven Cohen Isn’t In Jail” by Sheelah Kolhatkar (2014), <http://www.businessweek.com/articles/2014-01-02/why-sac-capitals-steven-cohen-isnt-in-jail>

f. HSBC Violation of Money Laundering Laws

In December, 2012 HSBC, the global UK bank agreed to pay a record \$1.9 billion in U.S. penalties for violations of money laundering laws in its dealings with various questionable and criminal enterprises.

The Department of Justice and U.S. Treasury said Tuesday that HSBC allowed the most notorious international drug cartels to launder billions of dollars across borders. In addition, the government said HSBC violated U.S. sanctions for years by illegally conducting transactions on behalf of customers in Iran, Libya, Cuba, Sudan and Burma.

At a news conference in Brooklyn, N.Y., Assistant Attorney General Lanny Breuer said the settlement concluded a five-year investigation in which the department reviewed 9 million documents.

"HSBC is being held accountable for stunning failures of oversight," said Breuer in a department statement. "The record of dysfunction that prevailed at HSBC for many years was astonishing."

HSBC CEO Stuart Gulliver accepted responsibility for the banks' mistakes. "We have said we are profoundly sorry for them, and we do so again," Gulliver said in a statement.

The deal includes a deferred prosecution agreement with the Department of Justice. No charges will be brought against the bank provided certain conditions are met. Breuer didn't rule out individual prosecutions.

As part of the settlement, HSBC is required to take actions to strengthen its compliance policies and procedures. HSBC has also replaced its senior management, and "clawed back" deferred compensation bonuses given to its most senior officers in the money laundering compliance division. . . ."

In Mexico, HSBC became the preferred bank for drug cartels and money launderers, according to the Justice Department. The government said the bank didn't raise red flags even when billions of dollars in transactions took place in cash, the typical mode of operation for drug dealers.

Between 2006 and 2009, according to DOJ, HSBC failed to monitor \$670 billion in wire transfers and \$9.4 billion in cash transactions from its Mexico bank operations.

Because of these failures, at least \$881 million in drug trafficking money -- including those of the Sinaloa Cartel of Mexico and the Norte del Valle Cartel of Colombia --

were laundered through HSBC, according to Justice.

The DOJ said HSBC also helped process \$660 million in prohibited transactions from Iran, Cuba, Sudan, Libya and Burma by deliberately hiding the identities of these countries.

Record fines: 'New normal' for banks?

The London-based **HSBC** joins a long list of financial institutions that have faced scrutiny from U.S. regulators over allegedly illicit money transfers, but the size of its combined settlement with eight different U.S. authorities is unprecedented.

U.K. bank **Standard Chartered** agreed Monday to pay \$327 million to settle charges that it violated international sanctions on transactions with Iran, Burma, Libya and Sudan.

In June, Dutch bank **ING** agreed to pay a \$619 million penalty for moving billions of dollars through the U.S. financial system at the behest of Cuban and Iranian clients.

Back in 2010, Wachovia Bank paid \$160 million to resolve allegations that its weak internal controls allowed Mexican cartels to launder millions of dollars worth of drug proceeds. Wells Fargo bought Wachovia in 2008.

And Swiss bank Credit Suisse paid \$536 million in 2009 to settle U.S. claims concerning business with Iran and other countries.

While HSBC's penalty dwarfs these other settlements, it's still just a fraction of the \$16.8 billion in profits the bank recorded globally last year.⁴⁷

As part of the agreement, the bank will admit to violating the Bank Secrecy Act, the Trading with the Enemy Act and other U.S. laws intended to prohibit money laundering, a government official said. . . .

The report by the Senate Permanent Subcommittee on Investigations detailed a regulatory culture at HSBC that shocked even its own employees, according to testimony provided to the committee and at a hearing.

Senate investigators concluded HSBC did little to clean up operations that should have raised concerns. HSBC's Mexico bank had a branch in the Cayman Islands that had no offices or staff but held 50,000 client accounts and \$2.1 billion in 2008, the report said.

What is this, the School of Low Expectations Banking?" one HSBC Latin America compliance official wrote in a complaint about the practices at HSBC Mexico, according to the Senate report. The HSBC official said the Mexico bank's antimoney-laundering committee 'can't keep rubber-stamping unacceptable risks because someone on the business side writes a nice letter. ... We have seen this movie before, and it ends badly.'

In 2010 Wachovia Bank paid \$160 million to settle similar Justice Department

⁴⁷ O'Toole and Riley (2013)

charges.⁴⁸

g. Manipulation and Rigging of the LIBOR Interest Rate Benchmark

LIBOR is the London Interbank Offered Rate. This interest rate, set by submissions of borrowing rates by a dozen banks, plays a major role in determining the interest rate on “\$750 trillion worth of financial products, including mortgages, credit cards and student loans as well as to set the prices of vast amounts of derivatives being traded.”⁴⁹

The *New York Times* (2013) reports that:

In 2012, Libor became the center of one of the biggest financial scandals in recent years, as investigators in the United States and Britain focused on possible criminal wrongdoing by a number of the world’s biggest banks over the manipulation of Libor. Questions have also been raised about the failure of regulators in both countries to stop the practice, despite evidence that both the Bank of England and the Federal Reserve of New York were aware of it.

The scandal came to light in late June 2012, when Barclays, the British financial giant, agreed to pay \$450 million to settle accusations by American and British authorities that some of its traders attempted to manipulate Libor rates to bolster profits. Authorities also accused Barclays of submitting low rates to deflect concerns about its health during the financial crisis. The scandal prompted the resignations of top bank officials, including the chief executive, Robert E. Diamond Jr.

Protest and Scott (2012) report that: “In the Barclays case, regulators say they uncovered “pervasive” wrongdoing that spanned a four-year period and touched top rungs of the firm, including members of senior management and traders stationed in London, New York and Tokyo. A 45-page complaint laid bare the scheme that unfolded from 2005 to 2009, describing how Barclays had made false reports with the aim of manipulating rates to increase the bank’s profits. Barclays was also accused of “aiding attempts by other banks to manipulate” Euribor. . . .

The practice of submitting false numbers prompted unease among some employees, who worried the bank was “being dishonest by definition.

Amid speculation that the bank was struggling to raise money, Barclays’ senior management asked employees to lower the rates submitted to the Libor committee, according to the regulatory filings. Management wanted the bank’s rates in line with rivals. Senior Barclays executives instructed employees not to put your “head above the parapet.” Some employees resisted, but eventually followed orders from top executives, according to regulatory documents. One concerned employee called the rates “patently false.

On July 1, 2012 The Telegraph⁵⁰ newspaper published an article authored by an employee at a large British bank (not Barclays) entitled: “Libor scandal: How I Manipulated the Bank Borrowing Rate”. The Telegraph’s introduction to the article is as follows:

An anonymous insider from one of Britain’s biggest lenders – aside from Barclays – explains how he and his colleagues helped manipulate the UK’s bank borrowing rate. Neither the insider nor the bank can be identified for legal reasons.

⁴⁸ Barrett and Perez (2012).

⁴⁹ New York Times (2013)

⁵⁰ See Anonymous Insider, Telegraph (2012).

<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9368430/Libor-scandal-How-I-manipulated-the-bank-borrowing-rate.html>

In the insider's own words, he goes on to explain as follows:

It was during a weekly economic briefing at the bank in early 2008 that I first heard the phrase. A sterling swaps trader told the assembled economists and managers: "Libor was dislocated with itself". It sounded so nonsensical that, at first, it just confused everyone, and provoked a little laughter.

Before long, though, I was drawing up presentations to explain the "dislocation of Libor from itself" for corporate relationship managers. I was deciphering the subject in emails, internally and externally. And I was using the phrase myself openly with customers of the bank.

What I was explaining was that the bank was manipulating Libor. Only I didn't see it like that at the time.

What the trader told us was that the bank could not be seen to be borrowing at high rates, so we were putting in low Libor submissions, the same as everyone. How could we do that? Easy. The British Bankers' Association, which compiled Libor, asked for a rate submission but there were no checks. The trader said there was a general acceptance that you lowered the price a few basis points each day.

According to the trader, "everyone knew" and "everyone was doing it". There was no implication of illegality. After all, there were 20 to 30 people in the room – from management to economists, structuring teams to salespeople – and more on the teleconference dial-in from across the country.

The discussion was so open the behavior seemed above board. In no sense was this a clandestine gathering.

Looking back, I now feel ashamed by my naivety. Had I realized what was going on, I would have blown the whistle. But the openness alone suggested no collusion or secrecy. Management had been in the meeting, and so many areas of the Treasury division of the bank represented, that this was clearly no surprise or secret.

As an aside, notice in this excellent example how the “occurring” shaped how the situation showed up for this person – how a patently illegal act showed up as something that was perfectly honest and upstanding. And as we have said, when the occurring shifts, behavior shifts to be consistent with it.

In December of 2012, the Swiss bank UBS, paid record total fines of \$1.5 billion “for its role in a multiyear scheme to manipulate interest rates”, its Japanese subsidiary plead guilty to a charge of felony wire fraud, and the Justice Department “filed criminal charges against two former UBS traders”. On December 19, 2012 Mark Scott and Ben Protess (2012) writing for DealBook reported the following:

The cash penalties represented the largest fines to date related to the rate-rigging inquiry. The fine is also one of the biggest sanctions that American and British authorities have ever levied against a financial institution, falling just short of the \$1.9 billion payout that HSBC made last week over money laundering accusations.

The severity of the UBS penalties, authorities said, reflected the extent of the problems. The government complaints laid bare a scheme that spanned from at least 2001 to 2010, describing how the bank reported false rates to squeeze out extra profits and deflect concerns about its health during the financial crisis. The Commodity Futures Trading Commission, the American regulator leading the case, cited more than 2,000 instances of illegal acts involving dozens of UBS employees.

The findings we have set out in our notice today do not make for pretty reading,” Tracey McDermott, enforcement director for the Financial Services Authority of Britain, said in a statement. “The integrity of benchmarks,” she said, “are of fundamental importance to both U.K. and international financial markets. UBS traders and managers ignored this.

The UBS case reflects a pattern of abuse that authorities have uncovered as part of a multi-year investigation into rate-rigging. The inquiry, which has ensnared more than a dozen big banks, is focused on key benchmarks like the London interbank offered rate, or Libor.⁵¹

The New York Times (2013) reports: “Canadian, Swiss and Asian authorities as well as the Justice Department, the Commodity Futures Trading Commission and Britain’s Financial Services Authority are investigating more than a dozen banks. Along with UBS, the futures commission was focused on potential wrongdoing at two American banks, Citigroup and JPMorgan Chase, officials said. HSBC was also under scrutiny.

As the Justice Department announced its case against UBS, prosecutors also took aim at two former UBS traders at the center of the rate-rigging scheme . . . the Justice Department charged Tom Hayes⁵² and Roger Darin with conspiracy to commit wire fraud. Mr. Hayes also faces an additional count of wire fraud and another related to price fixing. “By causing UBS and other financial institutions to spread false and misleading information,” Attorney General Eric Holder said in a statement, “these alleged conspirators – and others at UBS – manipulated the benchmark interest rate upon which many consumer financial products – including credit cards, student loans, and mortgages – are frequently based.”⁵³

J.R. (2013) writing for the Dec. 19, 2012 *Economist* column, “Schumpeter: Business and Management” summarizes some of what was unfolding in the manipulation of LIBOR and EURIBOR interest rates in his column entitled “Horribly Rotten, Comically Stupid” as follows:

For any who doubted whether there was honour among thieves, or indeed among investment bankers, solace may be found in the details of a settlement between UBS, a Swiss bank, and regulators around the world over a vast and troubling conspiracy by some of its employees to rig LIBOR and EURIBOR, key market interest rates. Regulators in Britain and Switzerland have argued that manipulation of interest rates that took place over a long period of time, involved many employees at UBS and that, according to Britain’s Financial Service Authority, was so “routine and widespread” that “every LIBOR and EURIBOR submission, in currencies and tenors in which UBS traded during the relevant period, was at risk of having been improperly influenced to benefit derivatives trading positions.

. . .

Yet, even in the midst of this wrongdoing there was evidence of a sense of honour, however misplaced. One banker at UBS, in asking a broker to help manipulate submissions, promised ample recompense:

I will f..king do one humongous deal with you ... Like a 50,000 buck deal, whatever. I need you to keep it as low as possible ... if you do that ... I’ll pay you, you know, 50,000 dollars, 100,000 dollars ... whatever you want ... I’m a man of my word.

Further hints emerge of the warped morality that was held by some UBS employees and their conspirators at brokers and rival banks. In one telling conversation an unnamed broker asks an employee at another bank to submit a false bid at the request of a UBS trader. Lest the good turn go unnoticed the broker reassures the banker that he will pass on word of the manipulation to UBS.

Broker B: “Yeah, he will know mate. Definitely, definitely, definitely”;

Panel Bank 1 submitter: “You know, scratch my back yeah an all”

⁵¹ Scott and Protes (2012)

⁵² Hayes was convicted of manipulating LIBOR. See below for a discussion of that UK trial.

⁵³ Dealbook (2012), <http://dealbook.nytimes.com/2012/12/19/2-former-ubs-traders-exposed-in-rate-rigging-case/>

Broker B: "Yeah oh definitely, yeah, play the rules."

Regulators found that brokers at these firms helped coordinate false submissions between banks, posted false rates and estimates of where rates might go on their own trading screens, and even posted spoof bids to mislead market participants as to the real rate in the market.

In addition, in early 2013 the Royal Bank of Scotland (RBS) was fined \$612 million by regulators for manipulating the Libor Rate.⁵⁴ And in 2012 the attorneys general of New York and Connecticut issued subpoenas to Citigroup, Deutsche Bank, JPMorgan Chase and HSBC and it has yet to be seen what comes from those investigations.⁵⁵

Interestingly there are indications that the manipulation of LIBOR was going on as early as 1991, and attempts to call attention to that manipulation were ignored by the authorities. See Douglas (2012).

In its September 21, 2015 issue Bloomberg Businessweek published a detailed history of the manipulation of LIBOR focusing on the story of one man, Tom Hayes (already mentioned above). See Vaughan and Finch (2015) for the history and facts of the situation and Vaughan and Finch's forthcoming book (2016) on the topic. On May 26, 2015 Hayes went to trial in London charged with 18 counts of rigging LIBOR and nineteen days later was found guilty on all charges and sentenced to 14 years in prison for his crimes in manipulating LIBOR.⁵⁶ Others are scheduled to be tried as well.

The following blurb for the forthcoming book reveals much that is consistent with our concerns for putting integrity into finance:

The first thing you think is where's the edge, where can I make a bit more money, how can I push, push the boundaries. But the point is, you are greedy, you want every little bit of money that you can possibly get because, like I say, that is how you are judged, that is your performance metric" (Tom Hayes, 2013.)

In the midst of the financial crisis, Tom Hayes and his network of traders and brokers from Wall Street's leading firms set to work engineering the biggest financial conspiracy ever seen. As the rest of the world burned, they came together on secret chat rooms and late night phone calls to hatch an audacious plan to rig Libor, the 'world's most important number' and the basis for \$350 trillion of securities from mortgages to loans to derivatives. Without the persistence of a rag-tag team of investigators from the U.S., they would have got away with it...

The Fix by . . . Bloomberg journalists Liam Vaughan and Gavin Finch, is the inside story of the Libor scandal, told through the journey of the man at the centre of it: a young, scruffy, socially awkward misfit from England whose genius for math and obsessive personality made him a trading phenomenon, but ultimately paved the way for his own downfall. . . . *The Fix* provides a rare look into the dark heart of global finance at the start of the 21st Century.

On November 5, 2015 two British traders employed by the Dutch bank, Rabobank were (between them) found guilty on all 28 charges of rigging the LIBOR rate by a New York jury (19 counts for one and 9 counts for the other defendant).⁵⁷ At trial three of the four other Rabobank

⁵⁴ Finch, Fortado and Brush (2013)

⁵⁵ Forbes (2012)

⁵⁶ Bray (2015, p. B3)

⁵⁷ Smith (2015, p. B1)

traders who all pled guilty to participating in the scheme testified against the two British traders. As the New York times summarized: “More than a half-dozen banks, including Rabobank, have paid more than \$10 billion to settle charges with regulators and law enforcement agencies that they conspired to rig LIBOR.⁵⁸ Along with some of the world’s largest banks Rabobank itself “admitted to manipulating the rate . . . and “agreed in 2013 to pay \$1 billion in penalties to US, Dutch, and British regulators of which \$325 million was levied by the U.S. Justice Department.⁵⁹

⁵⁸ Smith (2015, p. B1)

⁵⁹ Matthews (2015, p. C2)

14. APPENDIX 2: ONE'S WORD – DEFINITIONS AND CLARIFICATIONS⁶⁰

A. ONE'S WORD DEFINED

We define a person's or other human entity's word as consisting of each of the following six elements:

Word-1. **What You Said:** Whatever you have said you will do or will not do, and in the case of do, by when you said you would do it.

Note a: *Requests Of You Become Your Word Unless You Have Timely Responded To Them:* There are four legitimate canonical responses to a request, namely: accept, decline, counter offer, or promise to timely respond at some specific later time. If when you receive a request you do not timely respond to that request with one of the four legitimate responses, you have in effect accepted (given your word to) that request. That is to say, that request is part of your Word 1.

Note b: *In Contrast, Your Requests Of Others Do Not For You Become Their Word When They Have Not Responded In A Timely Fashion:* The efficacy (workability) of the asymmetry between Note a directly above and this Note is explained below in [Section B](#), Word-1 (p. 67)

Word-2. **What You Know:** Whatever you know to do or know not to do; and in the case of do, doing it as you know it is meant to be done and doing it on time – unless you have explicitly said the contrary to those who are counting on you.

Also see in [Section B](#) below, Word-2 (p. 67)

Word-3. **What Is Expected of You (that is, expectations that are in fact unexpressed requests of you):** Whatever anyone with whom you desire a workable relationship expects you to do or not do, and in the case of do, doing it on time – unless you have explicitly said to the contrary. (Obviously, this includes what you have *allowed* others to expect of you even though you have not *said* that you could be expected to do it or not do it.)

For the rationale for and the efficacy (workability) of this, see [Section B](#) below, Word-3 (p. 68) (including numbers 1 through 5).

Note: *Your Expectations Of Others (Expectations That Are In Fact Unexpressed Requests) Are Not For You Their Word:* What you expect of others and have not explicitly expressed to them (requested of them) is not for you part of their word as defined in this new model. Only those expectations you have of others that you have made clear to them by an explicit request is part of their word for you (unless they decline or counter-propose your request). The efficacy (workability) of the asymmetry between 1) others' expectations of you being (for you) your word, while 2) your expectations of others are not (for you) their word, is explained below in [Section B](#), Word-3 Note (p. 69).

⁶⁰ The content of this Appendix is a revised version of the definition of one's word contained in: Werner Erhard, Michael C. Jensen, and Steve Zaffron, "Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics, and Legality – Abridged" (March 7, 2010). <http://ssrn.com/abstract=1542759>

Word-4. What You Say Is So: Whenever you have given your word to others as to the existence of some thing or some state of the world (canonically, an assertion), your word includes you being willing to be held accountable that the others would find your evidence for what you have asserted makes what you have asserted valid for those others.⁶¹

Note: *What You Knowingly Allow Others To Assume Or Believe:* In addition to what you have outright asserted, your Word-4 includes anything you knowingly allow others to assume or believe. If you allow them to continue to assume or believe it, your word includes you being willing to be held accountable that they would find that your evidence (including any contrary evidence) for what you have allowed them to assume or believe also makes it valid for them.

Notice that at one end of the spectrum of Word-4 there is outright lying, while the other end of the spectrum involves simply allowing others to believe or assume something that is for you not valid.

Also see in [Section B](#) below, Word-4 (p. 70)

Word-5. What You Stand For: What you stand for is a fundamental aspect of who you are for others. And, while perhaps less obvious, what you stand for is even a fundamental aspect of who you are for yourself. In each case, what you stand for is your word.

What you stand for (canonically, a declaration) is constituted by 1) who you hold yourself out to be for others (the way of being and acting you say others can count on you or you allow others to count on from you), and 2) who you hold yourself to be for yourself (the way of being and acting you say or you assume you can count on from yourself, whether specifically articulated by you or not).

Given that your word as what you stand for with others and with yourself is a fundamental aspect of who you are, when your word as what you stand for lacks integrity (is less than whole, complete, unbroken, sound, in perfect condition), you as a person lack integrity. In a real sense you as a person are less than whole, complete, unbroken, sound, in perfect condition. This is true not only for a person, but just as true for any other human entity, e.g., a corporation, partnership, agency, or association.

Also see [Section B](#), Word-5 below (p. 70).

⁶¹ See: Searle, 1969, *Speech Acts: An Essay in the Philosophy of Language*, Cambridge, UK: Cambridge University Press, especially for his discussion of assertions.

Word-6. **Moral, Ethical And Legal Standards:** The *social moral standards*, the *group ethical standards* and the *governmental legal standards* of right and wrong or good and bad behavior in the society, groups and state in which one enjoys the benefits of membership are also part of one's word (what one is expected to do or not do) unless a) one has explicitly and publicly expressed an intention to not keep one or more of these standards, and b) one is willing to bear the costs of refusing to conform to these standards (the rules of the game one is in).

Also see [Section B](#), Word-6 below (p. 70).

Note that in 1. through 6. above what we have defined is what constitutes a “*person's or other human entity's word*” – **not** what constitutes *integrity*. Integrity for a person or other human entity is that person's or that human entity's *word* (each of the six aspects of one's word spelled-out above) *being whole, complete, unbroken, sound, in perfect condition*.

B. CLARIFICATIONS OF “ONE’S WORD” AS DEFINED ABOVE

Word-1. Most people will not have a problem with Word-1 (*their word being constituted by that to which they have given their word*).

About The Two Notes In Word-1: However, many people will have a problem in Word-1 with the seeming “unfairness” of the asymmetry of Note b: Your requests of others *do not* become *for you* their word when they have not responded to your request in a timely fashion. Assuming that the non-response of another to your request is an acceptance on their part invites a breakdown in workability and a consequential decline in the opportunity for performance. Where another has not timely responded to your request, you avoid the chance of such a breakdown if you hold yourself accountable for obtaining a response. Note that integrity is a matter of the *workability* resulting from being whole and complete as to one's word, not an issue of fairness.

Conversely, others' requests of you *do* become *for you* your word if you have not timely declined, counter-offered, or promised to timely respond at some specific later time. This asymmetry avoids the possible breakdown of the other assuming your acceptance of their request, when you might have intended to decline their request. Again, integrity is a matter of the *workability* resulting from being whole and complete as to one's word, not an issue of fairness.

Word-2. Some people may have a problem with Word-2 (their word also being constituted by what they *know to do and doing it as it was meant to be done*), because there might be situations in which they don't know what to do, or may not know how it is meant to be done. If one does not know what to do, and one *does not know* that one does not know what to do, that does not fit the definition of one's word as stated in Word-2, (*doing what you know to do*). However, if one does not know what to do and one *knows* that one does not know, that does fit the definition of

one's Word-2, and explicitly saying that one does not know what to do would be a part of one's word, otherwise the other would be left with the belief that one does know what to do. Likewise with knowing how it is meant to be done.

Word-3. Many people will have a problem with their word being constituted by Word-3 (*whatever is expected of you by those with whom you desire a workable relationship unless you have said to the contrary*). Of course if someone has expressed his or her expectation of me in the form of an explicit request, I can accept, decline or counteroffer that expectation – no problem with that. It is being obligated by expectations that have not been expressed explicitly, and certainly those about which one is unaware, with which many people will have a problem. When unexpressed expectations are also considered as part of one's word, it occurs for many as inappropriate that one must then fulfill those unexpressed expectations in order to maintain one's word as whole and complete. There are five points to be considered.

1. In this model there is no *obligation* to fulfill others' expectations of you. However, if you do not either decline the expectations of others or fulfill them there will be a breakdown in your opportunity for performance in the relationship.
2. Suppose someone has expectations (expectations that are in fact unexpressed requests) of another. For better or for worse, what is expected of one is expected of one; in life there is no escaping expectations. And if there is an expectation, and you do not either meet that expectation, or uncover it and explicitly declare that you will not meet it, the outcome is the same as having given your word and not kept that word. That is, there will be a breakdown in *workability* in that relationship. When one's word in a relationship is less than whole, complete, unbroken, sound, in perfect condition, one's opportunity for performance in that relationship declines.
3. The notion of it being wrong or right (or bad or good, or unfair or fair) that you are affected by the unannounced expectations of others with whom you desire to have a workable relationship is a normative value judgment, and in this new model of integrity, integrity is devoid of such normative value judgments. Whether you like it or not is irrelevant from the standpoint of integrity, and therefore of workability and opportunity for performance. Given the obvious impact of unmet expectations on the workability of relationships, recognizing that the expectations of others matter (treating all expectations of those with whom you desire to have a workable relationship as part of your word unless you have explicitly declared you will not meet them), your integrity will increase. When integrity increases (that is, your word is more fully whole, complete, unbroken, sound, in perfect condition), the workability of your life increases, and your opportunity for performance increases. One follows the other, willy-nilly (i.e. willingly or unwillingly).
4. In light of the above two points, it follows that for a person's word to be whole and complete and to thereby create a life with high workability and high

performance, one has to be “cause in the matter” of what is expected of one. By looking at life from the perspective that I am cause in the matter (a declaration, not an assertion⁶²) of what people expect of me, I am then led to be highly sensitive, and motivated to ferret out those expectations and to take action to manage them. If I am straight with those who have expectations that I will not fulfill, my word will be intact, life will have greater workability, and my performance (however defined) will be greater.

5. Expectations and requests of you are your word only if you have failed to decline them. Consequently, when declining an expectation of you, you do not have to deal with any mess that arises as a result of your decline. Note that there may well be a mess in the relationship as a human system as a result of your decline. On the other hand, you will have continuing messes, and misidentify the cause of those messes, that arise from not being straight with those who have expectations that you will not fulfill. Speaking about the impact on one as a person of not being straight with those who have expectations that you will not fulfill, as the old adage says: “If you can’t say ‘no’, you can’t really say ‘yes’.” While not needing to do so as a matter of integrity, it would be wise to do something to deal with any mess that results from your decline.

In summary, one’s word as we have defined it in this new model is not a matter of being obligated or not (or even of being willing or not willing) to fulfill the expectations (expectations that are in fact unexpressed requests) of others. If there is an expectation, there is an expectation, and if you do not fulfill the expectation and have not said that you will not fulfill the expectation the consequence on workability and therefore performance is the same as that to which you have explicitly given your word. This is true even though you have a justification for not fulfilling the expectation. For example, like it or not a person’s performance is often judged against expectations (unexpressed requests), even if that person has never agreed to, or was not even aware of, those expectations (requests). Thus, to create workability with those with whom you desire to have a relationship you must clean up any mess created in their lives that result from their expectations of you that you do not meet and that you have not explicitly declined. This is what it means to take yourself to be cause in the matter of expectations of you.

Word-3

Note Your Expectations (unexpressed requests) of others Are Not The Word Of Others: There is an asymmetry here: As we said above, your word *includes* the unexpressed expectations of others unless you formally decline them; yet your unexpressed expectations are *not* for you the word of others. Thus you cannot hold others accountable for fulfilling your unexpressed expectations. Indeed, holding others accountable for fulfilling your unexpressed expectations will result in a diminution of workability and therefore performance, a consequence of your being out of integrity. This asymmetry – in effect an instance of “what’s good for

62

See: Searle (1969)

the goose is not good for the gander” – is required to be whole and complete in one’s word with oneself and with others.

- Word-4. With respect to Word-4, some people will have a problem that one’s word as to the existence of some thing or some state of the world includes being accountable that the other would find valid for themselves the evidence that one had for asserting something to be the case. Of course there are times when one says that this or that is so, or not so, but one would not be willing to be held to account for having evidence that the other would find valid. In such cases, one’s word would include acknowledging that, and perhaps saying what level of evidence one does have: for example when one *assumes* that something is the case.
- Word-5. The explicit content of what you stand for is not a matter of your integrity. However big or small what you stand for, if you deal with what you stand for with full integrity, you have the maximum opportunity for living up to that stand. Integrity is determined by simply living up to (living consistent with) what you said you stand for, and when you will not or have not, you honor your word by saying that you will not or have not, and by when you will or that you never will (revoking your word), and you clean up the mess your not having lived up to what you said you stand for with those who were counting on you. However, you should be aware that to a large extent the magnitude of what you stand for determines the size of your opportunity set for performance in the world, with others, and with yourself – performance defined in whatever way you wish to define it.
- Word-6. The moral, ethical and legal standards of the society, group and governmental entities in which one enjoys membership are a part of one’s word. Word-6 re-contextualizes the moral, ethical and legal standards of the society, group and governmental entities in which one enjoys membership from something inflicted on me – someone else’s will or in the language of this new model “someone else’s word” – to *my word*, thus, leaving me with the power to honor my word, either by keeping it, or saying I will not and accepting the consequences. As *my word*, I can enter with power (rather than force) the discussion about just what those standards should be.

A detailed discussion of the issues associated with defining one’s word is available on SSRN at the following:

Erhard, Werner and Jensen, Michael C., A Positive Theory of the Normative Virtues (Chapters 1 through 3) (December 7, 2011). Harvard Business School NOM Unit Working Paper No. 12-007; Barbados Group Working Paper No. 11-06. Available at SSRN: <http://ssrn.com/abstract=1906328>

Erhard, Werner, Michael C. Jensen, Steve Zaffron, “Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics and Legality” (March 23, 2009) <http://ssrn.com/abstract=920625>

Erhard, Werner, Michael C. Jensen, and Steve Zaffron, “Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics, and Legality – Abridged” (March 25, 2014). <http://ssrn.com/abstract=1542759>

References

- Abdulali, Adil. 2006. *The Bias Ratio™: Measuring the Shape of Fraud*. New York: Protégé Partners.
- Agarwal, Vikas, Naveen D. Daniel, and Narayan Y. Naik. 2011. “Do Hedge Funds Manage Their Reported Returns?”. *The Review of Financial Studies* 24, no. 10: 3281-3320.
- Aggarwal, Rajesh K., Laurie Krigman, and Kent L. Womack. 2002. “Strategic IP Underpricing, Information Momentum, and Lockup Expiration Selling”. *Journal of Financial Economics* 66, no. 1: 105-137.
- Anand, Shefali. 2006. “Harmed Investor? Just Wait – Brokerage Firms Pay \$255 Million, But Getting It Takes Time”. *Wall Street Journal*. Accessed 16 October, 2015. <http://www.wsj.com/articles/SB114264793946402057>
- Anonymous. 2013. “Libor (Barclays interest Rate Manipulation Case)”. *New York Times*, 3 March. Accessed 3 March, 2013. http://topics.nytimes.com/top/reference/timestopics/subjects/l/london_interbank_offered_rate_libor/index.html
- Anonymous Insider. 2015. “Libor Scandal: How I Manipulated The Bank Borrowing Rate”. *The Telegraph*, 22 November. <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9368430/Libor-scandal-How-I-manipulated-the-bank-borrowing-rate.html>
- Argyris, Chris. 1991. “Teaching Smart People How to Learn”. *Harvard Business Review*. May-June: 99-109.
- Barrett, Devlin, and Evan Perez. 2012. “HSBC to Pay Record U.S. Penalty: U.K.-Based Bank Expected to Admit Money-Laundering Lapses as Part of \$1.9 Billion Agreement”. *Wall Street Journal*, 11 December. Accessed 25 February, 2013. <http://online.wsj.com/article/SB10001424127887324478304578171650887467568.html?KEYWORDS=HSBC+Money+laundrying>
- Bartov, Eli, Dan Givoly, and Carla Hayn. 2000. “The Rewards to Meeting or Beating Earnings Expectations”. *SSRN*. Accessed 16 October, 2015. <http://ssrn.com/abstract=247435>
- Blankfein, Lloyd, and Gary D. Cohn, 2012. “Our Response to Toda’s New Times Op-Ed”, in “Goldman Sach’s Response to Greg Smith’s Op-Ed,” *Bloomberg Business Week*, 14 March. Accessed 19 September, 2014. <http://www.businessweek.com/articles/2012-03-14/goldman-sachs-response-to-greg-smiths-op-ed>

- Bird, Alexander. 2011. "Thomas Kuhn". *The Stanford Encyclopedia of Philosophy. Winter 2011 Edition*. Edward N. Zalta (ed.). 4.2 Perception, Observational Incommensurability, and World Change. Accessed 16 October, 2015. <http://plato.stanford.edu/archives/win2011/entries/thomas-kuhn/>
- Bray, Chad. 2015. "Ex Trader Is Convicted In Rate-Rigging Case". *New York Times*, 4 August.
- Bray, Chad. 2015. "HSBC Searched". *New York Times*, 19 February.
- Bodnaruk, Andriy, Massimo Massa, and Andrei Simonov. 2007. "The Dark Role of Investment Banks in the Market for Corporate Control". *EFA 2007 Ljubljana Meetings Paper*. Accessed 16 October, 2015. <http://www.econ.upf.edu/docs/seminars/bodnaruk.pdf>
- Boston, William and Sarah Sloat. 2015. "Volkswagen Sales Fall in October Amid Emissions Scandal". *Wall Street Journal*, 13 November.
- Brunnermeier, Markus K. 2009. "Deciphering the Liquidity and Credit Crunch 2007-2008". *Journal of Economic Perspectives* 23, no. 1: 77-100.
- Bradshaw, Mark T., Scott A. Richardson, and Richard G. Sloan. 2005. "The Relation Between Corporate Financing Activities, Analysts' Forecasts and Stock Returns". *Journal of Accounting and Economics Conference*, 2004.
- Burgstahler, David, and Ilia Dichev. 1997. "Earnings Management to Avoid Earnings Decreases and Losses". *Journal of Accounting and Economics* 24, no. 1: 99-126.
- Bushee, Brian. 2004. "Identifying and Attracting the "Right" Investors: Evidence on the Behavior of Institutional Investors". *Journal of Applied Corporate Finance* 16, no. 4: 28-35.
- Burton, Jonathan. 2003. "Fund Roundup: A Review of the Firms Implicated So Far in Trading Scandal". *Market Watch (Dow Jones)*. Accessed 16 October, 2015. <http://www.marketwatch.com/story/scorecard-of-firms-people-implicated-in-fund-scandals>
- Clement, Michael B. 1999. "Analyst Forecast Accuracy: Do Ability, Resources, and Portfolio Complexity Matter?". *Journal of Accounting and Economics* 27, no. 3: 285-303.
- Cowen, Amanda, Boris Groyberg, and Paul M. Healy. 2003. "Which Types of Analyst Firms Make More Optimistic Forecasts?". *Harvard NOM Working Paper No. 03-46*. Accessed 16 October, 2015. <http://ssrn.com/abstract=436686>
- Darrough, Masako, and Rangan Srinivasan. 2005. "Do Insiders Manipulate Earnings When They Sell Their Shares in an Initial Public Offering?". *Journal of Accounting Research* 43, no. 1: 1-33.

- Dealbook. 2010. "Goldman Settles With S.E.C. for \$550 Million". *New York Times*, 15 July. Accessed 16 October, 2015. <http://dealbook.nytimes.com/2010/07/15/goldman-to-settle-with-s-e-c-for-550-million/>
- Dealbook. 2012. "2 Former UBS Traders Exposed in Rate-Rigging Case". *New York Times*, 19 December. Accessed 16 October, 2015. <http://dealbook.nytimes.com/2012/12/19/2-former-ubs-traders-exposed-in-rate-rigging-case/>
- Dechow, Patricia M., Amy P. Hutton, and Richard G. Sloan. 1999. "The Relation Between Analysts' Forecasts of Long-Term Earnings Growth and Stock Price Performance Following Equity Offerings". *SSRN*. Accessed 16 October, 2015. <http://ssrn.com/abstract=168488>
- Dealbook. 2010. "Goldman Settles With S.E.C. for \$550 Million". *New York Times*, 14 July. Accessed 16 October, 2015. <http://dealbook.nytimes.com/2010/07/15/goldman-to-settle-with-s-e-c-for-550-million/>
- Degeorge, François, Jayendu Patel, and Richard Zeckhauser. 1999. "Earnings Management to Exceed Thresholds". *Journal of Business* 72, no. 1: 1-33.
- Dikolli, Shane S., Thomas Keusch, William J. Mayew, and Thomas D. Steffen. 2014. "Using Shareholder Letters to Measure CEO Integrity". *SSRN*. Accessed 16 October, 2015. <http://ssrn.com/abstract=2131476>
- Douglas, Keenan. 2012. "My Thwarted Attempt to Tell of Libor Shenanigans". *Financial Times*, 27 July.
- Dyson, Freeman. 2011. "How to Dispel Your Illusions". Review of *Thinking, Fast and Slow*, by Daniel Kahneman. *The New York Review of Books*, 22 December. Accessed 16 October, 2015. <http://www.nybooks.com/articles/archives/2011/dec/22/how-dispel-your-illusions/>
- Eaglesham, Jean, and Dan Fitzpatrick. 2012. "J.P. Morgan Sued on Mortgage Bonds". *Wall Street Journal*. Accessed 16 October, 2015. <http://online.wsj.com/article/SB10000872396390444138104578030903731665328.html>
- Erhard, Werner, and Michael C. Jensen. 2011. "A Positive Theory of the Normative Virtues". *Harvard Business School NOM Unit Working Paper No. 12-007*; *Barbados Group Working Paper No. 11-06*. Available at SSRN: <http://ssrn.com/abstract=1906328>
- Erhard, Werner, Michael C. Jensen, and Kari L. Granger. 2012. "Creating Leaders: An Ontological/Phenomenological Model". In *The Handbook for Teaching Leadership: Knowing, Doing, and Being*, edited by Scott Snook, Nitin Nohria, and Rakesh Khurana. Los Angeles: SAGE Publications. 2013. *Harvard Business School NOM Unit Working Paper 11-037*; *Barbados Group Working Paper No. 10-10*; *Simon School Working Paper Series No. FR 10-30*. Available at SSRN: <http://ssrn.com/abstract=1681682>

- Erhard, Werner, Jensen, Michael C., and Barbados Group. 2010. "A New Paradigm of Individual, Group, and Organizational Performance". *Harvard Business School NOM Unit Working Paper No. 11-006; Barbados Group Working Paper No. 09-02*. Available at SSRN: <http://ssrn.com/abstract=1437027>
- Erhard, Werner, Michael C. Jensen, and Steve Zaffron. 2009. "Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics and Legality". *Harvard Business School NOM Working Paper No. 06-11; Barbados Group Working Paper No. 06-03; Simon School Working Paper No. FR 08-05*. Available at SSRN: <http://ssrn.com/abstract=920625>
- Erhard, Werner, Michael C. Jensen, and Steve Zaffron. 2014. "Integrity: A Positive Model that Incorporates the Normative Phenomena of Morality, Ethics, and Legality – Abridged (English Language Version)". *Harvard Business School NOM Unit Working Paper No. 10-061; Barbados Group Working Paper No. 10-01; Simon School Working Paper No. 10-07*. Available at SSRN: <http://ssrn.com/abstract=1542759>
- Erhard, Werner, and Michael C. Jensen. 2014. "The Hidden and Heretofore Inaccessible Power of Integrity: A New Model" (PDF of Keynote Slides). *Harvard Business School NOM Unit Working Paper No. 10-068*. Available at SSRN: <http://ssrn.com/abstract=2439838>
- Erhard, Werner, and Michael C. Jensen. 2012. "Putting Integrity into Finance: A Purely Positive Approach". *Harvard NOM Unit Research Paper No. 12-074; European Corporate Governance Institute (ECGI) No. 417/2014; Barbados Group Working Paper No. 12-01*. Available at SSRN: <http://ssrn.com/abstract=1985594>
- Finch, Gavin, Lindsay Fortado, and Silla Brush. 2013. "RBS Fined \$612 Million by Regulators for Manipulating Libor Rate". *Bloomberg*, 6 Februar. Accessed 3 March, 2013. <http://www.bloomberg.com/news/2013-02-05/rbs-said-to-face-up-to-783-million-fine-for-manipulating-libor.html>
- Fireman, Paul. 2013. "Commencement Address to the Suffolk University Sawyer Business School", 19 May, Boston, Massachusetts. Accessed 28 February, 2014 <http://www.youtube.com/watch?gl=US&hl=en&client=mv-google&v=ITw0GX4nVXs&nomobile=1>
- Forstmoser, Peter. 2006. "Integrity in Finance – Theory and Practice: A Positive Approach". Speech given to Swiss Banking Institute, 15 November.
- Fuller, Joseph, and Michael C. Jensen. 2002. "Just Say No To Wall Street". *Journal of Applied Corporate Finance* 14, no. 4: 41-46. Available at SSRN: <http://ssrn.com/abstract=297156>
- Goldstein, Noah J., Steven J. Martin, and Robert B. Cialdini. 2007. *Yes! 50 Secrets From The Science Of Persuasion*. London: Profile Books.

- Graham, John R., Chambers R. Harvey, and Shivaram Rajgopal. 2005. "Economic Implications of Corporate Financial Reporting". *SSRN*. Accessed 3 March, 2013.
<http://ssrn.com/abstract=491627>
- Gustin, Sam. 2013. "Not So 'Fabulous' Fab: Ex-Goldman Sachs Trader Fabrice Tourre Found Liable for Fraud". *Time Magazine*. Accessed 16 October, 2015.
<http://business.time.com/2013/08/01/not-so-fabulous-fab-ex-goldman-sachs-trader-found-liable-for-fraud/>
- Harsanyi, John C. 1953. "Cardinal Utility in Welfare Economics and in the Theory of Risk-Taking". *Journal of Political Economy* 61: 434–435.
- Harsanyi, John C. 1955. "Cardinal Welfare, Individualistic Ethics, and Interpersonal Comparison of Utility". *Journal of Political Economy* 63: 309–321.
- Hayn, C. 1995. "The Information Content of Losses". *Journal of Accounting & Economics* 20: 125–153.
- Hayward, Mathew L. A., and Warren Boeker. 1998. "Power and Conflicts of Interest in Professional Firms: Evidence from Investment Banking." *Administrative Science Quarterly* 43, no. 1: 1–22.
- Healy, Paul M. 1985. "The Effect of Bonus Schemes on Accounting Decisions". *Journal of Accounting & Economics* 7, no. 1–3: 85–107.
- Healy, Paul M., and Krishna Palepu. 2000. "Information Asymmetry, Corporate Disclosure and the Capital Markets: A Review of the Empirical Disclosure Literature". *JAE Rochester Conference April 2000*. SSRN. Accessed 16 October, 2016.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=258514
- Healy, P. M., and J. M. Wahlen. 1999. "A Review Of The Earnings Management Literature And Its Implications For Standard Setting. *Accounting Horizons* 13: 365–383.
- Holt, Jim. 2011. "Two Brains Running". Review of *Thinking Fast and Slow*, by Daniel Kahneman. *New York Times*, 25 November.
- Hong, Harrison and Jeffrey D. Kubik. 2003. "Analyzing the Analysts: Career Concerns and Biased Earnings Forecasts." *The Journal of Finance* 58, no. 1: 313–351.
- Hutton, Amy. 2002. "Determinants of Managerial Earnings Guidance Prior to Regulation Fair Disclosure and Bias in Analysts Earnings Forecasts". *SSRN*. Accessed 16 October, 2016.
<http://ssrn.com/abstract=567441>
- Hutton, Amy. 2004. "Beyond Financial Reporting – An Integrated Approach to Disclosure". *Journal of Applied Corporate Finance* 16, no. 4: 8–16.

- Hutton, Amy, and James Weber. 2001. "Progressive Insurance: Disclosure Strategy". *Harvard Business School Case*, 9-102-012, 12 December.
- Isberg, Steven C., Tomas Thundiyil, and Rob Owen. 2012. "Integrity and Learning: Enhancing Workability and Student Performance Outcomes". *SSRN*. Accessed 16 October, 2016. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2148783
- Jacob, John, Thomas Z. Lys, and Margaret A. Neale. 1999. "Experience in Forecasting Performance of Security Analysts." *Journal of Accounting and Economics* 28: 51-82.
- Jensen, Michael C. 2001. "Paying People to Lie: The Truth About the Budgeting Process" (Revised September, 2001). Harvard NOM Research Paper No. 01-03, and HBS Working Paper No. 01-072, *European Financial Management* 9, (September): 379-406, 2003. Available at SSRN: <http://ssrn.com/abstract=267651>
- Jensen, Michael C. 2001. "Corporate Budgeting Is Broken, Let's Fix It". *Harvard Business Review* (November): 94-101. Available at SSRN: <http://ssrn.com/abstract=321520>
- Jensen, Michael C. 2005. "Agency Costs of Overvalued Equity". Harvard NOM Working Paper No. 04-26; ECGI - Finance Working Paper No. 39/2004. *Financial Management* 34, no. 1. Available at SSRN: <http://ssrn.com/abstract=480421>
- Jensen, Michael C. 2004. "The Agency Cost of Overvalued Equity and the Current State of Corporate Finance". Harvard NOM Working Paper No. 04-29, *European Financial Management* 10 (December): 549-565. Available at SSRN: <http://ssrn.com/abstract=560961>
- Jensen, Michael C., and Werner Erhard. 2011. "A 'Value-Free' Approach to Values" (PDF File of Powerpoint Slides). *Harvard Business School NOM Unit Working Paper No. 11-010; Barbados Group Working Paper No. 10-06; Simon School Working Paper No. FR10-26*. Available at SSRN: <http://ssrn.com/abstract=1640302>
- Jensen, Michael C., Kevin J Murphy, and Eric G Wruck. 2004. "Remuneration: Where We've Been, How We Got to Here, What are the Problems, and How to Fix Them". *HBS NOM Paper No 04-28; ECGI - Finance Working Paper No. 44/2004*. Available at SSRN: <http://ssrn.com/abstract=561305>
- Jewish Virtual Library. "Bernard Madoff". *Jewish Virtual Library*. Accessed 25 February, 2013. http://www.jewishvirtuallibrary.org/jsource/biography/Bernard_Madoff.html
- Kahneman, Daniel. 2011. *Thinking, Fast and Slow*. London: Penguin.
- Kahneman, Daniel. 2002. "Daniel Kahneman – Biographical". *Nobelprize.org*. Accessed 4 March, 2012. http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2002/kahneman-bio.html

- Kahneman, Daniel, and Amos Tversky. 1979. "Prospect Theory: An Analysis of Decision under Risk". *Econometrica* 47, no. 2: 263-291.
- Kohatkar, Sheelah. 2014. "Why SAC Capital's Steven Cohen Isn't In Jail". *Bloomberg Businessweek*, 2 January. Accessed 17 October, 2015.
<http://www.businessweek.com/articles/2014-01-02/why-sac-capitals-steven-cohen-isnt-in-jail>
- Kothari, S. P, Elena Loutskina, and Valeri Nikolaev. 2005. "Agency Theory of Overvalued Equity as an Explanation for the Accrual Anomaly". Accessed 17 October, 2015.
<http://ssrn.com/abstract=871750>
- Kuhn, Thomas S. 1962, 2012. *The Structure of Scientific Revolutions*. Chicago: University of Chicago Press.
- Lauricella, Tom. 2003. "Strong Steps Down From Board But Stays On as Head of Firm". *Wall Street Journal*, 3 November.
- Lauricella, Tom, and Christopher Oster. 2003. "Second Strong Executive Snagged in Probe – Anthony D'Amato of CEO's Office Was Involved in a Deal to Allow Canary to Rapidly Trade Shares". *Wall Street Journal*, 19 November.
- Lauricella, Tom, and Christopher Oster. 2004. "Strong Funds And Regulators To Settle Case – Agreement Would Clear the Way For Possible Sale to Wells Fargo; Considerable Challenges Ahead". *Wall Street Journal*, 5 June.
- Lewis, Michael. 2013. "The Trouble With Wall Street". *New Republic*. Accessed 18 September, 2014. <http://www.newrepublic.com/article/112209/michael-lewis-goldman-sachs>
- Lin, Hsiou-wei, and Maureen F. McNichols. 1998. "Analyst Coverage of Initial Public Offerings". Stanford University. Unpublished manuscript.
- Lin, Hsiou-wei, and Maureen F. McNichols. 1998. "Underwriting Relationships, Analysts' Earnings Forecasts and Investment Recommendations". *Journal of Accounting and Economics* 25, no. 1: 101-127.
- Lin, Hsiou-wei, Maureen F. McNichols, and Patricia C. O'Brien. 2003. "Analyst Impartiality and Investment Banking Relationships": National Taiwan University, Stanford University, and University of Waterloo. Unpublished manuscript.
- Ljungqvist, Alexander, Christopher J. Malloy, and Marston, Felicia C. 2007. "Rewriting History". *AFA 2007 Chicago Meetings Paper*. Available at SSRN: <http://ssrn.com/abstract=889322>
- Matthews, Christopher M. 2014. "Martoma Sentenced to Nine Years in Insider-Trading". *The Wall Street Journal*, September 8. Accessed 17 October, 2015
<http://online.wsj.com/articles/martoma-sentenced-to-nine-years-1410208845?mod=djemalertNEWS>

- Matthews, Christopher M. 2015. "Two Are Convicted For Libor Rigging". *The Wall Street Journal*, 6 November.
- Matsumoto, Dawn A. 2002. "Management's Incentives to Avoid Negative Earnings Surprises". *Accounting Review* 77, no. 3: 483-514.
- McLaughlin, David. 2013. "BofA Probed by New York Over Mortgage Securities". *Bloomberg*, 1 March 1, 2013. Accessed 3 March, 2013. <http://www.bloomberg.com/news/2013-03-01/bofa-probed-by-new-york-over-mortgage-securities.html>
- McNichols, M., and P. O'Brien. 1997. "Self-selection and Analyst Coverage". *Journal of Accounting Research* 35 (Supplement): 167-199.
- Michaely, R., and K. L. Womack. 1999. "Conflicts of Interest and the Credibility of Underwriter Analyst Recommendations". *Review of Accounting Studies* 12: 653-686.
- Mochizuki, Takashi. 2015. "Toshiba Must Adjust Operating Profit Down By \$1.2 Billion". *Wall Street Journal*, July 20. Accessed 1 November, 2015. <http://www.wsj.com/articles/toshiba-must-adjust-operating-profit-down-by-151-8-billion-1437400355>
- Murphy, Kevin J. 2013. "Executive Compensation: Where We Are, and How We Got There". Chapter 4 in George Constantinides, Milton Harris, and René Stulz (eds.) *Handbook of the Economics of Finance*. Amsterdam: Elsevier Science North Holland.
- Murphy, Kevin J., and Jensen, Michael C. 2011. "CEO Bonus Plans: And How to Fix Them." *Harvard Business School NOM Unit Working Paper 12-022*; *Marshall School of Business Working Paper No. FBE 02-11*. Available at SSRN: <http://ssrn.com/abstract=1935654>
- Myers, James N., Linda A. Myers, and Douglas J. Skinner. 2005. "Earnings Momentum and Earnings Management". *SSRN*. Accessed 23 February, 2015. <http://ssrn.com/abstract=741244>
- New Oxford American Dictionary*. 2010. Edited by Angus Stevenson and Christine A. Lindberg. New York: Oxford University Press.
- O'Brien, Patricia C. 1990. "Forecast Accuracy of Individual Analysts in Nine Industries." *Journal of Accounting Research* 28, no. 2: 286-304.
- O'Toole, James, and Charles Riley. 2012. "HSBC Pays \$1.9 Billion To Settle US Probe". *CNN Money*, 11 December. . <http://money.cnn.com/2012/12/10/news/companies/hsbc-money-laundering/index.html>
- Phenomenology Online*. Accessed 21 December, 2010. <http://www.phenomenologyonline.com/inquiry/>

- Pool, Veronika Krepely, and Nicolas P.B. Bollen. 2007. "Do Hedge Fund Managers Misreport Returns? Evidence from the Pooled Distribution". *SSRN*. Accessed 3 March, 2013.
<http://ssrn.com/abstract=1018663>
- Protest, Ben, and Mark Scott. 2012. "Barclays Settles Regulators' Claims Over Manipulation of Key Rates". *Dealbook*, 6 June. Accessed 3 March, 2013.
<http://dealbook.nytimes.com/2012/06/27/barclays-said-to-settle-regulatory-claims-over-benchmark-manipulation/?ref=londoninterbankofferedratelibor>
- Rajan, Raghuram, and Henri Servaes. 1997. "Analyst Following of Initial Public Offerings." *Journal of Finance* 52, no. 2: 507-529.
- Rangan, Srinivasan. 1998. "Earnings Management and the Performance of Seasoned Equity Offerings". *Journal of Financial Economics* 50: 101-22.
- Rawls, John. 1971. *A Theory of Justice*. Cambridge: Belknap Press.
- Rawls, John. 2001. *Justice as Fairness: A Restatement*. Cambridge: Belknap Press.
- Richardson, Scott, Siew Hong Teoh and Peter Wysocki. 2004. "The Walk-down to Beatable Analyst Forecasts: The Role of Equity Issuance and Insider Trading Incentives". *Contemporary Accounting Research* 21, no. 4: 885-924.
- R, J. 2012. "UBS and Libor: Horribly Rotten, Comically Stupid". *Economist* Column: Schumpeter: Business and Management, 12-19. Accessed 27 February, 2013.
<http://www.economist.com/blogs/schumpeter/2012/12/ubs-and-libor>
- Robinson, Howard. 2014. "Substance". *The Stanford Encyclopedia of Philosophy* (Spring Edition). Edward N. Zalta (ed.). Accessed 23 November 2015.
<http://plato.stanford.edu/archives/spr2014/entries/substance>
- Roose, Kevin. 2012. "Former Goldman Employees Divided on Controversial Quitter". *Dealbook*, March 14. Accessed 19 September, 2014. http://dealbook.nytimes.com/2012/03/14/former-goldman-employees-divide-on-controversial-quitter/?_php=true&_type=blogs&_r=0
- Scannell, Kara, and Camilla Hall. 2014. "Bank of America Set to Settle Mortgages Case for \$16bn-plus" *Financial Times*, 6 August. Accessed 23 October, 2014.
<http://www.ft.com/cms/s/0/f567b9e2-1d6c-11e4-b927-00144feabdc0.html#axzz3sbz0sx67>
- Schatzker, Erik, and Stephanie Ruhle. 2012. "Greg Smith Quit Goldman After 'Unrealistic Pitch for \$1M'". *Bloomberg*, 18 October. Accessed 20 September, 2014
<http://www.bloomberg.com/news/2012-10-18/greg-smith-quit-goldman-after-unrealistic-pitch-for-1m.html>

- Scott, Mark, and Ben Protess. 2012. "As Unit Pleads Guilty, UBS Pays \$1.5 Billion Over Rate Rigging". *Dealbook*, 19 December. http://dealbook.nytimes.com/2012/12/19/as-unit-pleads-guilty-ubs-pays-1-5-billion-in-fines-over-rate-rigging/?_r=0. Accessed March 3, 2013.
- Searle, John. 1969. *Speech Acts: An Essay in the Philosophy of Language*. Cambridge: Cambridge University Press.
- Skinner, Douglas J., and Richard G. Sloan. 2002. "Earnings Surprises, Growth Expectations, and Stock Returns or Don't Let an Earnings Torpedo Sink Your Portfolio". *Review of Accounting Studies* 7, 289-312.
- Smith, Greg. 2012a. "Why I Am Leaving Goldman Sachs". *New York Times*, 14 March. Accessed 20 September, 2014. http://www.nytimes.com/2012/03/14/opinion/why-i-am-leaving-goldman-sachs.html?pagewanted=all&_r=0
- Smith, Greg. 2012b. *Why I Left Goldman Sachs: A Wall Street Story*. New York: Grand Central Publishing.
- Smith, Randall. 2015. "Two Traders Found Guilty of Rigging Libor Rate". *New York Times*, 6 November.
- Smith, Randal, and Tom Lauricella. 2006. "Moving the Market: Bear Stearns to Pay \$250 Million Fine; Net Rises 36%". *Wall Street Journal*, 17 March.
- Stewart, Bennett. 2004. "Making Financial Goals and Reporting Policies Serve Corporate Strategy: The Case of Progressive Insurance. An Interview with Tom King, VP and Treasurer, Progressive Insurance". *Journal of Applied Corporate Finance* 16, no. 1: 8-19.
- Stewart, James B. 2012. "A Tell-All on Goldman Has Little Worth Telling". *New York Times*, 19 October. Accessed 19 September, 2014. <http://www.businessweek.com/articles/2012-03-14/goldman-sachs-response-to-greg-smiths-op-ed>
- Tenbrunsel, Ann and Jordan Thomas. 2015. *The Street, the Bull and the Crisis: A Survey of the US and UK Financial Services Industry*. New York: Labaton Sucharow.
- Teoh, S., I. Welch, and T. Wong. 1998. "Earnings Management and the Underperformance of Seasoned Equity Offerings". *Journal of Financial Economics* 50: 63-99.
- Thaler, Richard H., and Cass R. Sunstein. 2008. *Nudge: Improving Decisions About Health, Wealth, and Happiness*. New Haven & London: Yale University Press.
- Touryalai, Halah. 2012. "7 Banks Hit With Libor Subpoenas Courtesy of NY Attorney General Schneiderman". *Forbes*, 15 August. Accessed 3 March, 2013. <http://www.forbes.com/sites/halahtouryalai/2012/08/15/7-banks-hit-with-libor-subpoenas-courtesy-of-ny-attorney-general-schneiderman/>

- U.S. Securities and Exchange Commission*. 2010 “Goldman Sachs to Pay Record \$550 Million to Settle SEC Charges Related to Subprime Mortgage CDO”, July 15. Accessed 20 September, 2014. <http://www.sec.gov/news/press/2010/2010-123.htm>
- Vaughan, Liam, and Gavin Finch, 2015. “Was Tom Hayes in Charge of a \$350 Trillion Conspiracy? Or Just Taking the Fall for One?”. *Bloomberg Businessweek*, 21 September.
- Vaughan, Liam, and Gavin Finch. 2016 (Forthcoming 8 April). *The Fix: How Bankers Lied, Cheated and Colluded to Rig the World's Most Important Number*. New York: John Wiley & Sons.
- Webster's New World Dictionary & Thesaurus* (Version 2). 1998. Accent Software International. London: Macmillan Publishers (electronic version).
- Webster's Third New International Dictionary Unabridged*. 2015. Merriam-Webster.com. Accessed 23 February, 2015. <http://unabridged.merriam-webster.com/unabridged/>

About ECGI

ECGI is an international non-profit membership organisation that provides a platform for debate and dialogue among academics, policymakers, and business leaders, with a focus on major corporate governance, ESG, and stewardship issues.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

www.ecgi.global

ECGI Working Paper Series in Finance

Editorial Board

Editor

Nadya Malenko, Professor of Finance, Boston College

Consulting Editors

Renée Adams, Professor of Finance, University of Oxford

Franklin Allen, Professor of Finance and Economics, Imperial London

Julian Franks, Professor of Finance, London Business School

Mireia Giné, Professor of Finance, IESE Business School

Marco Pagano, Professor of Economics, Facoltà di Economia Università di Napoli
Federico II

Series Manager

Asif Malik, ECGI Working Paper Series Manager

<https://www.ecgi.global/publications/working-papers>