



NORWEGIAN  
BUSINESS SCHOOL

# Conflicts of Interest in finance

## Can we regulate them and does disclosure minimize them?

Professor dr. juris Morten Kinander  
Handelshøyskolen BI

# Rule production

- **Agenda/purpose**
- **Accentuate the centrality of rules on conflicts of interests in business ethics and in finance**
- **Ask if COIs can be successfully regulated**
- **Look at conceptual development, history and defining features**

# Moral experiments

- Numbers from the auditing industry
- The Defining Issues Test
- James Rest: Heinz and the drug

***Please rate the following statements in terms of their importance in making a decision about what to do in the dilemma. (1=Great importance, 2=Much importance, 3=Some Importance, 4=Little importance, 5=No importance)***

1. Whether a community's laws are going to be upheld.
2. Isn't it only natural for a loving husband to care so much for his wife that he'd steal?
3. Is Heinz willing to risk getting shot as a burglar or going to jail for the chance that stealing the drug might help?
4. Whether Heinz is a professional wrestler, or had considerable influence with professional wrestlers.
5. Whether Heinz is stealing for himself or doing this solely to help someone else.
6. Whether the druggist's rights to his invention have to be respected.
7. Whether the essence of living is more encompassing than the termination of dying, socially and individually.
8. What values are going to be the basis for governing how people act towards eac other.
9. Whether the druggist is going to be allowed to hide behind a worthless law which only protects the rich anyhow.
10. Whether the law in the case is getting in the way of the most basic claim of any member of society.
11. Whether the druggist deserves to be robbed for being so greedy and cruel.
12. Would stealing in such a case bring about more total good for the whole society or not.

***Now please rank the top four most important statements. Put the number of the statement in the blank:***

- \_\_\_ Most important item
- \_\_\_ Second most important item
- \_\_\_ Third most important item
- \_\_\_ Fourth most important item

# Gjennomsnitt DIT-score for ulike grupper

- Post graduate students in philosophy and political science 65,2
- Students at a ministerial seminar 57,8
- Higher level law students 52,2
- Physicians 49,5
- College students 42,3
- Adults 40
- High school students 31,8
- Secondary school 21,9
- 16 year old juvenile institutionalized 18,9

# US accountants

# Numbers

- **Age has a negative impact on the score**
- **Women has far superior scores than men**
- **But**
- **Score declines with experience and higher position in the company**
- **Why?**
  - Experience dilutes independent thinking
  - Regulation and sanctions

# Summing up so far

- **The amount of rules can lead to lower ethical level of reflection**
- **Does it matter if rules do the work?**
  - Levelling down
  - Orients focus away from relevant and important areas

# COI: Standard definition

- **Person X has a conflict of interest iff (1) X stands in a relationship to another person Y requiring X to exercise judgment on behalf of Y and (2) X has a special interest that can interfere with the right and proper execution of that judgment in that relationship (Michael Davis)**
- **Central terms:**
  - Relationship, judgment, interest and execution

# Core idea

- **Archtype: The professional – advisor/fund manager – who has an obligation to take care of anothers' interests, but who is confronted with a choice that *can* lead to his own interests being fulfilled at the expense of the other's**
- **The situation as such, not the actual choice or result**

# The judgment

- **Too much emphasis on the ability to know when we are in a COI-situation**
- **Ethical and moral principle: Deterioration of the quality of the service that is paid for**

# The development of COI

- Relatively recent phenomenon
- None of the great philosophers used the term as we use it
- No traces of the term before 1930s
- Not included in Oxford English Dictionary in 1971
- But for first time in Black's Law Dictionary in 1971
- Even younger as a term in business ethics (1980)
- Today: impossible to give advise without COI-routines

# Why so new?

- **The phenomenon itself is not new: The sultan and the harem guards**
- **Still: COI-concept covers more than corruption and professional standards**
- **Growth in regulation and the complexities of modern societies vs former trust-based societies**

# What to do?

- **Expectation to limit, minimize, escape and disclose all COI-situations**
- **Regulation presupposes that one is capable of identifying COIs**
- **But what does science say?**

# Cognitive bias

- **Cognitive biases are tendencies to think in certain ways that can lead to systematic deviations from a standard of rationality or good judgment**
- **”There is reason to believe [based on empirical research] that individuals often cannot make good use of information about their own cognitive capacities and biases, even when such information can be made available”  
(Norman/MacDonald)**

# Cognitive bias

- Reason to believe we do not know *that* we are in a COI-situation or if biased when in one
- Control deficit on own judgment
- Kahnemann: Anchoring
- But COI-regulation rests on the opposite premise: knowing when we are in a COI-situation and what to do

# COI

- **From the auditing business: auditors have proven incapable of overcoming bias in favor of clients *even when they are financially motivated to make audit reports accurate and not just favorable***
- **Implication 1: consulting and auditing go badly together**  
**Implication 2: impossible to eradicate COIs effect on the business**
- **Empirical research gives little reason for optimism on regulating COIs**

# Informer the client?

- **Cain et al.: substantial scientific proof for**
- **(1) clients are largely incapable of discounting information about COIs**
- **(2) when giving COIs, professionals who disclose give more skewed advice than the ones who don't disclose**
- **For example, disclosure can make advisors feel free to give worse (i.e., more biased) advice because advisees “have been warned”**
- **Or: Too careful since client knows I have a COI**

# Conclusions

- **Information of potential and actual COIs can be contraproductive**
- **Creating traps for the client**
- **Regulating ethics can be harmful!**