RE-DEFINING THE SOCIAL UTILITY OF FINANCIAL SERVICES

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Abstract: Informational asymmetries, misaligned incentives and artificially elongated chains of intermediation have created a disconnect between the financial sector and the "real economy" that is detrimental to the public interest. Courts and regulators are increasingly intervening to break the cycle. Fiduciary law offers a conceptual framework both for understanding and responding to this trend. We argue that the financial sector, rather than waiting for this trend to develop and reacting to new rules in a piecemeal way, should be proactive and try to shape the way in which this trend develops.

Introduction

Society faces increasingly complex governance challenges. While there is a growing recognition that we need to take and act on a longer-term view, the incentives for myopic leadership and action remain acute. There is much aspirational talk about social responsibility, social reporting, long-termism and the like, but implementation is nascent and still sporadic. While temporal discounting has long been known to matter in making individual choices, its nature and utility in collective decision-making remains poorly understood. Likewise, our willingness to control activities with negative externalities has been limited by uncertainty with respect to future costs and, more importantly, a lack of incentives to price and allocate such costs equitably.

There is little question as to the trajectory of the law. By choice, by chance or by default it is increasingly responding to "reasonable expectations". To the extent that legislators are unable or unwilling to do so, our courts and other adjudicative tribunals have demonstrated a willingness to step in.

This is increasingly the case with respect to the regulation of corporate conduct. Corporate law is premised on the notion of limited liability conferred by statute – to facilitate the

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mobilization of capital legislators have determined that shareholders need not be personally responsible for a corporation's liabilities. However, of late the scope of limited liability is being circumscribed by the courts in response to claims that it improperly shifts risks and costs from shareholders to innocent third parties. These courts have concluded that, in some circumstances, the principle of limited liability should yield to a reasonable expectation that controlling shareholders should bear at least some responsibility for corporate misconduct.[1]

This article focuses on similar trends in the financial sector – one that stands out for scrutiny for a variety of reasons. There is now widespread agreement that increasing complexity in financial flows, instruments and regulation has exacerbated informational asymmetries, eroded institutional cultures and confounded traditional regulatory frameworks – often to the detriment of consumers and society in general.[2] Yet the sector continues to enjoy significant public subsidies without a clear and current articulation of its social purpose and responsibility.[3]

Financial services are critical to ensuring future well-being. To do so, the sector must have broad regard for systemic effects – focusing on how investment can create better markets tomorrow, rather than simply "beating" the market today. Courts and regulators are finding opportunities to better define and protect this public interest. This will lead to the imposition of public stewardship responsibilities throughout the supply chain.

A Pending Inflection Point

Before considering how a dynamic re-framing of fiduciary obligations is likely to motivate a re-imagining of the social utility of financial services, it may be helpful to highlight a few

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[1] See e.g. *PBGC v. Asahi Tec Corp.*, No. 10-1936 (ABJ), 2013 WL 5503191 (D.D.C. Oct. 4, 2013) (where the U.S. District Court for the District of Columbia concluded that it a Japanese corporation could be held liable for the underfunded pension liabilities of its bankrupt U.S. subsidiary, despite the corporation's argument that the court lacked jurisdiction); *Choc v. Hudbay Minerals Inc.*, 2013 ONSC 1414, 116 O.R. (3d) 674 (where the Ontario Superior Court denied a motion by Hudbay Minerals Inc. to dismiss a claim arising from security incidents at a mine operated by its Guatemalan subsidiary in which one man died, one was seriously injured and several women were raped).

[2] See Hu 2012; Sah, Lowenstein & Cain 2013; Haldane & Madouros 2012; Zingales 2012.

[3] According to one recent study, reported in *Bloomberg* on February 20, 2013, for the ten largest U.S. banks, "too big to fail status" means benefits equivalent to an $83 billion annual subsidy from taxpayers.

recent examples of dysfunction, and consequential regulatory responses, which suggest the likelihood that we have reached an inflection point.

In none of these examples are the highest echelons of these institutions clearly implicated in any wrongdoing. In some examples, the behaviour these institutions engaged in may not even have been technically illegal. What went wrong, rather, was that these institutions focused on doing things "right" – i.e., in technical compliance with whatever legal rules existed at the time – rather than doing the right thing. They engaged in conduct that was technically legal but unfair to market participants. We argue that regulatory reactions to this conduct – increasingly punitive sanctions, justified on the basis of market fairness – should lead institutions to rethink their assumptions about the purpose the financial sector is intended to serve and about how best to respond to rising public expectations.

Regulators in several jurisdictions are investigating alleged manipulation of the U.S.$5.3 trillion-a-day foreign exchange market. The allegations involve collusion among traders to fix benchmark exchange rates in their favour, resulting in higher costs for consumers. In a market this large, even a scheme that skims fractional amounts translates into billions of dollars. The fact that traders' bonuses are based on trading profits gives them reason to collude, especially in the absence of transparent markets or strong oversight.

Since 2009 the largest U.S. banks[4] have paid out or set aside more than U.S.$45 billion for mortgage misrepresentation issues (and incurred roughly U.S.$50 billion in combined legal expenses) (S&P 2013, 2). Standard & Poor's estimates it may need to pay out an additional U.S.$55-$105 billion to settle mortgage-related issues (S&P 2013, 2). In 2013 alone, J.P. Morgan paid out regulatory penalties of US$20 million on matters ranging from mortgage misrepresentations to failing to report Bernard Madoff's suspicious activities to the authorities. Many believe the institution, and others like it, have become so large and complex that it may be impossible to keep employees in line – according to one analyst, "there is too much of an incentive for an individual to cut corners".[5]

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[4] Bank of America, Citigroup, Goldman Sachs, JP Morgan, Chase, Morgan Stanley and Wells Fargo.
[5] Quote from Paul Miller, a bank analyst at FBR Capital Markets, reported in Peter Eavis, "Steep Penalties Taken in Stride by JPMorgan" New York Times, January 8, 2014, at A1.

In July 2013, Thomson Reuters suspended the practice of selling market-moving data (a consumer confidence index) to high-frequency algorithmic traders up to 2 seconds ahead of making it available to other subscribers. This was in response to an investigation launched by the New York State Attorney General's office in response to a whistleblower complaint. There was no allegation of conventional illegality. Indeed, Thomson Reuters insisted that it had the right to "legally distribute non-governmental data" to "fee-paying subscribers".[6]

Likewise, BlackRock (the world's largest asset management company) recently entered into a settlement with the New York Attorney General to end its practice of surveying Wall Street analysts prior to public dissemination of their research reports. The firm also paid US$400,000 to cover investigation costs. In a January 2014 press release, Attorney General Eric T. Schneiderman called BlackRock's decision to end this practice "a major step forward in restoring fairness in our financial markets and ensuring a level playing field for all investors".

The U.K. Financial Reporting Council recently invoked new sanction powers to issue a "severe reprimand" and a £14 million fine against Deloitte for "placing their own interests ahead of the public" and compromising their own objectivity "in flagrant disregard of the professional standards expected and required" (*Deloitte* 2013, paras. 200, 270).[7] The case arose out of corporate finance advice provided by Deloitte on the sale of MG Rover. While the ethics rules of the U.K. professional accounting body require accountants to consider the public interest, the traditional view was that this only applied in respect of audit mandates (ICAEW 2013, paras. 1.2, 100.1).[8] The tribunal explicitly rejected the notion that in corporate finance and tax work, the firm's only duty is to its client (*Deloitte* 2013, para. 42).

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[6] Reported in Matt Taibbi, "Sixteen major firms may have received early data from Thomson Reuters", Rolling Stone, September 5, 2013, http://www.rollingstone.com/politics/blogs/taibblog/16-major-firms-may-have-received-early-data-from-thomson-reuters-20130905. More recently, Berkshire Hathaway's Business Wire reported that it has decided to stop giving high-speed traders direct access to news releases, after consultations with the New York Attorney-General's office. See Scott Paterson, "Traders' Access to Releases Curbed", Wall Street Journal, February 21, 2014, at C.I.

[7] The F.R.C. found that Deloitte had failed to manage conflicts of interest arising from the dual role it took on as auditor to MG Rover and advisor to a group of directors that sought to buy the company. The directors succeeded in buying the company in 2000, but the company collapsed in 2005.

[8] See also "Unintended consequences of MG Rover", economia, September 13, 2013, http://economia.icaew.com/opinion/september-2013/unintended-consequences-of-mg.

A September 2013 study by the U.K. Office of Fair Trading of the defined contribution workplace pension market raised concerns about a number of older defined contribution plans, in which as many as 190,000 savers were thought to be paying 1% or more in annual charges (as opposed to the "new wave" of defined contribution plans, where charges tend to be half that amount) (OFT 2013, paras. 6.42-6.51, 9.58).[9] The study also highlighted the lack of trustee competence and poor governance in 3,000 smaller pension schemes (OFT 2013, para. 9.25). In response to the study, the Association of British Insurers (the "**ABI**") agreed to conduct an audit of the older plans (OFT 2013, para. 9.22). The ABI also launched a public review of retirement income needs and the extent to which the current system meets them (ABI 2013).

In each of the foregoing examples, and countless others, those involved thought they were doing things "right", but did not give enough thought to whether they were doing the right thing. In most, there was no technical breach of the law but, rather, an attempt to maximize advantage, with insufficient regard for the long-term consequences.

It is clear that doing it "right" is no longer enough. Regulators, courts and legislators that find "fairness" problems in markets will intervene, often with punitive sanctions. The question is whether there is a way of understanding this pattern, predicting its future course, and prescribing conduct that avoids further sanctions. Fiduciary law offers an answer to these questions.

Fiduciary Society: Evolving Standards in the Financial Sector

As the body of human knowledge continues to grow exponentially traditional tools for supervising counterparties, available through the law of contract, cannot guarantee the effective delivery of specialized services. Individuals do not have the resources to determine whether their interests are actually being served. Instead, individuals need to trust that the specialists they retain will keep their best interests at heart (Frankel 1983).

[9] See also Josephine Columbo, "OFT stops short of a fees cap" Financial Times, September 20, 2013. According to the OFT report, the life-cycle effect of a 1% annual charge can reduce retirement savings by around 20%.

Fiduciary law aims to promote this trust (Flannigan, 310; Mitchell, 480). It applies to relationships where one party gains discretionary power over another in circumstances where both parties would "reasonably expect" that the fiduciary will exercise power in the best interests of the beneficiary.[10] It imposes a standard of conduct higher than that normally found in the marketplace, by subjecting the fiduciary to well established duties of loyalty, obedience, and care. In combination, they oblige the fiduciary to act prudently in the best interests of the beneficiary.

In setting out new norms to govern the financial sector, legislators, regulators and courts are relying on a broader view of the duty of loyalty imposed on fiduciaries – one no longer limited to disclosing or avoiding conflicts of interest. Disclosure has been shown to be an ineffective tool for managing conflicts (Cain, Loewenstein & Moore 2005), and while the avoidance of conflicts is a necessary step towards reinforcing trust in financial markets, it is not sufficient.

The Supreme Court of Canada's jurisprudence on the duty of loyalty offers the clearest outline of how this view works in practice. In the 2008 case *BCE* v. *1976 Debentureholders*, the Court reviewed a claim by bondholders who alleged that the board of BCE Inc. had not adequately considered their interests before agreeing to a change of control transaction. The Court, upholding the board's decision, held that the board, in executing its duty of loyalty to the corporation, was required to reflect on the interests of the corporation both as an economic actor and as a "good corporate citizen." (*BCE*, para. 66). The Court added that, in doing so, it was legitimate for directors to consider not only the interests of shareholders and creditors, but also broader social interests (BCE, para. 40).

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[10] Historically, fiduciary duties only applied to lawyers, partners, corporate directors, and trustees. The Supreme Court of Canada has led the common law world in adopting the more principled approach to defining fiduciary duties. Other jurisdictions later followed this court's lead. See *Guerin v The Queen*, [1984] 2 S.C.R. 335, 384; *Bristol & West Building Society v Mothew*, [1996] 4 All E.R. 698 (C.A.); *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991). The circumstances in which a reasonable expectation that one party will act in the best interests of the other will arise varies from jurisdiction to jurisdiction. The most common circumstances where this reasonable expectation arises are where such an undertaking is imposed by statute or by agreement; it can also arise where one party seeks advice from another party on a highly specialized field (e.g. law or medicine) in which the latter party has expertise. See *Galambos v. Perez*, 2009 SCC 48, [2009] 3 S.C.R. 247, at para. 84.

In addition, the "duty of impartiality" requires fiduciaries to consider and balance the divergent interests of beneficiaries.[11] Fiduciaries charged with managing and advising investment vehicles that encompass multiple generations of beneficiaries (e.g., defined benefit pension plans) must therefore consider the intergenerational implications of their decisions (or advice).[12] This imports the principle of intergenerational equity into the duty of loyalty.[13]

The definition of the duty of loyalty adopted in the American "public trust doctrine" is instructive. This doctrine starts from the premise that social and economic progress depend on a common infrastructure – natural resources - the preservation of which for future generations is a vital public goal. It aims to achieve this goal by imposing on government a duty to do so. While the present generation is entitled to reasonable use of these resources, any use that interferes with the rights of future generations is prohibited (Wood 2009a; Wood 2009b). This lies at the heart of the definition of fiduciary duty – which is to preserve assets entrusted to the fiduciary.

The logic is readily applied to the financial sector. Investors rely on a common infrastructure – their success is predicated on, among other things, a natural environment capable of sustaining their operations, an education system that prepares that enterprise's potential labour base for the workforce, and a stable, equitable economy capable of sustaining a strong consumer base for the enterprise's products or services. If this infrastructure is allowed to fail, the resultant losses will be passed on to investors, both present and future. The duty of loyalty, as it is increasingly envisioned by courts, regulators and legislators, thus imposes a similar resulting obligation on financial actors to preserve and continue to develop this infrastructure, as well as their own, for the public good.

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[11] Restatement (Third) of Trusts: Prudent Investor Rule, § 78; *Edge v. Pensions Ombudsman*, [1998] Ch. 512, aff'd. [1999] EWCA Civ 2013, 4 All E.R. 546 (C.A.).

[12] See *Withers v. Teacher's Retirement System of City of New York*, 447 F. Supp. 1248, 1257-78 (S.D.N.Y. 1978); *Varity Corp. v. Howe*, 516 U.S. 489 (1996).

[13] See, for example, *Bennett v. British Columbia*, 2009 BCSC 1358, 77 C.C.P.B. 56; *B.C. Nurses' Union v. Municipal Pension Board of Trustees*, 2006 BCSC 132, 50 C.C.P.B. 77.

Policy Proposals

Below, we describe strategies that financial institutions could follow to take into account these expectations and responsibilities. We also discuss ways in which regulators and legislators can encourage institutions to adopt these strategies. If one theme unites these proposals, it is a call for a shift in emphasis from *reactive* regulatory and compliance strategies to *proactive* ones.

Rather than satisfying themselves with "check box" compliance to regulation, institutions should anticipate future risks and consider how they may be expected to respond to these risks. Regulators, in turn, should shift from a strategy of imposing detailed, complex rules that simply respond to past failures – one that simply encourages more "check box" compliance from institutions – to strategies that do a better job of compelling institutions to think about and mitigate emerging long-term risks. Because no one institution can, acting alone, address these risks, we also propose deeper collaboration between different players in the financial sector – particularly large issuers and investors.

(a) The Fiduciary of the Future

The fiduciary of the future will need to be an ethical fiduciary: one that recognizes and follows through on its responsibility to preserve and build on the institutional system in which the fiduciary is embedded, and on which it relies. The financial sector generates wealth by directing resources to individuals and organizations that can do something constructive with them. However, as noted above, these individuals and organizations rely on more than investment for their enterprises to succeed.

This implies a duty to help preserve this infrastructure by ensuring that externalities are properly priced and moral failures are addressed (Henderson & Ramanna 2013). Fiduciaries will also be expected to identify and take advantage of opportunities to mobilize and allocate more of the resources they control for broader social, economic and environmental goals as part of their investment strategy. In many cases, this will mean seeking out and investing in existing asset classes, but it may also mean devising new ones, and new markets for them.

This will require a shift from the zero-sum perspective that has crept into finance towards a fiduciary culture - one in which the sector is imbued with a clearly articulated and generally accepted public purpose, and is perceived as a contributor (rather than extractor) of value. This implies a shift back to a culture that is relationship-based, rather than transaction-based.

The ten "Investment Beliefs" adopted in the fall of 2013 by the California Public Employee Retirement System (CalPERS), is illustrative. Their purpose is made clear from the outset: "to provide a basis for strategic management of the investment portfolio, inform organizational priorities, and ensure alignment between the Board and CalPERS staff". The principles reflect an understanding of the relationship between the generation of wealth, sound institutions, and a sustainable environment. For instance, Belief 2 states that "[a] long time investment horizon is a responsibility and an advantage". In light of this belief, CalPERS pledges to "[c]onsider the impact of its actions on future generations of members and taxpayers", "[f]avor investment strategies that create long-term sustainable value", and "[a]dvocate for public policies that promote fair, orderly and effectively regulated capital markets". Belief 9 concedes that "[r]isk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error". To address this, CalPERS commits to "consider risk factors, for example climate change and natural resource availability, that emerge slowly over long time periods, but could have a material impact on company or portfolio returns".

Similar standards should be adopted throughout the financial sector. For them to be taken seriously, institutions will need to communicate them through actions as well as words and their major investors/clients will need to be more thoughtfully engaged. As management comes to understand how such standards serve the purpose of the organization, they will start to play a larger role in the way managers monitor their subordinates day-to-day.

Enforcement should take the form of rewards – the most powerful being advancement. Clear, demonstrated commitment to ethical standards should be a crucial factor in making promotion decisions. In this way, an organization can demonstrate that it values compliance and ensure that its senior management is populated by people who place a premium on

these standards. An organization should also ensure that its compensation mechanisms do not work at cross-purposes with new standards. If pay for performance is retained, it should be oriented towards long-term performance and explicitly engineered to reward prudence and a commitment to sustainability.

(b) Collaboration

Sound, sustainable governance requires an investment. One can understand why issuers and investors would be reticent to make these investments unilaterally. It is challenging for an institutional investor to compete for investors seeking a low-cost investment vehicle while at the same time incurring the short-term costs necessary to improve the way their portfolio companies are governed (Gilson & Gordon 2013, 894-95). An issuer cannot incur the costs necessary to ensure better governance without being assured that it has the support of its largest investors. It is therefore unsurprising that, even though a culture of integrity appears to add value, on average such cultures are weaker among public companies (Guiso, Sapienza & Zingales 2005).

This is what game theorists would call a "trust dilemma". The short-term benefits of refusing to make the necessary investment until someone else steps up outweigh the short-term benefits of being the first to contribute. The way out is agreeing to share the costs. Over time, as institutions interact in a repeated and consistent manner with one another, trust develops into the default option – past trust provides the social glue that makes continued trust easier.

Collaboration drives more efficient and resilient use of resources. Existing coalitions, such as the International Corporate Governance Network, the U.S.-based Council of Institutional Investors, and the Canadian Coalition for Good Governance, have produced thoughtful proposals for reform. These efforts should be supplemented by another model, guided by three broad principles. First is collaboration between the "real" and financial sectors. Too much of the dialogue over good governance has been one-sided: e.g., asset owners telling issuers how they ought to act. It is easy to understand why managers would respond defensively. The result is that a relationship that ought to be cooperative is often seen by

both sides as antagonistic. Seating both sides at the same table, as equal partners with a common agenda, can forge the kind of trust necessary to effect collaborative change.

Second is working with a small group of leading players. Large groups have legitimacy and they an important role in defining social norms. But it is difficult for them to effect focused, practical action. The work of these groups needs to be complemented by that of a smaller, group, whose members have the capacity to follow through on their proposals. The G20 is a signal example – it played a central role in framing the international response to the global financial crisis because it was small enough to act nimbly and reach consensus quickly, but inclusive enough to ensure that its membership had the ability to transform consensus into meaningful change.

Third, such groups should be imbued with a sense of urgency, and should not be allowed to outlive their usefulness. One way of doing so is to impose a sunset clause on these coalitions (Martin Commission 2013, 45-58). Otherwise these coalitions may feel less of a need to justify their continued existence by delivering on clear goals. They may take their continued existence for granted and thus risk becoming largely self-congratulatory, with their members seeing membership as an end in itself rather than as merely a means of achieving change.

(c) Legal Mechanisms to Protect Future Generations

The problems that arise from the short-termism in the market is amplified by the short-termism of our political systems (Martin Commission 2013, 45-47). Designing public institutions to counteract such systemic weaknesses is another challenge that must be addressed.

One model is to establish a commissioner or ombudsperson for future generations, with the task of thinking about, consulting and speaking up for those who cannot speak for themselves in the struggle to define public policy and regulatory mechanisms. Several countries have experimented with this model (Weiss 2010, 110-11). The concept of an ombudsperson with a singular focus on preserving options for future generations could

draw on similar mechanisms in respect environmental and human rights that are well developed in many jurisdictions (Innerarity 2011).

Such work could be supplemented by broader reforms that seek to minimize the influence short-term political interests have on government planning and priorities. More day-to-day decision-making on issues that relate to sustainability, including infrastructure, health, and environmental protection, could be delegated to non-partisan, independent agencies, which would have sufficient power and discretion to resist short-term political pressure, but whose long-term priorities would continue to be defined by political institutions (Martin Commission 2013, 58). Guaranteed term lengths for senior administrators offer another means of securing independence from short-term political pressure. Such a reallocation of power would allow governments to "focus more on steering rather than rowing" (Martin Commission 2013, 58).

(d) Rethinking Regulation

Notwithstanding the flurry of regulation in the five years after the "global financial crisis" scant attention has been paid to some of the "big questions". How does our financial system add value? How should it add value? How can regulators better identify and respond to emerging risks? Instead of responding to these questions in a thoughtful way, most regulators have been mired in a backward-looking, highly politicized, and adversarial process. On the other side of the regulatory relationship, many financial institutions, rather than thinking about ways to innovate and develop, are focused on defending their incumbency – from regulatory intervention or in court. The result is a vicious cycle – complicated rules breed complicated systems, and in turn an "is it legal" approach to product design and institutional cultures that can put consumers at risk.

Part of the challenge is to refocus on core expectations, rather than detailed policies and procedures. Rule-making should be coherent, concise, responsive and enforceable. For example, the U.S. Federal Reserve recently issued a statement of bank capital planning that stipulated the need for "economically intuitive" criteria by which directors and management are to judge actions throughout a firm and for which they will be held accountable (Federal Reserve Board 2013, 18).

Another key is to focus on emerging risks, particularly for those most vulnerable, rather than simply respond to past failures. The U.S. Office of Financial Research, established under the Dodd-Frank Act to "to improve the quality of financial data available to policymakers and to facilitate more robust and sophisticated analysis of the financial system" (OFR 2013), may prove a useful mechanism for promoting a more holistic, forward looking and effective regulatory paradigm. This is a key argument for integrated reporting – promoting a more holistic view of value creation.

Our courts will also fill gaps in redefining the roles and responsibilities of fiduciaries. Models for "soft law" – consensual norms that reflect "reasonable expectations" migrating into enforceable legal standards are rapidly evolving. Notable examples are the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. The Office of the UN High Commissioner for Human Rights has recently confirmed the application of the Guiding Principles to financial institutions, and that they give rise to a responsibility for such institutions to conduct risk-based human rights due diligence and to use their influence to mitigate human rights harm with which investee entities are directly linked.[14]

Initiatives similar to these with respect to human rights are now being launched to develop consensual norms for sustainable financial systems. For example, the United Nations Environment Programme (UNEP) launched such an inquiry in January 2014, aiming to identify and link a growing number of complementary initiatives in "green" and sustainable finance. In the same month, the Chinese Development Research Center of the State Council released an initial exploration on "Greening China's Financial System". The leadership of emerging nations in such an enterprise is particularly promising.

Another set of legal mechanisms that merit consideration would be prophylactic rules, deliberately designed to do more than is necessary to resolve a policy problem (Ford 2010,

[14] See Letter from Craig Mokhiber, Chief, Development and Economic and Social Issues Branch, Officer of the High Commissioner for Human Rights, to Joris Oldenziel, Centre for Research on Multinational Corporations, Apr. 26, 2013, http://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf. See also Letter from Francesca Marotta, Officer-in-Charge, Development and Economic and Social Issues Branch, Officer of the High Commissioner for Human Rights, to Roel Nieuwenkamp, Chair, Working Party for Responsible Business Conduct, Organization for Economic Cooperation and Development, Nov. 27, 2013, http://www.ohchr.org/Documents/Issues/Business/LetterOECD.pdf.

55, 257, 298-99). Such rules set clear, simple standards that keep essential systems functioning while regulators determine whether a more nuanced solution ought to be imposed (Ford 2010, 298-99). They exist to prevent failure while regulators gather more information on a problem. Just as it is rational to insure a house before it burns down, it is rational to use prophylactic rules to insure against systemic risks.[15] Regulators should have both the legal power and the confidence to impose these kinds of mechanisms to deal with problems as they arise, before they have complete certainty as to the nuances of the problem.

Conclusion

The trajectory of the law is clear. Regulators, legislators and courts are expanding "fiduciary" duties based on reasonable expectations that finance should serve the public interest.

Viewed broadly, the financial sector has a choice. It can continue to be reactive, and seek to maintain an unsustainable status quo, or take a proactive and collaborative approach that is responsive to this rapidly emerging dynamic. The immediate consequences of choosing the first option are already well known - more regulation that implies higher compliance (and foregone opportunity) costs, higher penalties, lower public confidence and a less effective financial system. The longer term consequences, environmental and social as well as financial, of a failure to be proactive pose greater threats (WEF 2014, 23).

In his first economic message, Pope Francis noted that "whatever is fragile, like the environment, is defenseless" against markets that show a "lack of real concern for human beings" (Francis 2013, paras. 55-56). He argued that a financial system imbued with ethical values "would make it possible to bring about balance and a more human social order" (Francis 2013, para. 57). The Pope's remarks reflect a broader current in public opinion, a current that is increasingly reflected in the actions of regulators and courts: the understanding that the market system has achieved tremendous successes and continues to have enormous potential to serve the common good, but a belief that this potential can only

[15] See "Andy Haldane: the full transcript", The Independent, December 10, 2013, http://blogs.independent.co.uk/2013/12/10/andy-haldane-the-full-transcript/.

be achieved so long as the financial sector is guided by a sense of social purpose. This is the inflection point that our financial sector will either embrace or have imposed upon it.

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