



AlphaGovernancePartners

Governance for Sustainability in Finance and Fintech

Sound fiduciary decision-making for investment directors:
support from moral philosophy

Prepared for



CFA Society
Netherlands

vba

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April 2022

Bologna - Copenhagen - Geneva - London - New York - Singapore - Tokyo - Toronto - Zurich



DIFFICULT DECISIONS

Market ▲ 0.5 ▼ 0.12

Oil ▲ 2.45 ▼ 0.96

Index ▲ 1.56 ▼ 0.78

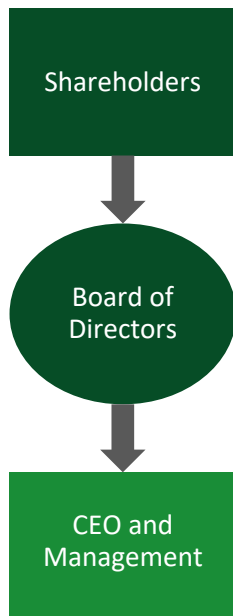
Forex ▲ 3.6 ▼ 1.65

Gold ▲ 0.02 ▼ 0.25

GOVERNANCE IN ASSET MANAGEMENT IS DIFFERENT: INVESTMENT (FUND) GOVERNANCE...

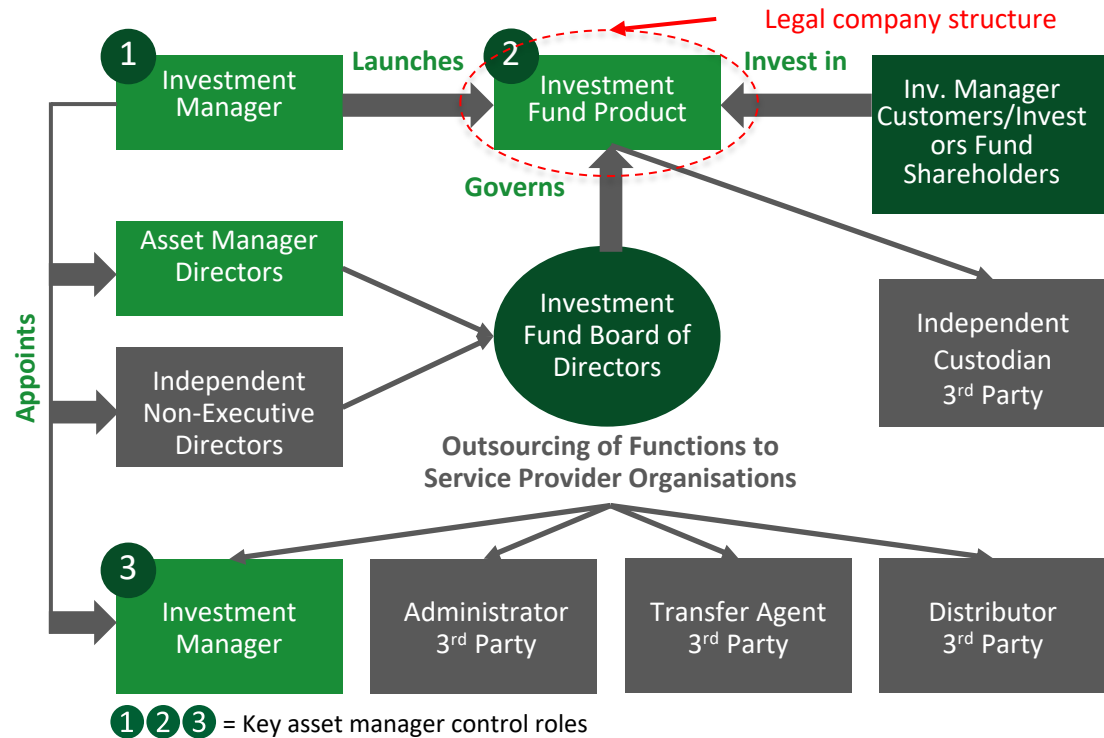


Corporate Governance Architecture



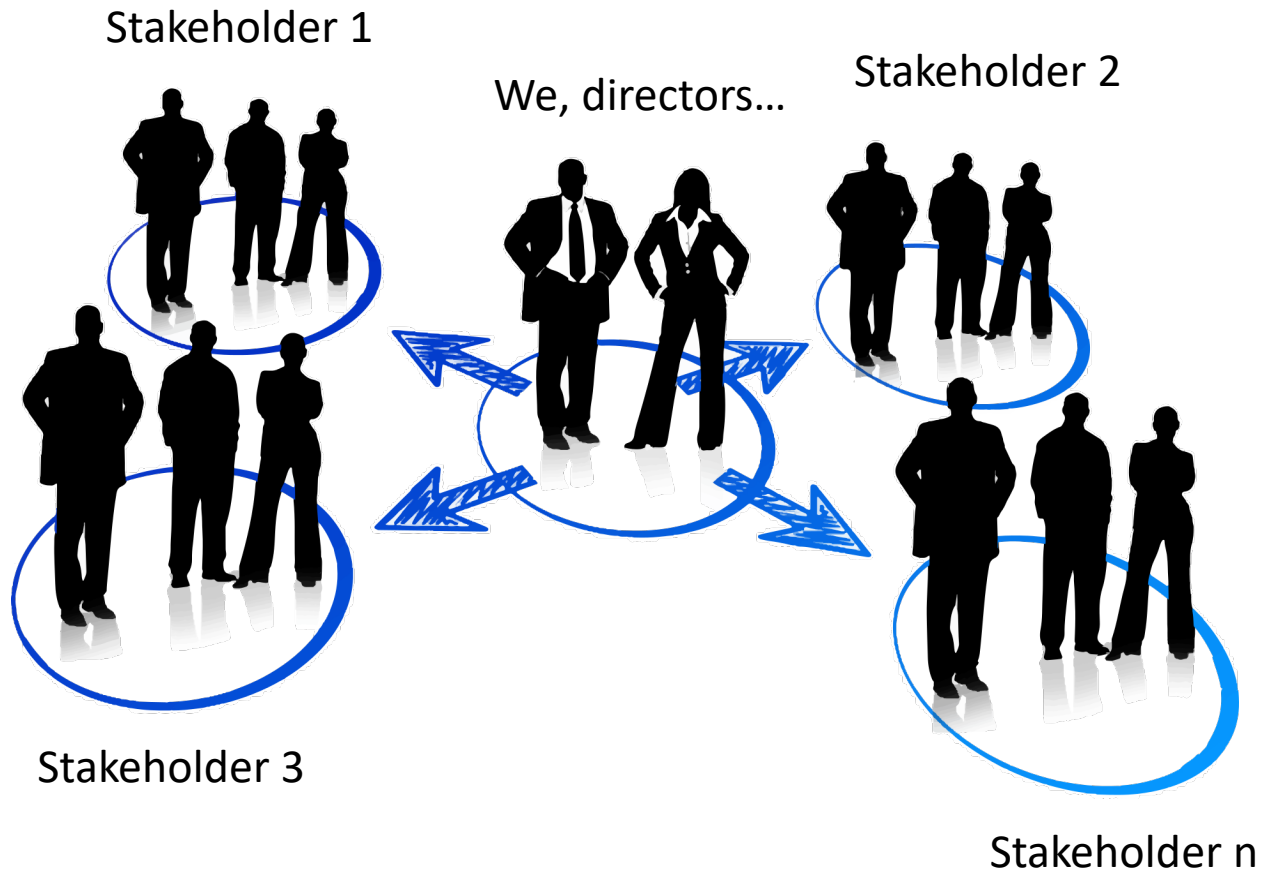
vs.

Investment Fund Governance Architecture (similar to other outsourced setups)



Cullen, M. and Brennan, N. (2017) "Differentiating control, monitoring and oversight: Influence of power relations on boards of directors – insights from investment fund boards", *Accounting, Auditing & Accountability Journal*, 30(8), pp.1867-1894.

DIRECTORS FACE DIFFICULT DECISIONS, ON THE PROCESS OF INVESTMENT MANAGEMENT AND ON CONFLICTS OF INTEREST



DECISIONS CAN HAVE VARIOUS MORAL DIMENSIONS



Directors' judgment is needed on moral intensity¹:

1. Social consensus: social agreements on what's right and wrong
2. Magnitude of consequences: overall benefit and harm of a decision
3. Probability of effect: likelihood that decision will lead to harm
4. Temporal immediacy: time between decisions and its consequences
5. Proximity: the psychological distance between director and those affected
6. Concentration of effect: spread of harm over few or many people

And on moral framing²: this determines the way a situation involving ethical aspects is presented or perceived and can be used by financial decision-makers to diminish the ethical dimension involved to justify unethical courses of action.

¹Jones, T. (1991) "Ethical decision making by individuals in organizations: an issue contingent model" *Academy of Management Review*, Vol.16, No.2, pp. 231-248.

²Trevino, L. and Nelson, K. (2007) *Managing business ethics: straight talk about how to do it right*. 4th ed. Hoboken NJ: John Wiley & Sons.

DIRECTORS FACE VARIOUS CONFLICTS OF INTEREST



	Investment managers...	Investors...	Remarks
1	want to push their investment funds through financial advisors, who need to be compensated for this	do not want to pay these fees if they receive no benefits from them	Asset volume bolstering may take place at the cost of existing investors
2	want to lower unreimbursed brokerage costs through soft-dollar commissions	want best-price execution of trades and lowest commissions	Quality of trade execution for clients may suffer
3	want to favor their own investment funds by obtaining shelf space in distribution channels	want access through advisors to the best and most appropriate investment funds for their needs	Investors may not reach the best investment fund given asset growth goals of investment manager
4	want to be able to organize investment funds to assist other business interests of the firm (group?)	want all investment decisions by the investment manager to be at arm's length and objective	Abuse of the investment fund from the investor's point of view may interfere with the quality of the investment manager's investment decision
5	prefer independent directors who comply with rules but who are cooperative	prefer directors who will robustly perform their fiduciary duties	Investment fund directors should be free to act only in the best interest of the investors
6	want maximum fees and expense reimbursements	want their fund directors to negotiate minimum total cost	The best interests of both parties are diametrically opposed
7	want to ensure they are reappointed	want boards that act vigorously in selecting the best service providers	Investment managers take the lion share of the revenues from the investment fund
8	want to increase assets under management	want optimal investment returns	The investment manager may sacrifice investment returns to enable asset growth

Smith, R. and Walter, I. (2006) *Governing the modern corporation*. New York: Oxford University Press, pp.138-144.

DIRECTORS' DECISION-MAKING CAN BE SERIOUSLY FLAWED



Carillion PLC

Carillion directors to face FCA action for misleading investors

UK regulator plans to publicly censure the company rather than impose financial penalties



Carillion was liquidated in 2018 with just £29m in cash and £7bn in liabilities, leaving taxpayers to pick up the pieces © Bloomberg

Matthew Vincent and **Gill Plimmer** NOVEMBER 13 2020

The UK's financial regulator has said it is planning to take action against former directors of Carillion, almost three years after the government contractor collapsed under £7bn of liabilities, leaving taxpayers to pick up the pieces.

<https://www.ft.com/content/55a5136a-25a2-43a6-a085-3904ee72f60c>

WITH DRAMATIC CONSEQUENCES...



- Huge financial and reputational losses for a variety of stakeholders
- Erosion of trust in the system of governance: law makers, regulators, directors
- Societal anger, feeling of betrayal, followed by withdrawal: “*why bother?*”



A black and white photograph of two men in business attire standing in front of a large window. They are both holding and looking at documents. The man on the left is partially visible, wearing a dark suit jacket. The man on the right is shown in profile, wearing a light-colored button-down shirt. The window behind them shows a blurred cityscape with buildings and trees. The overall mood is professional and focused.

WHAT AGAIN IS A DIRECTOR'S DUTY?

LET'S BACKTRACK: FIDUCIARY DUTY OF A DIRECTOR



- We all know the legal fiduciary duty in our jurisdiction
- Directors accept a fiduciary duty (based on merit, for a fee)

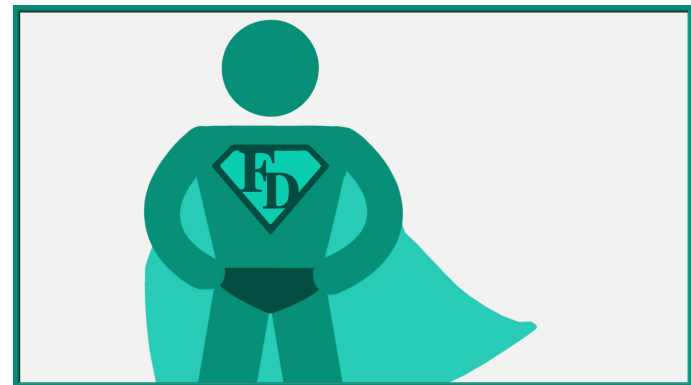
But: what does *fiduciary* mean?

- A relationship is fiduciary in nature when one party (the fiduciary) has *discretionary power over the interest of another* (the beneficiary) and *is obligated to use that power to serve the other's best interest*
- The investment industry is so specialised that clients need to trust strangers. The beneficiary *cannot meaningfully oversee* the work of the fiduciary – the beneficiary is *vulnerable...*

LET'S BACKTRACK: FIDUCIARY DUTY OF A DIRECTOR



- So, it is *related to trust*: protecting assets for those who cannot manage this themselves
- In 1928 already, Chief Judge Cardozo (1928) stated: *“a trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior”*
- So the fiduciary duty is not a market element, and is not part of contract law...
- Fiduciaries serve a huge social interest; failure is seen as a huge moral wrong...



Cardozo, C. in *Meinhard v. Salmon*, 249 NY 458, 464, 164 NE (1928), pp. 545-546

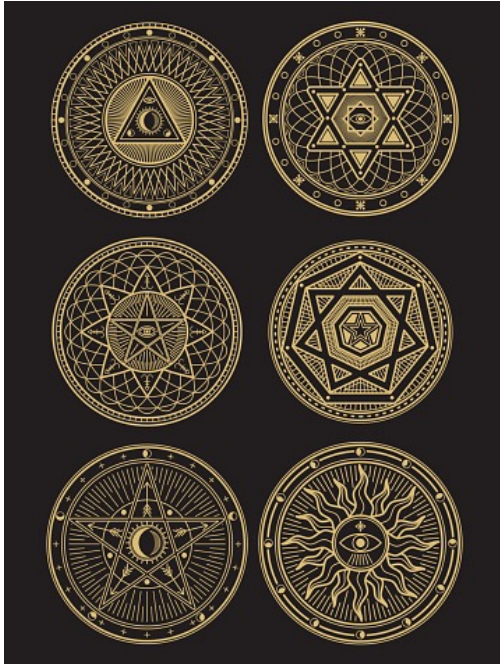


CAN MORAL PHILOSOPHY HELP?

WHAT IS ETHICS, REALLY?



- Ethics as a field of practice: it sounds esoteric, however, we want to be precise, know for certain. Can directors handle ambiguity? What is ethics, really?



WHAT IS ETHICS, REALLY? (CONT'D)

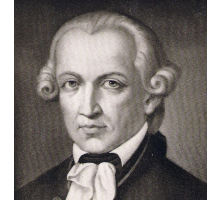


- Ethics or moral philosophy is a branch of philosophy that *involves systematizing, defending, and recommending concepts of right and wrong behaviour* (Wiki 😊)
- Ethics seeks to resolve questions of human morality by defining concepts such as good and evil, right and wrong, virtue and vice, justice and crime
- Ethics is having the right thought and doing the right thing - it doesn't get more precise



- So on making good decisions for others, it seems fiduciary duty falls in the domain of ethics...

ULTRA BRIEF INTRODUCTION TO DEONTOLOGY



Immanuel Kant (1724-1804)

(1) Look at actions, not in isolation, but as following from rules of conduct (laws)

(2) *“Morals is not really the doctrine of how to make ourselves happy, but of how we are to be worthy of happiness”*

(3) *“Act as if the maxim of your action were to become, by your will, a universal law of nature”*: this is Kant’s definition of reasonability, it focuses on intent

(4) An instruction to behave in a particular way is an imperative. Only the categorical imperative has moral content: absolute and unconditional

The ultra brief introductions are sourced from Wolff, J. (2018) *An introduction to moral philosophy*. New York: W.W. Norton & Company.

ULTRA BRIEF INTRODUCTION TO DEONTOLOGY (CONT'D)



An action has moral worth if used according to (3) (*universal law*). Neglecting others is a failure of a duty to other people. Kant considers human beings under two aspects:

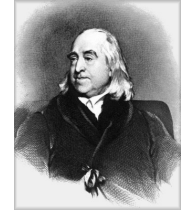
- a) A natural, empirical being of experience, with desires and happiness-seeking
- b) A being with inner freedom, acting in accordance with reason and capable of following moral law

Each person is both ruler and ruled: morality as a system of rational laws, a system that binds people. It follows then that a duty to oneself is a duty to subjugate one's desires to one's rational freedom (so follow reasonability as in (3)...)

ULTRA BRIEF INTRODUCTION TO UTILITARIANISM



Jeremy Bentham (1748-1832)



Principle of greatest happiness (= utility): that principle which approves or disapproves of every action whatsoever, according to the tendency if the action promotes or opposes happiness

Happiness is understood to be the balance of pleasure over pain, cumulated for all humanity. Bentham's central convictions:

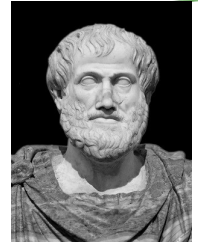
- (1) Morality requires everyone to be treated as an equal
- (2) Only things that matter are the pleasures and pains of sentient creatures (...)
- (3) Morality and good governance (of humanity) have to be based on firm principles



Observations

- Measurement problem: how can we compare pains and pleasures against each other and across persons? Bentham: in intensity and duration, Mill: quality. How can/should we discount future pains and pleasures? Maybe we just ask people...
- Sedgwick: it is rational that we try to achieve works of excellence for the happiness of others
- Nozick: what matters is not so much how things feel to us, but whether we really have accomplished the things we set out to accomplish in our lives
- Example of an application: taxation (is this justice? Yes/no, because...

ULTRA BRIEF INTRODUCTION TO VIRTUE ETHICS



Aristotle (384-322 BC)

- (1) People cannot always expect to find precise answers to ethical questions, because these are often messy, complicated and ambiguous
- (2) People should expect answers to be tentative or imprecise
- (3) Acting morally, focused on living a good life, requires practical wisdom, which requires judgment and experience, it requires thinking and acting
- (4) Concern is with what sort of people we should be: what character we should try to develop – what do we feel (e.g. sympathy) – how should we live



(5) Living a good life = being happy (\neq pleasure) -> Aristotle focuses on the function of a human being, which is flourishing

(6) „*Human good turns out to be the activity of soul exhibiting virtue, in accordance with the best and most complete*“

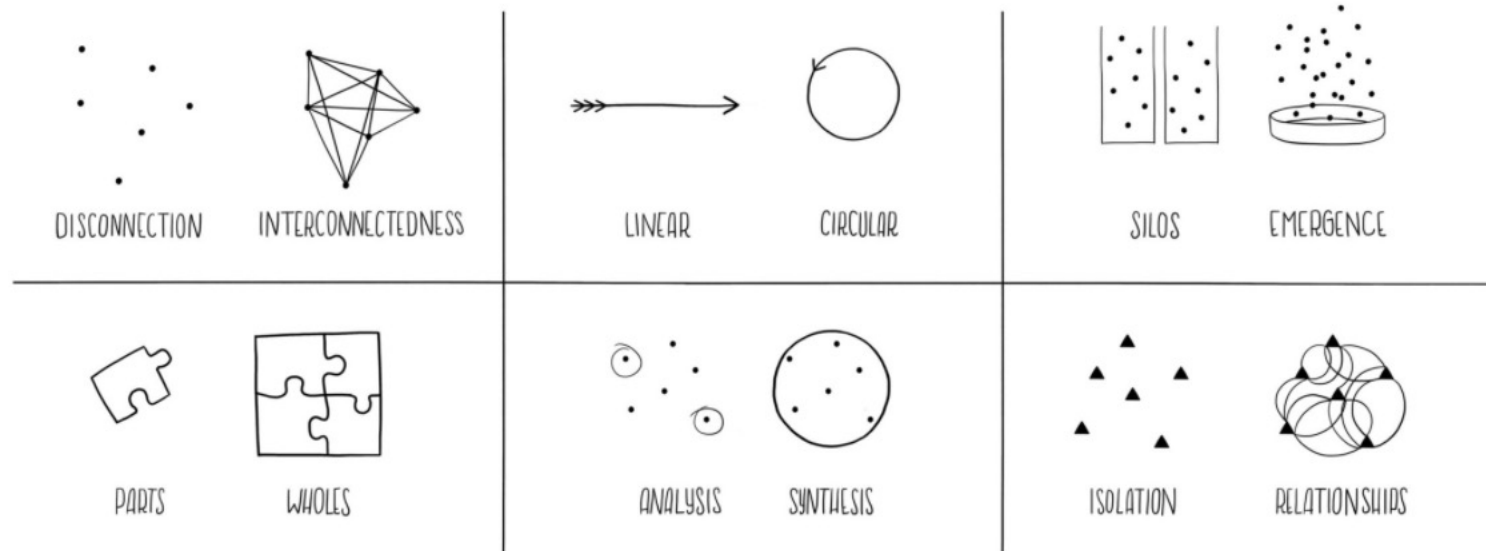
(7) Intellectual virtues: reflection and contemplation leads to the highest degree of happiness, because it is more godlike than anything else we do, or: the conception of happiness is to live life in conformity with human excellence, or virtue

(8) A morally admirable person is someone who possesses the virtues and acts on her/his perceptions on what ought to be done (a.k.a. practical wisdom)

INTERIM CONCLUSION FROM MORAL PHILOSOPHY



There are thinking systems out there, which can help make sense of it all



p.s. what are you? One example of a self-test:

<https://www.propofs.com/quiz-school/story.php?title=are-you-utilitarian-deontologist>



ETHICS CAN SUPPORT DECISION MAKING

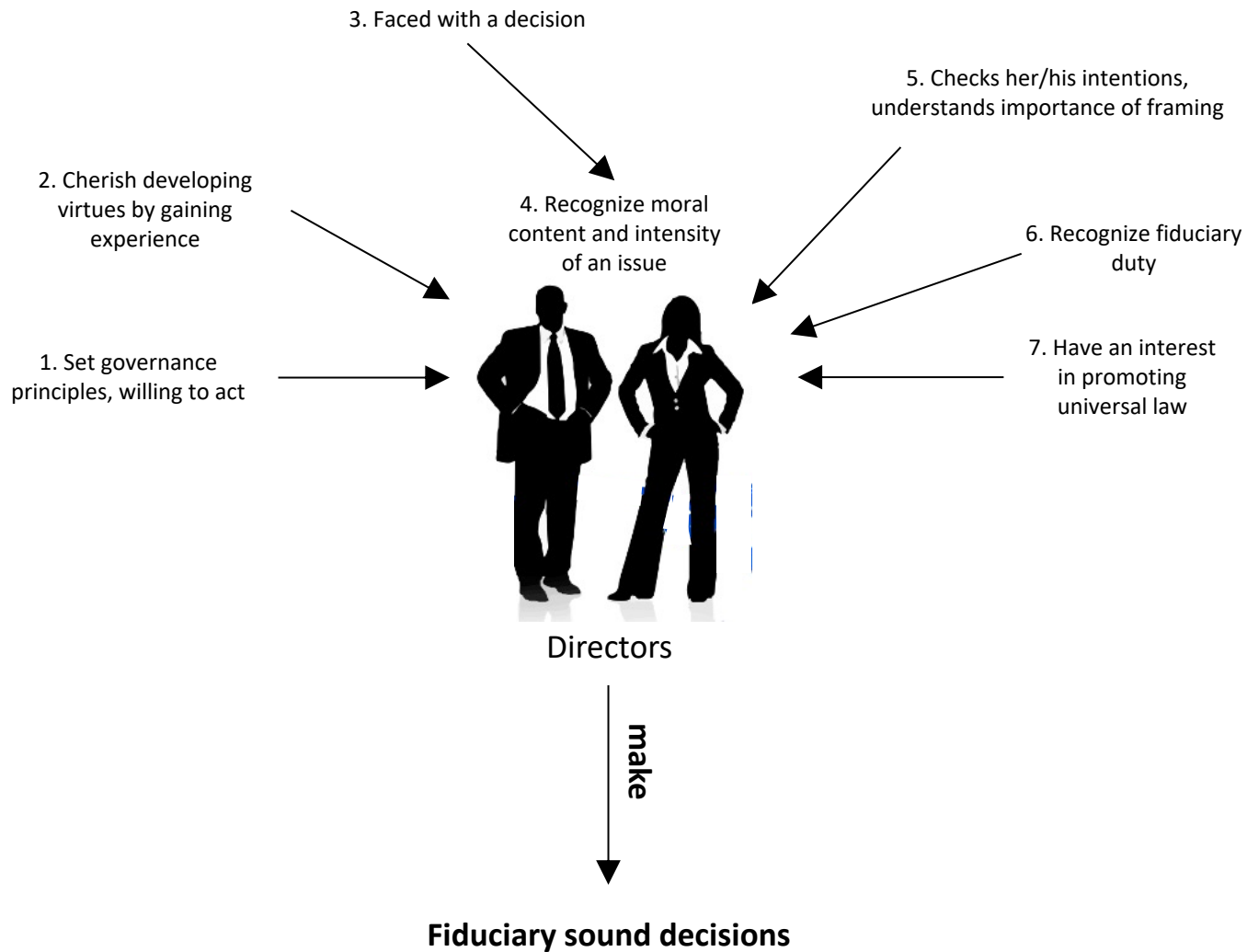
CONCLUSION FROM MORAL PHILOSOPHY



Deontology	Utilitarianism	Virtue Ethics
Rules of conduct can be established (excluding influencing dependencies)	Firm principles for governance can be established	Virtues are important. Check how they are impacted by relationships, commitments, assets at stake, incentive systems, inside information etc.
Check intention and categorize as categorical	Stakeholders can be seen as equal persons	
Check if a decision be seen as universal law	Happiness of stakeholders can be assessed	

While we can regulate, many questions remain: on how to gain experience, on how situations may vary, on consistency. But we already know from the legal definition that some virtues are required: care, prudence, loyalty, impartiality, and others

CONCLUSION FROM MORAL PHILOSOPHY (CONT'D)



CONCLUSION FROM MORAL PHILOSOPHY (CONT'D)

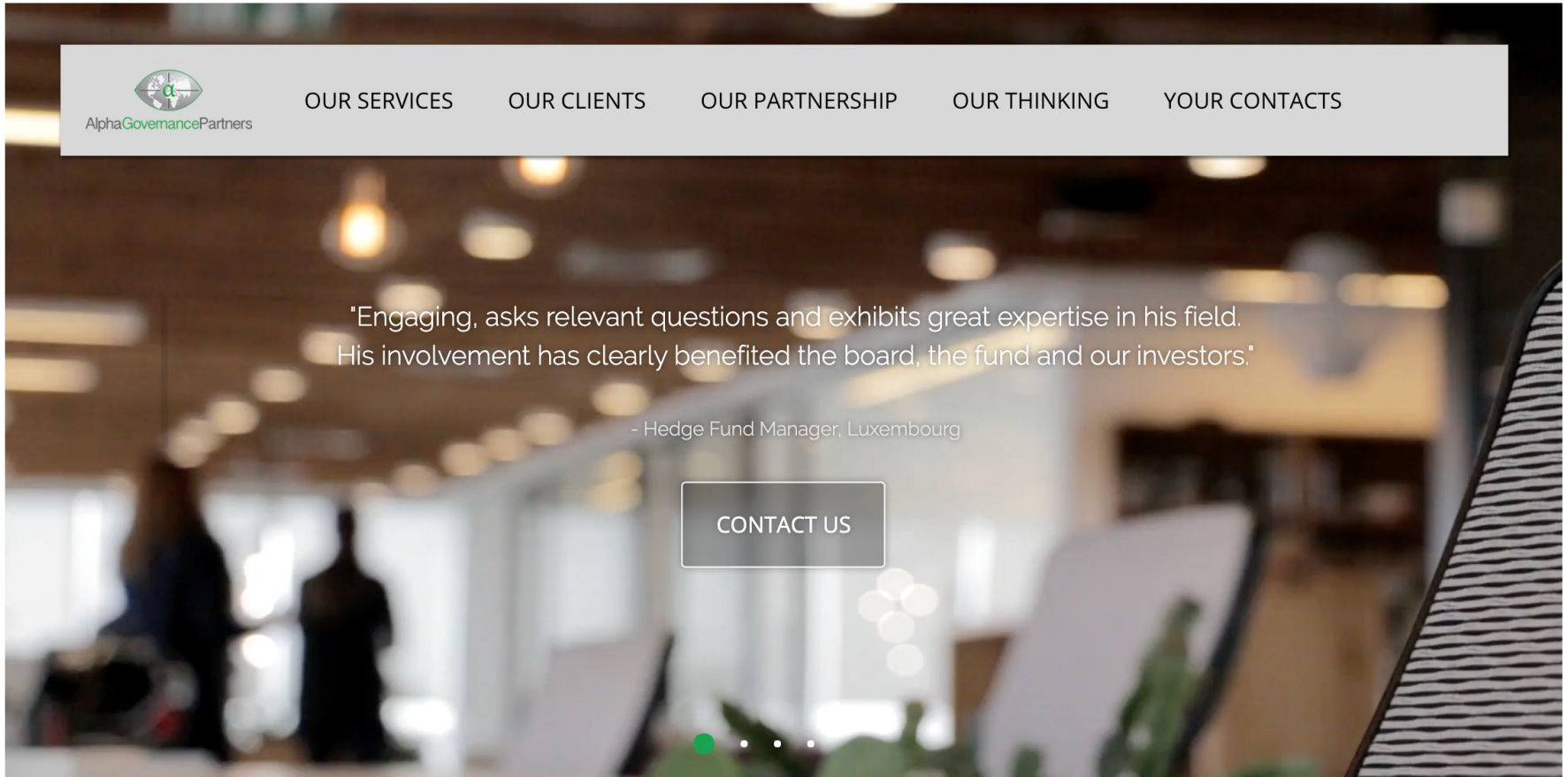


The checklist: a director...

1. sets governance principles and is willing to act on them
2. cherishes developing virtues by gaining experience
3. who is faced with a decision, in which a conflict of interest may or may not appear
4. recognizes the moral content and intensity of the issue at hand
5. checks her or his intentions, understands the importance of framing
6. recognizes her or his fiduciary duty
7. has an interest in promoting universal law, and...

... makes a sound fiduciary decision


APPENDIX: MORE ON WWW.ALPHA-GP.COM



Welcome to Alpha Governance Partners: high-end investment and fintech fiduciaries.

ANNEX 2: DR. EELCO FIOLE, CFA, FELLOW IOB - ZURICH & SINGAPORE



 Managing Partner (co-founder), Alpha Governance Partners (AGP), fiolo@alpha-gp.com, +41 76 522 8140, +65 8820 7815, @eelco_fiolo
Alpha Governance Partners, the only jurisdiction-agnostic, conflict of interest-free, high-value-add partnership providing professional fiduciaries with high cognitive diversity to any financial company or vehicle. The 6 partners serve on financial service entities such as banks, wealth managers, asset managers, investment funds, charities, family office vehicles, management companies, supra-nationals, pension funds and fintech incl. blockchain and crypto and are spread over Bologna, Copenhagen, Geneva, London, New York, Singapore, Tokyo, Toronto and Zurich

Summary

Eelco is a non-linear T-shaped finance polymath and accomplished and trusted, regulator-approved professional fiduciary and advisor. Versatile and hands-on, up-to-date lateral thinking, resilient and enabling, globally networked, bridging the big picture and the detail. Strong analytical, synthesis and communication, motivation and negotiation skills, building cross-functional relationships on all levels, across cultures. With 25+ years in the industry, of which 15+ years in fiduciary board-, CFO- and COO-roles, strategizing and executing, clients and peers value his integrity, presence, hands-on experience, initiative, creativity, judgment and methodological team approach to solve issues, allowing for ambiguity. Eelco is a regular guest speaker on governance, ethics and risk



Formative Experience

Designing financial and investment management for the Tezos Foundation (largest blockchain fundraising in 2017), managing a burning multi-bn hedge fund platform at Credit Suisse, the Lehman-, Madoff-, Parmalat-events, a pan-African change project at a Lagos-listed universal bank, controlling for exponential growth at UHNWI-firm Centrum Bank, the UBS/SBC-merger integration, group-level ABN AMRO-training

Career

- **Professional director and advisor (AGP), 2015-**, blockchain (incl. tokenisation), sustainability (incl. SFDR, TCFD), impact private equity; previously: quant, hedge funds, emerging markets, insurance-linked, structured products, private debt, trade finance, China equities, Africa real estate
- **A decade as C-level in banking, wealth- and investment management, and blockchain** a.o. CFO at the Tezos Foundation in Zug (equity USD 600 mn (crypto and fiat)), COO at Credit Suisse Alternative Investments, with teams in Zurich, London, and New York, with risk-based veto rights (AuM USD 17 bn), Group-CFO at partner-owned alternatives provider Millennium Global Investments (backed by RIT Capital and APEX) in Geneva and London (AuM USD 15 bn), CFO at UHNWI-manager Centrum Bank, (AuM USD 10 bn), now part of VP Bank, Vaduz and CFO of the UBS Corporate Center in Zurich (incl. Group Treasury, -Participations and -Real Estate) during and after the UBS/SBC-merger
- **5 years as consultant and project leader**, incl. at PwC Zurich with focus on financial institutions (incl. on the ground in China, MENA, Africa). **6 years as corporate and institutional banker** and financial analyst at ABN AMRO Amsterdam/Maastricht and UBS Basel

Education

- PhD Economics (Basel), ExM Environmental Governance (Geneva, 2022), MSt Social Innovation (Cambridge), MAS Applied Ethics (Zurich), M Blockchain Technologies (Barcelona), M Positive Leadership (Madrid), M Laws (London), MSc Bus Admin, BEng Mech Engineering (both Rotterdam)
- CFA, FIoD (CDIR), QRD, FRM, SCR, CAIA, CDDA, CIFD, IFQ, CL6σBB, CMA, CPM, ACI Arb, exec. education at a.o. Chicago, Harvard, Stanford, Wharton

Extracurricular

- Languages: English, (Swiss) German, Dutch, with a base in French, Mandarin and Spanish
- Adjunct Professor Finance Ethics Universities of Lausanne and Neuchâtel, Member of Council, Institute of Directors, Chair Alpha Summit Advisory Group, CFA Institute, Jury Member Ethics & Trust in Finance Global Prize, Director Governance, Cambridge University Sustainability & Social Impact Society, Contributor thinktank Finance Transition Lab. Previously a.o. Instructor Investment Governance, Swiss Finance Institute, Instructor Risk Management, Euromoney, Program Director APAC, CIFD Institute, Member Exam Council CAIA Association, Contributor Sustainability Hedge Funds, UNPRI. Nominated Inspirational Leader Award, CFA Institute 2022. Author of various professional papers. Enjoys (professional) literature, seasonal sports, yoga and family, 20 years of substantial private exposure to China, travelled approx. 100 countries