

Ethics and Finance - Spring 2013 – Course Syllabus

University of Houston MBA Program – FINA 7397
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This course aims to use the lessons of Enron and the recent financial crisis to teach a practical approach to corporate ethics. Instruction will focus on how to identify important ethical issues and the handling of such issues within a business organization. Students will learn how to develop tactical plans that allow issues to be raised with the greatest probability of an ethical outcome.

The course is case study-based, with a focus on financial matters. A total of twenty-five case studies will be discussed in class. Half of these are new cases dealing with individuals and firms during the financial crisis. Each case includes background on market conditions, competitive dynamics and financial innovations. Students will encounter Enron's development of energy derivatives and Special Purpose Entities. They also will learn how Wall Street created subprime Collateralized Mortgage Obligations (CMOs), Credit Default Swaps, and Synthetic CMOs, and attempted to manage their associated risks. Guest speakers from Enron and Wall Street will share insights into ethical dilemmas they faced within high-pressure environments. Lesson harvested from the Enron history will be used to examine the financial crisis cases.

The first half of the course follows the trajectory of Enron's ethical decomposition. Beginning with case studies from 1987, students follow Enron through its downgrading of internal financial control, the abuse of mark-to-market accounting, its steadily more aggressive use of off-balance sheet financing, and corrupt related party transactions. Then students will examine the plight of Enron's resisters, such as Sherron Watkins, Jordan Mintz and Vince Kaminski, as they struggled to raise ethical issues with a deeply compromised management.

The second half examines ethical issues which arose during the recent financial market crisis. This will be examined both in terms of the large impersonal forces which encouraged ethical misconduct and the choices of individuals facing these ethical dilemmas. Specific attention will be given to the controls failures which caused investment banks and the Rating Agencies to ignore huge risk concentrations that almost overwhelmed the financial system. The course then concludes with financial whistleblower cases that examine new protection and disclosure options for resisters. Attention here is devoted to the Sarbanes-Oxley and Dodd-Frank laws and to new watch-dog blogs and whistleblower law firms.

Specific areas of instruction will include:

- Principal forms of corporate corruptions: Agency behavior, conflicts of interest, collusion, related-party transactions, false disclosure, and insider trading
- Personal readiness to confront ethical issues within a business career
- Financial Control fundamentals and the economic rationale for good controls
- How to develop a tactical game plan for working an ethics issue
- What constitutes the line between creativity and deception in:
 - “Managing “ reported accounting results
 - Announcing material disclosures in public markets
 - The use of off-balance sheet legal entities and financing
 - Transaction disclosures to clients and counterparties
- The conflict in-house legal counsels face between responsibility to the client and to the law, and the special capacities attorneys possess to resist unethical practices
- When it is both ethical and effective for resisters to take their concerns outside the company
- What risks does a whistleblower take and what protections are afforded by current laws

Classes will typically consist of two case studies per week, supplemented by lectures. Guest speakers will join us to critique presentations of cases in which they were involved. It is anticipated that Sherron Watkins, Vince Kaminski and Jordan Mintz will be the Enron alumni guest speakers.

We are also pleased to welcome back Eric Kolchinsky to our class. He will join us in March to analyze a case devoted to Moody’s ratings of sub-prime mortgage bonds and collateralized debt obligations (CDOs). Mr. Kolchinsky served as Managing Director for Sub-Prime Mortgage CDO ratings until October 2007.

Students should expect to participate in teams that organize and present at least two case studies during the course of the semester. Grades will be apportioned 60% to the case study presentations, 30% to a final exam and 10% for class participation. The final exam will likely be a take-home case study.

Reading assignments and case studies will primarily be found in *Resisting Corporate Corruption, 2nd Edition, Lessons in Practical Ethics from Enron and the Financial Crisis. (RCC)*, Stephen V. Arbogast, M & M Scrivener Press. *The Smartest Guys in the Room (SMGR)*, McClain and Elkind, will be used to provide background material on Enron. RCC will be available on Amazon on or about February 1. Until such time as the book is available, assigned cases will be posted on Blackboard. SMGR can be purchased in paperback from Amazon.com.

All students should read the first case study, Enron Oil Trading A, prior to the first class. For convenience sake, this case will be posted on Blackboard at least a week in advance of the first class. Student are encouraged to visit with the Professor to discuss their cases. His office is 220-D in Melcher Hall and office hours are Tuesday and Thursday from 4:30-6:00 PM. The Professor may also be contacted at svarbogast@comcast.net or svarbogast@uh.edu.

At the conclusion of the course, students should have an enhanced awareness of the ethical issues that arise in business, of the tactical options available to address such issues, and of the signal importance of sound financial control in maintaining an ethical business culture.

Good Luck and Enjoy the Course

Final Words:**Academic Honesty:**

The University of Houston Academic Honesty Policy is strictly enforced by the C. T. Bauer College of Business. No violations of this policy will be tolerated in this course. A discussion of the policy is included in the University of Houston Student Handbook, <http://www.uh.edu/dos/hdbk/acad/achonpol.html>. Students are expected to be familiar with this policy.

Accommodations for Students with Disabilities:

The C. T. Bauer College of Business would like to help students who have disabilities achieve their highest potential. To this end, in order to receive academic accommodations, students must register with the Center for Students with Disabilities (CSD) (telephone 713-743-5400), and present approved accommodation documentation to their instructors in a timely manner.

Class Topics, Cases and Readings

<u>Date</u>	<u>Topic</u>	<u>Assignments</u>
<u>Module 1: Causes & Nature of Corruption at Enron</u>		
January 15	Course Introduction, Why Finance? Why Enron? How to do an Ethics Case CEO's and Ethics: Ken Lay's Dilemmas w/ Enron Oil Trading	RCC: Preface SMGR, pp. 10-19 Case Study: <i>Enron Oil Trading (A)</i>
January 22	Personal Formation in Ethics Fundamentals of Financial Control Economics of Financial Control Role of Internal Audit Pressures on Audit; The Politics Of maintaining Audit's Role	RCC: Essay 3 SMGR, pp. 19-26 Case Studies: <i>Enron Oil Trading (B&C)</i> <i>Enter Mark-to-Market (A)</i>
January 29	Market Pressures & Ethics Compensation Systems & Ethics <i>Enron's "Gas Bank"</i> Ethics and "Creative" Accounting Enron's version of 'Mark-to-Market' Neutering Corporate Gatekeepers Ethics and the Aggressive Client	RCC: Essay 2 SMGR: 27-43 Case Studies: <i>Enter Mark-to-Market (B)</i> <i>Adjusting the Forward in the Back Room</i> Guest: Vince Kaminski
February 5	Spread of questionable practices when controls are impaired Abuse of "Off-balance Sheet" Efficient/Transparent Markets <i>Commodities Trading under MtM</i> Dealing with a Known Legal Violation	SMGR: 85-92, 114-118 Case Studies: <i>An SPE Too Far?</i> <i>Court Date Coming in California</i>
<u>Module 2: Resisting Corruption at Enron</u>		
February 12	Roots of the "Agency Problem" <i>LJM & Related-Party Transactions</i> Conflict of Interest Policy Standard Related-Party Controls <i>Going to the Top" with an</i> <i>Ethics Issue: Skilling and LJM</i>	SMGR: 208-211 Case Study: <i>New Counsel for Andy Fastow</i> Guest: Jordan Mintz

February 19	CEOs and Public Disclosure Internal vs. External Whistleblowing Could Enron Have Been Saved? Vinson & Elkins Investigation	Case Studies: <i>Lay Back and Say What? Whistleblowing before Imploding in Accounting Scandals?</i> Guest: Sherron Watkins
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Module 3: Unethical Roots of the Financial Crisis

February 26	Mortgages & Securitization <i>Evolution of Sub-prime Mortgages</i> Fannie Mae & Affordable Housing CMOs & CDOs Wall Street's Appetite for Risk Waiting Out a "Race to the Bottom"	Essay 4: <i>Tactical Lessons from Enron Cases</i> Case Studies: <i>Should Countrywide Join the Subprime Mortgage Race to the Bottom? Juggling Politics, Public Policy and Profits at Fannie Mae (A)</i>
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March 5	Competition, Commoditization And Scandal on Wall Street Banking vs. Trading on Ethics SOX & VIE Rules Bank Capital, Sub-prime & SIVs for "Super-Seniors"	Essay 5: <i>Underappreciated Origins of the Financial Crisis – a Personal Memoir</i> Case Studies: <i>Seeking a Sustainable Business Model at Goldman Sachs Admission of Material Omission? Citi's SIVs</i>
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March 13	SPRING BREAK	
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March 19	Why Rating Agencies were critical to Sub-prime securitization NRSROs as Public Companies Internal Whistleblowing after SOX Legal immunity at NRSROs	Case Studies: <i>Ratings Integrity vs. Revenues at Moody's Investors Service</i> Guest: Eric Kolchinsky
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Module 4: Consequences at Firms in the Financial Crisis

March 26	What are Hedge Funds? Hedge Fund Disclosure Rules Derivatives Accounting at Fannie Mae	Case Studies: <i>Subprime Heading South at Bear Stearns Asset Management Juggling...at Fannie Mae (B)</i>
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April 2	<p>Corporate Corruption and Financial Markets:</p> <ul style="list-style-type: none"> - Deregulation & Corporate form - Evolution of Products/Markets - Compensation Systems <p>Innovation, Diminishing Returns And Pressures to sustain returns Wall Street Trading & Controls</p>	<p>Case Studies: <i>Facing Reputational Risk on Goldman's Abacus 2007-AC1</i> <i>Time to Drop the Hammer on AIG's Controls?</i></p>
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Module 5: Ethical Resistance at Corrupt Financial Firms

April 9	<p>Financial Market Guardians: The Role of the Rating Agencies and their conflicts of interest Role of the Rating Agencies in Financial Crisis SOX effective protection of whistleblowers</p>	<p>Case Studies: <i>Write to Rubin?</i> <i>Time to Report Moody's to the SEC?</i></p>
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April 16	<p>Outside Whistleblower Options <i>Expert Blogs & Hedge Funds</i> Dodd-Frank protections/bounties False Claims Act</p>	<p>Case Studies: <i>Wean Lehman off Repo 105?</i> <i>Take CitiMortgage to the Feds?</i></p>
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April 23	<p>Tax Avoidance & Ethics <i>The M&A "Mixing Bowl"</i> Examples of 'Over the Line' Tax Avoidance Structures Ethical gray zones & boundaries</p>	<p>Case Study: <i>Newco</i> Guest: Eric Herpin, Chief Tax Counsel</p>
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April 30	<p>Course Summary and Review for Take-Home Case Study Final</p>	
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