2013

Sworn to Fun, Loyal to None: Time Inconsistent Preferences in Investment Banking

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INTRODUCTION

"Sworn to Fun, Loyal to None" was the slogan on a popular T-shirt in the 1970's.[1] Parents put up with the T-shirts, and similar attire, but worried about fleeting sexual encounters, drugs and other irrational risks younger people took with their lives. Some young people got in trouble with the law, usually for controlled substances, civil disobedience and other relatively minor offenses. Short term thinking was a psychological

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[1] The T-shirt is still marketed widely. *See* <http://transfernation.com/shopsite_sc/store/html/sworntofuntshirt.html>

trait many people associated with immaturity, whether or not there was credible empirical evidence of an inverse correlation between this cognitive bias and age.

By the 1980's things began to change. Many young people cut their hair, mothballed their counterculture T-shirts, donned suits and interviewed for jobs in business. A generation that had indulged itself in the culture of immediate gratification in the 1960's and 1970's was presumably learning to set long term goals and work to accomplish them.

Beginning in the 1980's, however, it seemed that more corporate executives were getting into trouble with the law, usually for fraud and similar offenses. The perpetrators were both young and old. It seemed that, despite highly publicized criminal prosecutions and multiple legislative reforms to curtail corporate crime, the situation got progressively worse. The insider trading scandals of the 1980's[2] were followed by the S&L scandals of the early 1990's.[3] Then Enron and Wordcom collapsed and there were more criminal prosecutions as well as the Sarbanes-Oxley Act of 2002. The near collapse of the entire banking industry in 2008, the Madoff, Stanford and Petters ponzie schemes, and other scandals led to the Dodd-Frank Act of 2010. Even in 2011, MF Global's collapse revealed that billions of dollars of customer money had been "lost" and in 2012 JP Morgan lost over $6 billion because a derivatives trader dubbed the "London Whale" had exposed the bank to almost unlimited liability and then lied about it.

Was the business world of the 1980's forward really a place that would temper young people's desires to live for the moment and encourage thinking about long term goals? This anecdotal evidence from the last thirty years suggests it was not and is not. Indeed, the business world may shorten yet further the analytical time horizons of the people who enter it.

This comment addresses a particular segment of the business world, the investment banking industry. Over more than three decades,,

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[2] *See e.g.*, United States v. Boesky, 674 F. Supp 1128 (S.D.N.Y 1987); *see also* United States v. Milken, 3 Fed. Sent. R. 159 (1990), 1990 WL 310497 (S.D.N.Y 1990).

[3] The collapse of Lincoln Savings and Loan, and the troubled criminal case brought against its chairman, Charles Keating, was probably the most notorious case from this era. *See* United States v. Keating, 87 F.3d 1324 (9th Cir. 1996).

dramatic changes in society and in the industry created an environment that emphasizes short term thinking. "Sworn to Fun, Loyal to None" would become an acceptable mantra, although perhaps more appropriately displayed on a Hermes tie than on a faded T-shirt.

Drawing on the insightful observations about time inconsistent preferences in Professor Utset's article, this comment suggests a psychological and cultural explanation of what went wrong in investment banking from the 1980's through 2008 (this author and Professor Claire Hill will explore this topic in more detail in an upcoming book). Although the time inconsistent preferences that Professor Utset identifies are universal and are found in many different people and cultures, these biases probably influence decision making in some cultures more than others. Time inconsistent preferences also are not uniform in a single population; people think differently and have different preferences between short term and long term goals. Whether or not time inconsistent preferences are normally distributed among a population, there is a mean and a distribution around that mean. The relevant question for the investment banking industry is where on this distribution are the people who go into banking? Have people with the most extreme time inconsistent preferences selected careers in this industry and have investment banks selected and promoted these people within their ranks?

This comment does not propose a solution to this phenomenon (Professor Hill and this author have done that elsewhere[4]). Understanding the impact of time inconsistent preferences on the investment banking industry – and how that impact may have intensified in recent decades – is, however, a first step to determining what might be done about it.

I. THE GENERAL CULTURE

Broad cultural trends that intensify time inconsistent preferences in society as a whole also impact investment banking. Two of the most

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[4] *See* Claire A. Hill & Richard W. Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 SEATTLE U. L. REV. 1 (2010). A forthcoming book by the same authors will address these issues further.

pronounced trends in modern society are uncertainty about the future and the declining importance or intergenerational relationships.

A. UNCERTAINTY ABOUT THE FUTURE

Comparing future payoffs with present payoffs is difficult against a backdrop of uncertainty. This comparison is even more difficult if there is a significant chance that, no matter what one does now, the value of future payoffs is zero.

People who started their careers in the 1970's and 1980s grew up in an atmosphere of great uncertainty. The large scale destruction of human life in World War II and the Holocaust was followed immediately by the advent of the atomic bomb and the hydrogen bomb. The Cuban Missile Crisis of 1962 and other incidents of nuclear brinkmanship reinforced the lack of control most people have over their future. The close succession of World War II, Korea and Vietnam suggested that the lives of young people in particular were expendable in a society addicted to war.

Living for the moment might reduce future opportunities and enjoyment. Or it might not. When future payoffs are discounted by the possibility that life – or civilization itself – could come to an abrupt end, comparing these future payoffs with more certain present pay offs is a frightening and emotionally wrenching exercise. Not thinking too much about the future might be the more emotionally satisfying, and perhaps even the most "rational" alternative. The time inconsistent preferences that Professor Utset discusses in his article are perhaps consistent with overall welfare of an individual who does not know if he, or anybody he cares about, will be alive a few years later.

Less dramatic, but still significant, uncertainties have grown in recent years. The economy is perhaps the largest source of uncertainty. Massive layoffs hit the investment banking industry in the late 1980s and again in the early 1990's and in several downturns since then. The large amount of money investment bankers earn makes it that much more likely that many of them will be fired in an economic downturn. Even a senior position in an investment bank no longer provides the job security that it once did. Job stress also brings uncertainly about one's personal health.

And investment bankers' marriages probably are not as stable as they once were, creating additional uncertainty about personal as well as financial issues in the future. Estimating future payoffs requires some consideration of these and other factors that many investment bankers might prefer not to think about. Focusing on the short term allows them to avoid this.

B. The Breakdown of Generational Trust and Respect for the Law

Generational relationships are an integral part of making preferences more time consistent. Death is certain even if its timing is not, so future payoffs may go to future generations. A society in which the older generation passes both wealth and family reputation down to the younger generation is more likely to value future payoffs. A society characterized by intergenerational distrust – and that envisions every generation fending for itself – is more likely to display time inconsistent preferences.

The generational tensions of the 1960's and 1970's are well known. Society at about the same time also moved away from family status derived from "old money" and replaced it with an egalitarian philosophy that celebrates – even if it does not realize – the goal of an even playing field for each generation. This "new money" philosophy changes incentives in a productive way (some people work harder for a quick return on their investment) but also changes incentives with respect to the future (payoffs left to one's children are ideologically suspect, and in any event do not confer the social status they once did). A democratic ideal in which each generation enjoys the fruits of its own "labors" while each generation starts the process anew has many virtues, but time consistent preferences is not one of them.

Intergenerational transfer of moral values may also be less pronounced. Professor Utset's article discusses the role of law in controlling behavior. Sanctions imposed by the law are an important part of this control. Law also, however, is also intended to contain a moral sanction: loss of societal esteem and loss of self esteem should go along with breaking the law. Law communicates societal values, not just rules and the penalties for breaking rules.

After Vietnam and other public scandals, law lost much of its moral force for a substantial segment of the population. For many modern commentators law derived from moral principles is viewed with suspicion. Instead, the notion of "efficient breach" of the law is sometimes viewed as acceptable,[5] and law is viewed as principally a product of politics and power relationships.[6] All that remains in law is the possibility that violators will be detected and the punishment they will receive for the violation.[7] When the mantra of "question authority" evolves into "question legality" it is increasingly difficult for law to control time inconsistent preferences or any other aspect of human behavior. The problems Professor Utset identifies will be more pronounced in a society where law has less moral force.

II. THE BUSINESS AND CULTURE OF INVESTMENT BANKS

The business world that young people entered in the 1970's and 1980's was changing for many reasons: globalization, growth in the scale of business enterprises, new technology, the rise of an educational and business "meritocracy", the decline of racial and religious prejudice, and a political shift away from government regulation. Many of these were positive developments, but there were also signs that time inconsistent preferences were becoming more pronounced in the business world. Business people indulged themselves with astonishing frequency in pursuit of short term goals, even those that undermined the long term

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5 *See* Cynthia A. Williams, *Corporate Compliance With the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265 (1998) (discussing and critiquing this "law as cost" approach).

6 For some of the earlier works in this area, see Duncan Kennedy, Book Review: A Bibliography of Critical Legal Studies, 94 YALE L. J 461 (1984).

7 *See* Manuel Utset, *Corporate Actors, Corporate Crimes, and Time-Inconsistent Preferences*, 1 VA. J. CRIM. L. 2, 282 n.26 (2013) (citing RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 219–20 (6th ed. 2003) (economic approach to deterrence assuming that offenders are "rational actors")); *id.* at 19 n.27 (citing A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. ECON. LIT. 45, 47 (2000) (a person will violate the law if the expected utility from doing so exceeds the utility from obeying the law)).

goals of their businesses. This phenomenon, which had always been present, seemed to accelerate in the 1980's, in part because a vibrant market for hostile takeovers put pressure on managers to increase stock price quickly to save their own jobs.[8]

This comment mentions several of the ways in which investment banks changed during these years. These changes in the industry reinforced time inconsistent preferences of persons who work for and run investment banks. This process continued until 2008 when three of the country's three largest investment banks – Bear Stearns, Lehman Brothers and Merrill Lynch which were also among the oldest investment banks – collapsed. Most of the other large banks almost collapsed as well.

A. "Sworn to Fun, Loyal to None" Moves to Wall Street

Michael Lewis's 1987 book "Liar's Poker" chronicled the culture that emerged on the trading floor of one of Wall Street's most powerful investment banks, Salomon Brothers. Successful traders took big risks to make big money. They also had fun. They called themselves "big swinging dicks" suggesting that sexual gratification accompanied successful trading.[9] Big bonuses and everything that money could buy, including apparently sex, awaited the trader who threw caution to the winds and dared to make big bets. Bankers could also enjoy their money. Gone was "old money" snobbery toward conspicuous consumption and gone also was the 1960's rejection of materialism altogether.

A traditional approach to mitigating time inconsistent preferences is to adopt a business and social model that assigns a high present value to long term relationships. For example a business can assign a high value to relationships with customers, counterparties and even government regulators. Business people also sometimes share a common social network of relationships and interactions outside of work (clubs, charitable

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[8] Other explanations include the cultural changes discussed above and the fact that managers were increasingly paid in stock and stock options, making it easy for them to share in short term gains.

[9] MICHAEL LEWIS, LIAR'S POKER 56 (1989) ("If he could make millions of dollars come out of those phones, he became that most revered of all species: a Big Swinging Dick.").

endeavors, schools and universities, etc.). The more enduring these relationships are the more likely they are to mitigate the impact of time inconsistent preferences in those situations where succumbing to immediate gratification will likely cost someone a valued relationship.

Traditional investment banking was a relationship business. Repeat interaction between players reinforced the importance of acquiring long term reputational capital as well as financial capital in order to be successful. Sacrificing relationships or reputation for short term gain – giving in to time inconsistent preferences -- was not the preferred way to do business. The people who ran investment banks understood that short term temptation (time inconsistent preference) was present, but they made a concerted effort to control it. They also understood that the persons they did business with were in a position to impose immediate costs of misconduct[10] without the long delay and uncertainty of a lawsuit or other former legal proceeding.

Henry Kaufman, formerly the head economist for Salomon Brothers, recalls the way this problem was handled at his firm:

> During one of our executive committee meetings back in the 1970s, a young trader interrupted the meeting that was then being held by Bill Salomon, the managing partner, and he gave him a slip informing him of a very large bond trade we had just completed with one of our institutional clients.
>
> Bill asked, "How much did we take out of the trade?"
>
> The young trader replied, "A point," meaning one percentage point.
>
> Bill then called in the partner in charge of transactions, who reaffirmed that the firm had made one point.
>
> Bill Salomon's admonition was brief and to the point. He said, "Salomon Brothers does not take such a

[10] *See* Utset, *supra* note 7, at 62 (discussing the effectiveness of increasing the immediate costs of misconduct).

> profit." The bonds purchased were highly marketable, of high quality, and they were sold by an institution that was a valued client.
>
> He ordered the trading partner to return part of the profit to the institution. In addition, he told the trading partner that the participation in the profits of the firm for him was going to be reduced.
>
> The question then is: What prompted Bill Salomon to take this action in the 1970s? It was, among other things, to protect the relationship with an important institutional client. But it was also to ensure that this wouldn't happen in other transactions of this kind by the firm."[11]

The trader in this example had time inconsistent preferences; he would rather make more money on this transaction and risk losing future transactions with the same client. William Salomon, with the apparent support of the partnership management committee, had a very different set of preferences, and for the moment his view prevailed. And this was about an issue on which the law was neutral – the size of the profit Salomon took on a trade. Imagine William Salomon's reaction if he had been told that the trader did something illegal.

Probably the most valuable business relationship Salomon Brothers had was with the United States Treasury. The William Salomon portrayed in Kaufman's story no doubt would have exploded in fury if someone at Salomon Brothers tried to cheat the Treasury.

Fast forward fifteen or twenty years, and that is precisely what happened in 1991, after Mr. Salomon had retired from the firm. One of Salomon Brothers' "star" bond traders was caught illegally cornering the market in Treasury securities. Senior officers, including CEO John Gutfreund were told about it. The firm's general counsel told them that they had to report it to the Treasury Department. Instead they kept it secret, continuing to break the law. The Treasury Department found out anyway and almost shut down the firm. The SEC began an enforcement

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[11] Henry Kaufman, Civility in the Financial Sector, speech for the Carnegie Institute, June 20, 2011; http://www.carnegiecouncil.org/resources/transcripts/0412.html.

action and suspended Salomon's three most senior bankers from the industry.[12] When the dust settled, top management was fired, Warren Buffet installed new management and the firm was merged into Smith Barney.[13] Salomon Brothers, which for decades had been a gold plated brand in fixed income markets, was irreparably tarnished and the firm name was retired. The culture of the "big swinging dick" had swung back to devastate one of Wall Street's premier investment banks.

For Salomon bankers with time inconsistent preferences perhaps none of this mattered. Building up the firm's reputation with customers and regulators (the Treasury was both) was something that William Salomon and the firm elders had cared about when they ran the firm. Now in the 1980s and 1990s things were different – it was time to live for the present. Everyone made a lot of money and – until the Treasury and the SEC stepped in – everyone had a good time.

The reasons investment banks changed between the era of William Salomon and the era of Liar's Poker are complex. Part of the problem was that investment banks made less money from traditional relationships, such as securities underwriting[14] (including sale of government bonds) and brokerage services[15], and made more money in trading operations and then later in designing and selling exotic securities such as mortgage backed securities (Louis Ranieri, who had worked in Salomon's mailroom, moved up the ranks of senior management in the 1980's when he designed and

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[12] *See* In Re John H. Gutfreund, Thomas W. Strauss, and John W. Meriwether, Admin. Pro. File No. 3-7930, 51 SEC Dkt. 93 (1992).

[13] The Salomon Smith Barney firm was eventually merged into Citicorp.

[14] Beginning in 1981 SEC Rule 415 allowed issuers to file a registration statement in advance for securities later sold in a "shelf takedown." This gave issuers substantial leverage in negotiating underwriting spreads with investment banks that would have to compete with each other for the shelf takedown transaction. Previously, issuers had tended to rely upon a relationship with one or two investment banks that were sufficiently familiar with the issuer so they could prepare a registration statement for each separate offering.

[15] Beginning in 1975, the SEC abolished fixed brokerage commissions and introduced negotiated rates that allowed high volume institutional investors to negotiate lower commissions with their broker dealers.

marketed some of the earliest mortgage backed bonds[16]). These new lines of business were not dependent upon long term business and social relationships. Another part of the problem, discussed below, was the demise of the investment banking partnership, a close knit business and social organization that characterized the business for decades prior to the 1980's.[17]

B. THE DEMISE OF THE PARTNERSHIP AND PERSONAL LIABILITY

The partnership business model has built in protections against time inconsistent preferences. First, just because a banker makes money now does not mean the banker can enjoy it now. Partners' profits must be reinvested in the firm if the firm is to have sufficient capital to compete with its rivals (under partnership tax law, the partner still has to pay income tax on his share of firm profits even if those profits are not distributed to him; under the high tax brackets of the decades before the 1980's these taxes alone put a damper on many investment bankers' "lifestyle")).[18] Most of an investment bank partner's earnings become available to him only after he retires from the partnership, and even then though installments lasting several years. Collapsing short term profits into long term profits in this manner redirects his mind from time inconsistent preferences. Immediate monetary gratification is not an

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[16] *See* Louis S. Ranieri, *Your Mortgage was his Bond*, BUS. WEEK, Nov. 29, 2004, (part of a series of articles titled "The Great Innovators") ("The past quarter-century has seen a revolution in finance. It's felt every time a homeowner refinances a mortgage or signs up for a credit card. No one person can claim to have lit the fuse for this revolution—but Lewis S. Ranieri was holding the match. Joining Salomon Brothers' new mortgage-trading desk in the late 1970s, the college dropout became the father of 'securitization,' a word he coined for converting home loans into bonds that could be sold anywhere in the world.").

[17] *See generally* ALAN D. MORRISON & WILLIAM J. WILLHELM, INVESTMENT BANKING 276–84 (2007).

[18] Until 1970, the New York Stock Exchange prohibited member firms from having a public float of equity securities, making it difficult for investment banks to raise capital from outside the partnership. This rule was lifted in 1970. *See id.* at 278–79 (discussing the impact of the NYSE rule change); *see also* Hill & Painter, supra note 4, at 5.

option for many investment bank partners; they have to focus on long term wealth accumulation.

And then there is the personal liability part of the equation. If the firm fails, the partners pay. Again, as told by Henry Kaufman:

> In the earlier period, the owners of the business, the partners, were on-site, and many were actively involved in day-to-day affairs, and they had the use of the modern parlance "considerable skin in the game," which is to say their liability was unlimited.
>
> I will always remember when Sidney Homer, one of my mentors, told me that I would become a partner. He said, "I'm sure that you will rush to tell your wife." Then he added, "But be sure to tell her that once you sign the partnership papers next week you will be personally liable for $2 billion." . . . . That was the firm's total liabilities at the time and, therefore, the amount that each partner was personally exposed to.[19]

The old Lehman Brothers was run the same way, for years under Robert Lehman,[20] as were Morgan Stanley, Goldman Sachs and most of the other big investment banks. It is possible that a banker's time inconsistent preferences would cause him to discount the prospect of personal liability so severely that he would cause his firm to pursue short term profits with a risky business model. Such risk taking, however, was not likely given the enormous impact on a partner and his family when something goes wrong. This liability regime – coupled with the fact that most investment bankers had their retirement savings tied up in the firm – also reinforced the need for an older generation of bankers to train the younger generation in the virtue of prudence. Giving in to time

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[19] Henry Kaufman, Civility in the Financial Sector, speech for the Carnegie Institute, June 20, 2011; http://www.carnegiecouncil.org/resources/transcripts/0412.html.

[20] *See* CHARLES R. GEIST, THE LAST PARTNERSHIPS: INSIDE THE GREAT WALL STREET MONEY DYNASTIES 49 (1997).

inconsistent preferences would mean short term gratification for some but disaster for everyone, with perhaps a disproportionate impact upon the old.

All of this changed beginning in the late 1970's and early 1980's when investment banks changed over to the corporate form of organization (prior to 1970 the New York Stock Exchange had prohibited member firms from having a public float of their own securities[21]). Partners became managing directors, and were paid salaries and all important bonuses in cash or stock and stock options that were either immediately liquid or that would become liquid within a few years. Personal liability for firm debts was also gone. Investment bankers were given an opportunity to seek immediate gratification according to their time inconsistent preferences and many did. The story of Salomon Brother's scandal and demise has already been told (the firm was eventually folded into Citigroup). The other large banks grew exponentially as public companies, building up enormous amounts of leverage until they came crashing down in 2008.

Personal liability of course is not an effective answer to the most extreme time inconsistent preferences – for example a banker who prefers to enjoy present profits even by increasing the risk of losing everything later. Personal liability, however, does focus the minds of bankers on the future, and it is likely that the extreme consequences of firm failure are enough to persuade most bankers to be more careful. There were relatively few firm failures in the "major bracket" during the era of partnerships. Compare this with the 1980's, which saw the demise of Salomon Brothers Inc. and Drexal Burnham Lambert Inc., and then the near collapse of the entire industry in 2008.

C. The Complexity

Another hallmark of modern investment banking is the complexity of the financial instruments involved. Relatively simple stocks, preferred stocks and bonds are supplemented by a wide array of mortgage and other asset backed securities, security based swap agreement, synthetic securities, and a host of other instruments. Mathematical models are used

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[21] *See* Hill & Painter, *supra* note 4, discussing the impact of this rule change.

for designing securities and trading them.[22] Even if few investment bankers understand how these instruments actually work, many others pretend they understand. Senior bankers who are supposed to be in a supervisory role also pretend they understand even if they don't and boards of directors who are supposed to supervise the senior bankers do the same.

It is difficult to image an industry more prone to the information asymmetries and accompanying breakdown of monitoring that Utset describes in his article:

> The greater the informational asymmetries, the greater the likelihood that actors will be able to engage in repeated [time inconsistent] misconduct without being detected. One reason . . . . is that it will increase the likelihood that [time inconsistent] principals will procrastinate monitoring corporate actors.[23]

The up-front cost of getting up to speed for senior investment bankers and bank directors is very high. This is a clear deterrent for a time inconsistent supervisor faced with the alternative of simply assuming that everything subordinates are doing is alright.

D. IT'S THE MONEY

For most investment bankers the calculation affected by time inconsistent preferences boils down to money. The risk of criminal prosecution of individuals is low, and the risk of jail time is even less. Only one activity, insider trading, has sent a significant number of investment bankers to jail.[24] When a bank itself is criminally charged, the

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[22] *See generally id.*

[23] Utset, *supra* note 7, at 53 n.79.

[24] *See* United States v. Boesky, 674 F. Supp 1128 (S.D.N.Y 1987); United States v. Milken, 3 Fed. Sent. R. 159 (1990), 1990 WL 310497 (S.D.N.Y 1990). More recently a number of investment bankers and others have been charged in connection

result is payment of a fine, a cost usually born by its shareholders. The decisions that investment banker make about risks – both business risks and legal risks – are decisions about risks with money, most of it other people's money.[25]

Part of the problem could be the enormous amounts of money that the bankers themselves receive. Compensation for successful bankers is astronomical, and in two ways this may exacerbate time inconsistent preferences in the industry.

First, most of this compensation is front loaded. Bankers get it now and enjoy it now. As discussed above, the demise of the partnership model allows bankers to divest from their firms with relative ease, and many do not have to invest substantially in their firms in the first place. High compensation – and competition among bankers for annual bonuses based on contribution to a current year's reported profits – is an invitation for time inconsistent preferences to influence decision making.

Second, extremely high compensation allows money to crowd out the nonmonetary objectives that professionals normally seek through their work. Gone are the days when a partnership at Morgan Stanley or Salomon Brothers was like admission to an exclusive club, or an academic being named to a prestigious learned society. Bankers instead look outside the office to pursue social standing, meaningful involvement in the community and other objectives that provide fulfillment for the banker, and perhaps his or her family, over a longer period of time. Investment bankers thus pay large sums to join expensive country clubs, to buy houses in exclusive neighborhoods or donate large amounts of money to get on prestigious charitable boards. Their work at investment banks, however, is principally about the money that provides a means to these other ends. One's reputation as a banker, and the reputation of one's firm, is secondary.

Could it be that in the market for investment bankers, less might buy more? Might we have better bankers if we paid them less, at least in

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with the government's insider trading case against the Galleon hedge fund and its principles.

[25] This is not a new problem, and abuses of other people's money were particularly prevalent before enactment of the federal securities laws. *See* LOUIS BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT (1914).

the short term if not less overall? Professor Utset observes that reducing the immediate benefits from misconduct "is generally a more effective and economical way of deterring [time inconsistent] misconduct" than increasing future penalties.[26] For investment bankers, reducing the immediate benefit of misconduct means reducing the amount of money they get paid when they misbehave.

CONCLUSION

Professor Utset's insightful article analyzes the impact on corporate actors of "time inconsistent preferences" in which decision makers prioritize immediate gratification over long term goals. He points out how this psychological phenomenon is imbedded in cognitive processes and how it plays a significant role in corporate crime.

This comment expands the inquiry to cover extreme risk taking in situations where the risk may not be criminal (criminal law is still, however, sometimes relevant as the conduct of many investment banks has led to criminal cases, at least against the banks if not the bankers).[27]

Observers who believe short term thinking recedes with age and the social and emotional maturity that presumably comes with age, should read Professor Utset's article. Time inconsistent preferences are a pervasive phenomenon, and decisions affected by this cognitive bias are made by some of the most powerful business executives in the country.

This comment raises questions about the cultural component to time inconsistent preferences. Are time inconsistent preferences, while ingrained in cognitive psychology, more pronounced in some societies than in others and do these preferences change in a particular population over time? Because time inconsistent preferences, like other psychological traits, are not uniformly distributed in any single population, some people have preferences that are more time inconsistent while other persons have preferences that are less time consistent. Could a particular industry, such as investment banking, attract people at one end of this distribution, and

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[26] Utset, *supra* note 7, at 7.

[27] See the antifraud provisions in Exchange Act Section 10(b) and Securities Act Section 17a, both of which have criminal penalties.

might this also change over time as the cultural, compensation and liability norms of the industry change?

This comment raises these questions in the investment banking industry, and suggests a few answers, however incomplete. Further discussion of these issues, however, is imperative if we are to understand this enormously influential business and how time inconsistent preferences affect the way in which it is conducted.