**The Significance of Faith-based Ethical Principles in Responding to the Recurring Financial Crises**

*Syed Nazim Ali & Shariq Nisar*

*Abstract:**Due to a series of financial crises, the global financial system has been under tremendous pressure in recent years. With nearly every major economy affected, the cost of managing these crises - both the direct costs associated with keeping the system working as well as the indirect costs associated with loss of opportunity and diversion of precious financial resources - has been enormous. Some studies have identified a failure of ethics as the root cause of these financial crises, while others have focused on the structural flaws in the system. While both the diagnoses may be correct, the prescription for handling the crises lacks clear direction and consideration for its applicability over the long run. In this paper, we recognize how ethical flaws may explain the problem of lack of inclusiveness in the global financial system, while structural flaws largely explain its instability. This paper focuses mainly on the former aspect by recommending a few long-term measures that seek to improve moral behavior and indirectly may have impact on structural flaws in order to foster an inclusive, stable, and sustainable financial system. Few suggestions have been made to improve inclusiveness based on common religious, social and moral values and also some measures have been suggested to improve moral behavior for developing a healthy and sustainable model of finance.*

# Introduction

The global financial system has been under tremendous pressure in recent years, affecting many major economies of the world. Due to the interconnected nature of the world economy today, financial crises occurring at once place can quickly engulf other economies. As a result, many economies have suffered enormously due to diversion of precious financial resources to keep the financial system working, not to mention the tremendous suffering and loss of opportunity this diversion caused.

Many can recall when similar crises struck in less developed or developing countries (like the four “Asian Tigers”), most financial gurus brushed them aside, deeming them a symbol of the structural weakness of those economies. We started taking these challenges seriously only when big and developed economies started feeling the dominant effect of such crises despite strong regulations in place. This is clearly seen from the recent economic growth forecast done by the International Monetary Fund which showed how both developed and emerging economies were affected by the Global Financial Crisis in 2008. With the growth of developed economies expected to shrink (US economy is predicted to shrink by -0.7% in 2009 while the UK is set to be the worst affected of Western European countries with a contraction of -1.3%), emerging economies are expected to account for a greater proportion of global growth. As such, we can see how strong regulations alone are not sufficient to guarantee developed economies from being impacted from economic shocks, and that emerging economies with relatively weaker regulations may also show growth potential if we consider several other factors as well.

A number of structural causes have been identified (Rajan, 2010)[[1]](#endnote-2); however the purpose of this paper is to concentrate on the ethical aspect, in particular on dealing with human greed and mischief. The culture of greed is believed to be one of the main causes leading to financial mischief and ultimately to financial crises over time (Geithner, 2012)[[2]](#endnote-3). The ‘greed-is-good, greed is right, greed works’ mentality is encouraged in modern financial institutions, but it comes not only at the expense of consumers and suppliers but mainly the society at large. Customers tend to be at the highest risk as they rely almost entirely on fund managers and financial institutions to help them choose good investments. Contrary to their interests, we observe concerted efforts by all other stakeholders in the financial system to lure customers into making risky investments. Banks employ shadow banking strategies; rating agencies are focusing on the wrong metrics; and regulators are found wanting in fulfilling their responsibilities. Based on statistics from the Financial Stability Board, shadow banking has become an increasingly popular phenomenon with assets mounting to $67 trillion and a growth of more than 163% between 2002 and 2012. This is a worrying phenomenon because it means credit creation has been increasing through unofficial means and without any regulations. Another case in point of this phenomenon was clearly evident in the case of the Subprime Mortgage Crises (SMC) in 2008. Home loan seekers were tricked into housing mortgage which they could not afford. Excessive lending perpetuated by an ongoing loose monetary policy was the net result which is analyzed in detail by Atif Mian and Amir Sufi (2014)[[3]](#endnote-4) Art Perlo argues that “the subprime mortgage crisis is the trigger that has set off a whole number of financial imbalances — it triggered the whole pile to start falling. This crisis was caused by incredible greed and looting by the financial sector….” (Webb, 2007)[[4]](#endnote-5)

The erosion of ethics and fundamental moral values by financial agents and participants, have been a great challenge for financial systems today, and exacerbates the structural flaws inherent in the system. The *World Economic Forum Report on Faith and the Global Agenda: Values for the Post-Crisis Economy* reported, “the majority of people across the globe believe the global economic crisis is related to ethics and values” (World Economic Forum, 2010) [[5]](#endnote-6) In addition, it has been shown that religiosity, ethics and values among corporate workers mitigate unethical behavior of a Corporation as a whole. (Grullon, Gustavo, Kanatas, George, and Weston, James, n.d.)[[6]](#endnote-7)

This paper is organized into four major sections. After this introduction, section 2 attempts to diagnose the causes of recurring financial crises. Section 3 explores the significance of common platforms in reshaping and enhancing best practices in the global financial system. The final section provides the conclusion and some policy recommendations that are meant to address the root cause of recurring financial crises.

# Diagnosing the Causes of Recurring Financial Crises

# Though previous studies have focused on numerous probable causes of financial crises, this section identifies two major causes that are directly related to the central theme of the paper. Two major causes identified are: lack of access to financial information for consumers, and regulatory gaps and loopholes in the penalty systems for financial misconduct.

# Lack of access to financial information for consumers

Poor financial choices due to lack of access to information and ability to avail the right product have been a major contributing factors to financial crises (European Commission, 2010)[[7]](#endnote-8). In addition to lack of adequate access to information, unequal access (Lumpkin, 2010)[[8]](#endnote-9) to financial products constrains use and development of a just and stable economy. Providing affordable and easily accessible financial products to all people across the range of income levels and demographic characteristics is the need of the hour. The rise of many financial innovations today is accompanied by an urgent need to provide access and an information infrastructure for consumers to make informed financial choices. Consumers may not be well-educated or well versed in financial matters to comprehend financial innovations, many of which have intricacies to protect lender interests. According to the Organization for Economic Co-operation and Development (OECD),

With the rapid pace of financial innovation, the growing complexity of financial products, and the increasing amount and size of financial risks and responsibilities transferred to households, it has become very difficult for the average consumer to successfully navigate the financial marketplace, let alone for poorly informed individuals. (OECD Recommendation, 2009)[[9]](#endnote-10)

Financial institutions are also criticized for lacking a sense of social responsibility, focusing instead on the traditional goal of profit maximization. This comes at the expense of consumers, as the disclosures of financial products are insufficient or too complex and there is little protection for retail consumers. (Brix, Laura, and McKee, Katharine , 2010)[[10]](#endnote-11) Financial institutions should be as transparent as possible to consumers to aid them in making informed choices according to their financial abilities. Any hidden costs or unfair gain by them at the expense of the consumers should not be tolerated. Regulatory bodies such as Central Banks may intervene in the offering of financial products by banks to ensure that no deception or tricks are used to unfairly attract consumers from their competitors, and several features are revealed to consumers for the purpose of transparency and clarity.

## Regulatory Gap/Overlap and Loopholes in Penalty Systems for Financial Misconduct

Penalties, though in place, have been inadequate in curbing fraud and misconduct. This, coupled with compliance issues by financial firms, poses serious problems for the checks and balances mechanism in economies today. Firms have become more sophisticated in their dealings with the penalty systems, implementing a cost-benefit analysis, to get their way around the system. For example, many huge companies consciously violate the law because the profits they reap by doing so are far greater than the fines they might have to pay after being caught. (Durden, 2013) (Raice, 2013) [[11]](#endnote-12) If, however, the financial agents have an intrinsic moral sensibility of their actions, they will be inhibited from indulging in such immoral and illegal behavior. A concerted effort on an international level may be necessary to bring about a greater regulatory oversight over such financial misconducts. A case in point is an agreement that was signed in 2014 by finance ministers from 51 countries who joined forces to ensure the end of tax evasion and money laundering, with Switzerland deferring until 2017. Less than four months later Switzerland found itself embroiled in the biggest banking scandal in history.

# Exploring Common Platforms

### Ethics and Morality

Historically most financial crises exhibit similar patterns and are triggered by almost the same factors. (Mian, Atif and Sufi, Amir, 2014)[[12]](#endnote-13) Structural flaws in the financial system as argued by many experts are no doubt inherent which to a large extent could be addressed by policymakers and regulators. (IMF Research Center Conference, 2012)[[13]](#endnote-14) Masses in general have little role to play in that, but efforts to improve financial literacy with high emphasis on morality in financial systems will go a long way in addressing the lack of morality in the financial world. We need to address ethical flaws at every level of society. Inculcation of good moral values and conduct, developing a sense of social responsibility, transforming the culture and instilling the right type of education among the budding entrepreneurs and financial players could help the future of the financial system in a very positive way.

The most important challenge in this regard is how to encourage people to behave ethically and morally. Very often we notice the lack of incentives for those who behave well. Contrarily, those who cross the line are often seen climbing the ranks quickly. The capital market system has made selfishness a virtue in achieving goals as can be seen from the oft-quoted line by the Father of Economics “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.” There is a need for an effective mechanism to address this anomaly. A system is needed where good behavior can be objectively measured and appropriately rewarded at the same time any type of malfeasance is not only restricted but also punishable.

Transformation of beliefs, attitudes and mindsets of financial participants across all levels are hoped to bring about greater financial stability. On the other hand provision of rewards and penalties hope to bring greater coherence in compliance with law in its true spirit. Moreover it is felt that the main reason for financial exclusion of a vast majority of people across the globe is not really the lack of resources but the lack of spirit and motivation. Unfortunately, it is generally believed that the current financial system has led to more exploitation and misallocation of financial resources thereby making the rich the greatest beneficiaries.

One must admit that despite having the best of infrastructures ever in human history, modern economy has not been so compassionate towards the poor, vulnerable and marginalized. While corrective measures (such as in the rights of women and child labor) have been taken to right many wrongs in many other fields, the area of finance has been largely neglected of such efforts.

### Religious Teachings and Faith

Recognizing the plural nature of the financial system which involves a multitude of players, there is a need to establish a common ground that will spell out a code of conduct and establish an agreed-upon ethical system in finance. One way this could be done is by basing it on religious teaching and values which enforces a code of conduct on its followers.

Major religions of the world today, like Christianity, Islam, Judaism and Buddhism, share a similar stance on the areas of socially responsible investments. (Bhatt, Sultan, Shah, 2014)[[14]](#endnote-15) In the past, countries tended to be more homogenous in the religions represented, either by choice or by force. Apart from a few religions (e.g. Jews), citizens of a nation were typically all or mostly of the same faith, and so the concept of religious freedom was then a less important matter in people’s lives.

In present times with the advent of globalization, however, societies tend to be more multicultural and multi religious and, as a result, have to cope with pluralism in religion and culture. How governments treat their religious and cultural minorities has a bearing on the political stability, global image, and cultural environment.

There are two competing theories regarding the link between economic growth and religion. The first, known as the secularization hypothesis, (Weber, 1930)[[15]](#endnote-16) postulates that greater economic development causes individuals to abandon their faith and become less religious. This hypothesis also claims that economy as it becomes stronger it plays a larger role in the governance of the country than religion. The other theory (Smith, 1790)[[16]](#endnote-17) claims that as a society becomes religiously diverse, the different religions compete which results in stimulating more interest in religion. The latter hypothesis is strengthened by the study of Chaves and Cann (n.d.)[[17]](#endnote-18) who have shown that greater governmental sponsorship of religion paradoxically decreases the individual’s interest in religion. In a survey conducted in the United States, each of the most religious countries is relatively poor, with a per-capita GDP below $5,000. Similarly, the more advanced nations This reflects the strong relationship between a country's socioeconomic status and the religiosity of its residents.

On the other hand, in some societies, notably among the communist societies, religion is considered as “the opium of the masses”, and thus religious freedom and diversity are suppressed by the state as a policy. The above mentioned theories examine religion as an outcome of economic development or policy; comparatively little research (Barro and McCleary, 2013)[[18]](#endnote-19) has been done on religion as an antecedent to economic growth. Alon and Chase (2005)[[19]](#endnote-20) examined political and economic freedoms alongside religious freedom in explaining economic prosperity and found that religious freedom is a significant antecedent of economic prosperity.

Most of the faith based financial models, be it, Judaism, Christianity, Islam, Hinduism or Budhism, share some common goals such as the upliftment of labor and the down trodden section of society, abhorring violence, shunning vulgar entertainment etc. These common goals can be conveniently converted into actionable plans in the form of Corporate Social Responsibility, Corporate Governance, Human rights and the Environment.

Indeed, there have been clear calls advocating financial system regulators to revisit the teaching and wisdom of the faith traditions that may play an important role in staving off future financial crises. (Steele, 2010)[[20]](#endnote-21) As we know, across religions there are activities which are prohibited or abhorred like *interest*, *gambling* and businesses which are discouraged for causing economic harm to society. At the same time, there are also activities which are encouraged like sharing of risk, helping the poor and needy and giving to charities to help the underprivileged. For example, Islam views the economic system as a means or a tool to achieve social good, rather than an ends in itself. (Zaman, 2008)[[21]](#endnote-22)

There are also religiously sensitive investment strategies that are important in creating a common platform based on religious teaching and values. For example, the practice of excessive and highly speculative risk taking, especially in as much as they are of such a scale that they increase the level of systemic risk, must be examined and monitored in terms of their potential impacts on the common good. In the same way the impacts of the use of derivatives, credit default swaps and other activities such as short selling on the stability and soundness of the financial system and therefore the well-being of communities across the world must be monitored and evaluated.

The question one may ask is: How will faith and religion play a part in fostering a common platform in the financial industry? There are several ways this can be achieved. Firstly, faith-based teachings reintroduce the foundational belief and value that gives more emphasis on sustainability rather than short term profit. (Kaye, 2012)[[22]](#endnote-23) It will help check privatization of gains and socialization of loss and risk. A system that has its priorities set over serving the needs of all communities before enriching executives, traders and shareowners will be consistent with the vision of the faith traditions. This system will earn confidence of people and hence more inclusive.

Secondly, faith and religion serve as a reminder to the business and investment community of their responsibility toward the future of Earth and its sustainability for future generations. Financial and economic decisions based on values taught by the religious systems will serve as a moral compass for business community and investors.( Chapra, 1995)[[23]](#endnote-24)

Thirdly, religion allows their followers to integrate their beliefs into the management of their financial and commercial affairs. In this innovative space many faith traditions have established funds and innovative credit mechanisms that reflect more faithfully their foundational principles on the practice of credit, borrowing and lending while preserving wealth and posterity. They have done this successfully in the past through instruments and mechanisms that are more appropriate to the needs of respective communities, offer stable and accountable delivery systems and promote sustainability. The National Council of Churches, for example, has undertaken shareholder activism, social-purpose mutual funds and the like since the 1970s. Such initiatives are pertinent examples of the integration of Christian beliefs into the financial and commercial aspects in the lives of believers.

Fourthly, religious faiths working together can draw on the principles they hold in common to promote a more humane system and reform the dominant financial system. By working together they can bring the values of sustainability, social responsibility, and solidarity into a vibrant debate and conversation about the kind of economic model that is consistent with the vision of their beliefs. In the post-World War II period, for instance, we have examples of the modification of a free market individualistic capitalism to a more socially oriented market economy in some societies, especially European markets where mutual and cooperatives are experiencing growth. (*DGRV Die Genossenshaften, n.d.)*[[24]](#endnote-25) Mutual and cooperative insurance accounts for over a quarter of the global market, and is the fastest growing sector of the market.(ICIMF, 2014)[[25]](#endnote-26)

Finally the faiths can likewise find common ground with others in the ongoing process of evaluating the tools and innovations that are introduced into financial system by using the wisdom in their traditions and the environmental, social and governance (ESG) criteria that have been established. For example, using the precautionary principle from risk management in a financial setting may be useful. (Schettler, Barrett and Raffensperger, 2002) [[26]](#endnote-27)

As argued above, religious teachings and faith can facilitate the creation of common grounds for financial stability, inclusiveness and sustainability by establishing a more inclusive and morally conscious system rather than conducting financial transactions that merely adopt a legalistic attitude to financial regulation. The idea of faith-based ethical economies has now been espoused by all major faiths, which see the lack of morality and ethics as a cause of the financial crises, and look to their faith for the solution.

For instance, a leading Islamic finance expert, Muhammad Taqi Usmani argues:

“The crisis we are facing is not caused by some regulatory mishaps only; there are some systemic errors in our conceptual framework. This framework needs a revival of some noble values and a serious review of some basic principles on which we have constructed the whole edifice of our economy. There are two basic values of foremost importance that must be reflected in a balanced, sustainable and just economy. First, the common welfare of the society should take precedence over individuals’ selfish objectives. Second, the profit motive should not be extended to unlimited greed of wealth”. (Usmani, 2009)[[27]](#endnote-28)

The element of social welfare based on common good as espoused above is also emphasised by Lesley-Anne Knight*,* Caritasof theVatican City, who contends that:

“During the course of the 20th century, the Catholic Church elaborated a clear set of social values that are increasingly relevant today as we consider the kinds of institutions and governance mechanisms we need to ensure a more humane global economy.” (Knight, 2010)[[28]](#endnote-29)

Ensuring a more humane global economy requires sustainable practices that promote equity, fairness and justice without compromising the aspects of environmental conservation. Yukei Matsunaga of the Japan Buddhist Federation argues that:

“an emphasis on the interdependence of all living things—the vision of life taught in Japanese Buddhism—may provide effective suggestions for handling such pressing issues of modern society as human alienation and environmental destruction.” (Matsunaga, 2010)[[29]](#endnote-30)

While this contention is without doubt true, one must understand the transient nature of human existence and the need to promote sustainable practices in the economy. This mirrors the argument of Rabbi David Rosen of the American Jewish Committee who contends that:

“If enterprise and industry are detached from the human connection, then they will not be sustainable in the long term. Moreover, in order for there to be a common language—in the deeper sense of the term—that connects the various components of society, it is necessary for the members of that society to have a sense of the transcendent, a sense that there is something more to their existence and activity than purely “the edifice” itself.” (Rosen, 2010)[[30]](#endnote-31)

This eschatological basis should be the driving force that will trigger a sense of care and common good in the society. Rev. Katharine Jefferts Schori, the Presiding Bishop of the Episcopal Church believes that:

“this ethic of care for the least applies to all the major issues facing us: local, national and international economic praxis; ecological and climatic concerns; and the structure of the global market.” (Schori, 2010)[[31]](#endnote-32)

The way forward requires concerted efforts among all the stakeholders in promoting shared human values in financial matters. To this end, Sri Ravi Shankar argues that:

“the implementation of these human values in the corporate program…has to be developed holistically by including society’s four pillars: its economic establishments, its faith-based organizations, its political institutions and its social sector…Faith-based institutions can catalyze a huge transformation and engender much needed integrity in people.” (Shankar, 2010)[[32]](#endnote-33)

There should be a way of minimizing the effect of greed in personal behavior. Reverend Dr Olav Fykse Tveit, the General Secretary of the World Council of Churches explains the nature of greed from the economic parlance:

“Economic laws and principles from beginning to end are also a matter of personal behaviour. Because of the financial crisis, the attitude of greed now has a new face and new dimensions…We will never experience the total disappearance of greed. However, we can work together to define what kinds of attitudes build a sustainable global economy in a sustainable global community.” (Tveit, 2010)[[33]](#endnote-34)

Building a sustainable global economy is not an easy task. It requires long-term plan that will take into consideration several factors, particularly shared values. This is expected to transform the current socioeconomic model and make it more productive. Nevertheless, Kirill I, Patriarch of Russia contends:

“without a solid basis in values, however, any transformation of the existing socioeconomic model cannot be productive. A feasible new model of global development should be based on the principles of justice, efficiency and social solidarity.” (Kirill, 2010)[[34]](#endnote-35) This is what is encouraged by all faith-based finance initiatives and SRIs across the world.

### Culture and Society

Various cultures and societies have many common values which they have originally imbibed from religious teachings. But over a time, they become distinctly associated with certain cultures and societies. The way of life, system of beliefs and thoughts of every society forms the social fabric of every nation. Creating awareness of cultures around the world helps to build mutual respect and a sense of social responsibility amongst people. A survey was conducted to see how culture influences financial decisions, particularly among Easterners and Westerners. Many multinational corporations today tend to adopt the culture of the local environment they are operating in as they are aware of how these differences affect their business prospects. For example, the Hongkong-Shanghai Banking Corporation (HSBC) went on with a successful campaign to be dubbed “world’s local bank,” and emphasized the importance of recognizing cultural differences in business.

This idea is captured in The Business of Humanity project currently undertaken by the University of Pittsburgh, which seeks to improve strategic decisions made in organizations. It proposes that:

“**Strategic decision making that employs criteria falling under the rubric of "humanity" - in its two dimensions of "humaneness" and "humankind" - leads to superior economic performance.** **Humaneness in business decision-making focuses on criteria and programs related to safety, quality, diversity, environmental sustainability, gender equality, social sustainability, integrity, ergonomics and good design.” (University of Pittsburg, n.d.)**[[35]](#endnote-36)

### Education

Advancement in education and technology is leading to greater awareness about our environment and inspiring people to adopt more environmentally friendly mechanisms such as ethical, green and SRI movements, etc. Besides the focus on management processes and the technicalities of finance, an integrated education system which inculcates values and ethics to students is also important. (Mian and Sufi, 2014)[[36]](#endnote-37) Excellence in business and finance education is about creating value not only to the economy and financial industry, but also to society and contributing to sound economic growth, improving human conditions and balancing between social and economic needs. Management education should focus on deep study of universal laws, philosophy and ethics.

In addition, the syllabus taught in educational institutions should be reviewed to include a component of ethics and morality. (Kabir, Rasem, Oseni, 2013)[[37]](#endnote-38) For example, since September 2014 financial education has formed part of the compulsory national curriculum for all maintained schools in England. It's part of citizenship for 11-16 year olds and there are stronger links to it in maths for all ages Students of finance are usually taught the subject matter per se, and how they could maximize returns. However it should always be reinforced upon them to look at their role and responsibility as financial intermediaries and mobilizers for the general sections of the population who are financially less educated, and dependent on them. They should be taught to abide by the professional code of conduct of financial professionals within the industry, and avoid any acts of malfeasance.

### Environment

Nowadays many investors do not just look at their cash flows, but also concerned how these cash flows are generated. Many investors, for example, abstain from investing in firms that use child labor or adopt heavily polluting technologies (Schwegler and Reutimann, 2014)[[38]](#endnote-39). The investors today distinguish between “sin stocks” and clean investment opportunities. (Hong, Kacperczyk, 2009). [[39]](#endnote-40)

There is also an increasing level of awareness of firms to engage in socially-responsible and environmentally-friendly business practices. There have been widespread efforts in the incorporation of sustainability in the strategic vision of many financial institutions, realizing the importance of enabling the future generations to also benefit. For example, The World Bank has already established its own sustainability initiative called Wealth Accounting and the Valuation of Ecosystem Services (WAVES), which seeks to promote accounting methodologies that place value on the environment. Many ecosystems have placed tangible value in the form of tourism, drug development, natural disaster prevention, etc. In new methodologies, environmental assets would be included when calculating GDP.

### Socially Responsible Investments

Socially responsible investing (SRI), also known as “sustainable”, “socially conscious”, "green" or “ethical investing”, is a kind of investment strategy which seeks to consider both financial return and social good. These investors encourage corporate practices that promote environmental stewardship, consumer protection and human rights. They avoid businesses that sell or promote alcohol, tobacco, gambling, pornography, weapons, contraception/ abortion, fossil fuel production, etcAccording to data from the Social Investment Forum Foundation.Socially responsible investing nearly quintupled in the U.S. from 1995 to 2010 as measured by the amount of professionally managed dollars invested, growing from 9 percent to 12 percent of the national total. The rise of socially responsible investments could be an indicator of the growing importance of ethics and other social aspects in finance.

# Conclusion and Policy Recommendations

Financial crises have been primarily a result of the ethical failure of not only financial players but also of the regulators and those who were entrusted by people but failed to discharge their duties. Sometimes they just overlooked it, at other times it was plain abnegation and sometimes it was professional negligence, but ultimately it brought immeasurable suffering upon people. As discussed in this paper, many studies have analyzed the underlying issues and came up with different diagnosis and solutions but one aspect that has received less attention is ethical failure and the role of faith-based common values in addressing these problems. This paper focused on that aspect and attempted to highlight some of the important common teachings of various religious communities and how some emphasis on them could help to shape a better financial system that is more inclusive, stable and efficient.

Business ethics and moral values assist in sharpening and enhancing global practices in the financial industry. We need to consider major ties that bind various faith communities in order to unravel distinctive overlapping shared values that could form the basis of further discussions on a new global paradigm that merges faith-based initiatives with the SRI initiatives. One of the important areas for future research directions is the relevance of ethico-religious values to the global economy.

Ethical values represent a general theme that runs across financial communities, which eventually led to the introduction of SRIs. Similarly, the Islamic conception of economics is built on ethical business practices that promote justice, equity, and fair distribution of economic and financial resources. One of the important considerations of Islamic economic principles is that productive resources are not to be kept dormant or concentrated in the hands of few.

Incentivizing good behaviour is a way of rewarding firms which practice socially responsible decision making. One suggestion of such measures of incentives is by creating public ratings of well-performing and outstanding companies, which have been serving their clients well, on a fair and transparent basis, and avoiding any acts of malfeasance as far as possible. Such ratings are intended to give these companies a better business standing and increase their business prospects in the future.

Financial crises are brought on by financial mischief and criminal acts that go unnoticed over extended periods of time. This financial misconduct will be controlled by creating awareness and setting strong precedents of exemplary punishment to the guilty. To address this problem we could create a rating database for financial executives just like the database we have for borrowers for analyzing their credit history.

Rating is a public good just like regulation; leaving it in private hands creates a strong conflict-of-interest situation. Therefore rating systems should be publicly funded and made accountable for their actions, working in tandem with regulators. Also, companies engaged in financial businesses should be rated based on their compliance performance. A company or its shareholders/employees/directors punished for any misconduct should not go unnoticed for the purpose of regulatory compliance and cumulative rating. Companies falling short of the minimum cumulative rating should not be allowed access to public funds.

A final question is who is best equipped to regulate the ethical behavior of companies and work to implement the incentives described above. Central Banks are better equipped to deal with financial instability because of their macroeconomic perspective which enables them to conduct macro prudential regulation. Their intimate knowledge and experience provide them an ability to understand the impact of the failure of individual institutions on the financial system. However there are also concerns over the conflicting targets that arise when central banks are mandated with responsibilities/obligations that are in conflict with their primary task, effectively charging them both with effecting price stability using inflation, and also tasking them with securing their country’s growth and development. It is therefore necessary that independent regulatory bodies arise to supplement the regulatory role of central banks.

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    **Abbreviations**

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    | --- | --- |
    | SMC | Subprime Mortgage Crises |
    | OECD | Organization for Economic Cooperation and Development |
    | ESG | Environmental, Social and Governmental |
    | SRI | Socially Responsible Investments |
    | WAVES | Wealth Accounting and the Valuation of Ecosystem Services |
    | GDP | Gross Domestic Product |

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