

## BLIND SPOTS TEACHING NOTE

### I. INTRODUCTION

The Blind Spots e-case is designed to help students understand how cognitive biases can negatively impact ethical decision making. This e-case consists of two parts:

1. An 11-minute mini-documentary featuring the first-person story of Jay Nolan, a former commodities trader who ended his career by serving a five-year prison sentence for defrauding investors; and
2. A 10-minute learning module that explains the cognitive biases to which Jay succumbed along with tips for developing an individual ethical framework to help avoid going down a similar path.

### II. RECOMMENDED COURSE ADOPTION PLAN

It is recommended that instructors assign both components of the Blind Spots e-case as out-of-class assignments in which students are required to watch the mini-documentary and complete the learning module. The learning module contains a reflection question at the end which should take students between 15 and 30 minutes to complete. Therefore, total time needed to complete this assignment is less than one hour.

At the next class meeting following the assignment of the e-case, instructors should debrief students about the following:

- Their impressions of Jay as an individual, including:
  - Thoughts about the likelihood that an individual such as Jay would commit a crime
  - How and why Jay ended up on the wrong side of the law
  - The sincerity of Jay's regrets and lessons learned
- Rationalizations that led Jay to cross the line, including:
  - Relatability of the thought process that enabled Jay to ignore the fact that he was crossing the line
  - How rationalization prevented Jay from changing course once he realized he had crossed the line
- Strategies for avoiding the slippery slope, including:
  - Understanding what an ethical framework is and the role of an ethical framework in our decision making
  - How an ethical framework could have helped Jay avoid crossing the line or may have helped him to change course once he realized he had crossed the line
  - Applying the Daniels Fund Ethics Initiative Principles to Jay's situation and using it to pinpoint where Jay's decision making went awry
  - How students can use the Daniels Fund Ethics Initiative Principles as a framework to guide their own ethical decision making.

### III. BLIND SPOTS MINI-DOCUMENTARY NOTES

#### OVERVIEW

Jay Nolan was a very successful and well-known trader at the Chicago Board of Trade throughout the 1980s and 1990s. On November 24, 2009, Jay was arrested for defrauding investors. He was accused of lying to them about losses he sustained while trading on their behalf, creating phony documents to hide those losses, and unjustly charging the investors management fees. While there was no dispute that Jay had broken the law, the way in which he found himself on that path provides an important lesson about how one's decision making process can skew one's sense of what is right and wrong.

#### KEY POINTS

Jay allowed himself to fall victim to two common cognitive biases: overconfidence bias and loss aversion.

- Overconfidence bias – an individual's belief that their skills and judgments are unquestionably better than the norm despite objective proof to the contrary.
- Loss aversion – an individual's strong preference to avoid losing something versus gaining the very same thing. In other words, an individual would be more likely to take proactive steps to avoid losing \$10 than to gain \$10.

#### BACKGROUND READING ON JAY'S CASE

*Chicago Tribune: Bond Trader Jay Nolan Arrested After Big Time Trading Career:*

[http://articles.chicagotribune.com/2009-12-14/news/0912130129\\_1\\_open-outcry-futures-jay-nolan](http://articles.chicagotribune.com/2009-12-14/news/0912130129_1_open-outcry-futures-jay-nolan)

*FBI: North Suburban Man Charged with Cheating Handful of Investors Out of Several Million Dollars:*

<https://archives.fbi.gov/archives/chicago/press-releases/2009/cg112509a.htm>

### IV. BLIND SPOTS MINI-DOCUMENTARY VIDEO TRANSCRIPT

#### Jay Nolan

To this day, it's mystifying to me that I could have let it go so far.

The mistakes I made...

I'm not a swindler, you know, or a natural-born liar. I knew it was wrong from the start. I managed to justify it to myself and then at the end, I entertained what I guess were delusional thoughts to support that whole fantasy.

#### Narrative Slides

On November 24, 2009, Jay Nolan was arrested by the FBI. Once a prominent fixture in the bond trading pit at the Chicago Board of Trade, Nolan stood accused of defrauding investors of more than \$6 million. Jay's arrest and the revelation of his years-long fraud shocked those who knew him best. How could someone who seemed so unlikely to cross the line end up capping a long, successful career by serving a prison sentence?

Daniels Fund Ethics Initiative Case Bank  
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## Blind Spots

### Jay Nolan

What attracted me to the Board of Trade was the energy; the electricity on the floor. There's a certain kind of energy when a person can take risk and profit from it and take risk and lose from it. It's a different kind of energy than the normal work environment.

I was paying the bills and maybe making a little extra as a clerk in the silver and gold area and then a friend came in one day and said this new t-bond futures contract is all of a sudden — the interest in it is picking up. Salomon Brothers, the world's biggest bond trading company, came in from New York and decided that they wanted to participate in that market and they were looking for a broker. They threw their business out to competition for about a month and I won the competition. All of a sudden, there I was — a broker for Salomon Brothers.

The income was quite a bit more. But mostly, I was just caught up in the game of it on the trading floor. I placed 12 billion dollars into the market — in one day. That was a record. That shattered any volume records in futures. And to me, the game of it was more important than the money. To be master of the game was far more important to me.

The volatility was huge. The risk was ginormous. And at the end of the day, I was just happy not to be destroyed financially. I had had some gut-wrenching losses on the trading floor. I think I lost \$125,000 in a day early in my career — double my net worth at the time. I remember my clearing member talking to me he said, "Well, what are we gonna do?" And I was like, "I don't know. What's the procedure here?" And he said, "Get out of here and go make it back!" That was an early tone setter for my whole career, and that was the general attitude of being a professional trader. I mean, it was going to be made back.

### Narrative Slides

Jay made the money back — and then some. Over the course of his 21-year career as a bond trader, Jay's gross earnings were estimated to be between \$40 million and \$50 million.

In 1998, Jay's wife died suddenly, leaving him with five young children to raise. He left the bond pits to spend more time at home. Jay wasn't keeping up with the market on a daily basis and didn't notice that patterns were shifting in a major way. In this new, less familiar investing environment Jay's belief that losses could always be made back created a major blind spot that would ultimately lead to his downfall.

### Jay Nolan

Someone approached me in 2004 and said, "We heard you were a successful commodities trader at the Board of Trade at one time." And I said, "Well, 'at one time' is the operative phrase there. That was 10 years ago." And they responded, "We want to be in that sector."

And I thought, "Well, how bad can this get? I'll buy a couple of gold, a couple of oil. If it doesn't work out, I'll give him his money back."

So, I started around the beginning of '05. Mom and pop capital was starting to come on to these commodities markets which, in perspective, they're tiny. So, big capital coming into tiny markets, prices go up. Having traded them and watched them for 30 years, oil at \$70 didn't make any sense to me. So, I shorted it and got killed.

At the time, the fellow would just ask me, once in a while, how the fund was doing. And my thought when it first started taking losses was, "Well, been here before; had some gut-wrenching losses on the trading floor; always made it back." So, when the fellow said, "How's my account doing?" I said, "It's doing okay." I justified it by knowing — by *knowing* — that I would make the money back. I had never failed to in the past.

At the end of six months, I had lost half the money. Then by the end of that first year, that money had been recouped and it was actually up 19%, or something like that on the year. A net gain of 19% in a year. In retrospect, that was probably the worst thing that could have happened because the elation of actually delivering on that promise — it was beyond the highest high that you can imagine.

In year two, I experienced some further losses. And again, the fellow would just ask me when I saw him, "Hey, how's the account?" I said the same thing, "It's doing okay." Meaning, it *will be* doing okay.

It started to creep into my consciousness that I was in a mess. Then it was like, well, the only way to get out of this mess is to trade successfully. The minute I'm back to where I'm supposed to be, I'm closing it down; returning the money.

So, I continued to soldier on if you will, and the rest is history. I never did recover.

### **Narrative Slides**

Over a period of four years, Jay lost several million dollars of his investors' money trading commodities. All the while, he kept this information from them. He initially began misleading them by verbally telling them that the account was doing fine. Later, Jay began giving them fake statements.

### **Jay Nolan**

Well, at some point, the gentleman in question requested a paper statement. So, I made a paper statement which substantiated what I had been telling him verbally all along. I really started to feel like a major moron at that point. My self-esteem plummeted with every statement. And I redoubled my resolve to find that winning trade.

### **Narrative Slides**

Jay's lies were revealed when one of the investors called the trading account clearing firm to verify the account balances. Jay had reported to investors that the account held over \$6 million. The actual balance was less than \$300,000.

### **Jay Nolan**

And I was arrested. Of course I was in shock. There was no trial. There was never going to be a trial because I had made a statement on the phone to the investor and turns out he had it on tape.

I was convicted on one count of mail fraud and I was sentenced to 60 months, which is five years.

### **Narrative Slides**

Jay reflects on lessons he has learned.

#### **Jay Nolan**

If it feels wrong it is wrong. And, I know the pressures can be huge. They can be — they will be specific to our upbringing as well. And, I will never again do something that I know is wrong, by the way. If it feels wrong, I'm out. I'm not doing it. And the fact that I had to go to this extreme, to this day, it's mystifying to me that I could have let it go so far.

## **V. BLIND SPOTS LEARNING MODULE TRANSCRIPT**

As a successful trader, Jay Nolan was used to winning. Even when the chips were down, it was his experience that he would always come roaring back. This kind of track record of success can lead to a sense of invulnerability — a sense that no matter the circumstances, the individual will inevitably win. This belief can make an otherwise ethical individual susceptible to crossing ethical lines. And, as we saw with Jay, it can also lead them down a road that ultimately ends in prison.

### **LEARNING OBJECTIVES**

In this module, we will use Jay's story to explore two of the cognitive biases illustrated by his experience. Specifically, we will touch on the overconfidence bias and loss aversion. We will discuss what each of these concepts means and offer tips for avoiding them. We will also discuss the Daniels Fund Ethics Initiative Principles and explore how they can be used to help frame our ethical decision making.

### **COGNITIVE BIASES**

A cognitive bias is an inherent propensity to interpret information in a way that causes the individual to reach conclusions that are not supported by the facts of the situation. They are mental filters that each of us uses every day, in one form or another. They are mental shortcuts that evolved over time and serve us in ways that can sometimes be helpful. At other times, they can be harmful, or even detrimental.

Cognitive biases can have a profound impact on our ethical decision making and, it is for this reason, that we should be keenly aware of when they might be working against us as we strive to manifest our best, most ethical, selves.

### **THE OVERCONFIDENCE BIAS**

Put simply, the overconfidence bias is at work when an individual steadfastly believes that his skills or judgments are unquestionably better than the norm and certainly better than objective proof would otherwise attest to. This bias can lead an individual to ignore important, and often glaring, information to the contrary.

We can see this bias at work in Jay's story.

**Video Clip — Jay Nolan**

At the time, the fellow would just ask me, once in a while, how the fund was doing. And my thought when it first started taking losses was, “Well, been here before; had some gut-wrenching losses on the trading floor; always made it back.” So, when the fellow said, “How’s my account doing?” I said, “It’s doing okay,” and I justified it by knowing — by *knowing* — that I would make the money back. I had never failed to in the past.

Because Jay believed that he would make back the money he lost, he felt justified in misleading his investors about the status of their trading account. Jay didn’t recognize that he had crossed the ethical line by giving an untruthful answer because he believed that everything was ok since he expected to make back the money he’d lost.

**LOSS AVERSION**

Most of us hate losing. In fact, for most people, the fear of loss has a stronger emotional impact than the expectation or possibility of gain. This means that an individual is more likely to make an unethical decision to avoid losing something than he is to make an unethical decision to gain the very same thing. This is known as Loss aversion. According to Robert Prentice, Department Chair Business, Government & Society at UT Austin, loss aversion can lead people who have made mistakes or violated the law through carelessness or inattention to, upon realizing this fact, take their first consciously wrongful step in order to attempt to ensure that the mistake is not discovered.

We can also see this bias at work in Jay’s story.

**Video Clip — Jay Nolan**

It started to weigh on me quite a bit and the fear...plus it dawned on me that I’m not in that same situation where the losses are mine and I had to justify it to the clearing member, or the losses occur to Salomon Brothers, which is a ginormous company and they don’t care about this week so much. This was a different format. This was an individual person, so as it started to creep into my consciousness that I was in a mess already. Then it was like, well, the only way to get out of this mess is to trade successfully. The minute I’m back to where I’m supposed to be, I’m closing it down; returning the money. And this has been a harrowing experience and I never thought in a million years that it would be like this. I realized that I was in over my head.

Not wanting to admit that he had failed, Jay continued to keep up the lie. Rather than come clean about the situation to his investors, he falsified account statements. At this point, Jay knew that what he was doing was wrong, but admitting that he had failed seemed to him to be a far worse option than doing something that he knew was against the law.

As you watch Jay’s story or engage with this learning module, it can be quite easy to think that Jay’s situation is unique or that you would never find yourself in such a situation. While you may not now or ever work with investors, you will, in all likelihood, find yourself in a situation in which you’ve overestimated your own capabilities, and owning up to that fact may result in negative consequences that, at that time, you would rather avoid. In fact, you’ve probably had a scenario like that occur in your life at some point already. It’s only a matter of scale. Until now, the stakes haven’t involved potential jail time. But, as you get into your career, the stakes could not only involve jail time for you, they could also involve the risk of harm to others. Preparing



yourself now for how you will handle the inevitable ethical dilemmas you will face in the future is your best defense against going down the path that Jay, and many other good people, have traversed.

## DECISION MAKING FRAMEWORKS

Aristotle famously said: “We are what we repeatedly do. Excellence, then, is not an act, but a habit.” We can paraphrase this and apply it to ethical decision making. Ethical decision making is not an act. It’s a habit. We must build our ethical decision-making muscle by paying attention to how we behave in situations that seem inconsequential as well as in situations that are clearly of consequence.

We can increase the likelihood that we will make consistently ethical decisions by pre-planning our responses to potential ethical challenges and by developing frameworks that we can use to remind ourselves of our commitment to ethical behavior. Ethical frameworks can also help us evaluate our decisions before we act on them to ensure that they are aligned with our commitment. One example of an ethical framework we can use is the Daniels Fund Ethics Initiative Principles.

## DANIELS FUND ETHICS INITIATIVE PRINCIPLES

The Daniels Fund Ethics Initiative has outlined eight principles for ethical decision making. These principles are based upon the tenets by which Bill Daniels, a successful businessman and pioneer of the cable television industry, lived his life. The principles are:

- **Integrity** – Act with honesty in all situations
- **Trust** – Build trust in all stakeholder relationships
- **Accountability** – Accept responsibility for all decisions
- **Transparency** – Maintain open and truthful communications
- **Fairness** – Engage in fair competition and create equitable and just relationships
- **Respect** – Honor the rights, freedoms, views, and property of others
- **Rule of Law** – Comply with the spirit and intent of laws and regulations
- **Viability** – Create long-term value for all relevant stakeholders

Perhaps if Jay had been prepared to act on the basis of an ethical framework he believed in, he might have avoided the humiliation and hardship he ultimately experienced as a result of his actions.

## REFLECTION

Identify instances in which Jay’s actions violated each of the Daniels Fund Ethics Initiative Principles.

### *Answer Notes for Instructors*

Below are brief talking points the instructor may use to help guide and/or stimulate student responses.

*Ways in which Jay violated the Daniels Fund Ethics Initiative Principles include:*

- **Integrity** – By telling his investors that the account was fine when, in fact, it was losing money, Jay was dishonest and failed to act with integrity.

- **Trust** – Each time Jay misled investors, he missed an opportunity to build trust. In fact, with each act of dishonesty, Jay sowed feelings of distrust, which is what ultimately led one of the investors to verify the account balance independent of what Jay had told him.
- **Accountability** – Jay failed to accept accountability for his decision to continue trading the account despite the losses he incurred. He rationalized that he had no other choice but to continue down the wrong path. One always has a choice between doing the right thing and doing the wrong thing.
- **Transparency** – Jay’s verbal and written communications with his investors were filled with untruths. Although he believed that he would make back all of the losses, Jay actively hid the truth in his communication about the status of the account.
- **Fairness** – By misleading his investors about their trading losses, Jay unfairly denied them the right to withdraw their remaining funds and invest them elsewhere. This prevented them from making alternate arrangements and perhaps salvaging some of their investment capital.
- **Respect** – While Jay believed he was doing what was best by attempting to earn back the full amount of his investors’ capital, Jay did not show respect for their property (their money) when he decided to keep the truth from them, thereby denying them the ability to move their capital elsewhere.
- **Rule of Law** – Jay clearly violated the law when he began verbally misleading investors about the account. He further compounded this when he began creating fake account statements.
- **Viability** – Jay’s actions were not viable over either the long or short term. Not only did he not create long-term value for stakeholders, he actively destroyed the value of their investment.