The ethics of the financial crisis and financial reform

Irene van Staveren

Institute of Social Studies of Erasmus University Rotterdam

PO Box 29776

2502 LT The Hague

The Netherlands

staveren@iss.nl

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Abstract

The paper analyses the financial crisis and financial reform from two alternative ethical perspectives as compared to the mainstream one in economics, utilitarianism. It contrasts deontology with the ethics of care and argues that the rule-based deontological approach is not able to prevent a next serious crisis. It argues instead that apart from a minimum of rules, the contextual, relationship-oriented ethics of care is necessary for a stable and client-oriented financial sector. It poses the hypothesis that such an ethics of care is already available in the sector, although marginally, and quite effective. This hypothesis is tested with exploratory survey data from the Netherlands as well as two case studies of caring financial innovation from the Netherlands.

The ethics of the financial crisis and financial reform

... with one hand, Citibank sold a package of toxic mortgage-backed securities to unsuspecting customers – securities that it knew were likely to go bust – and, with the other hand, shorted the same securities – that is, bet millions of dollars that they would go bust. It doesn't get any immoral than this.

Thomas L. Friedman 'Did You Hear the One About the Bankers?'

New York Times, October 20, 2011.

Introduction

Academic interpretations of the financial crisis often refer to 'thick concepts', as Amartya Sen calls them, which have both descriptive and normative value. We see references to "hiding risky situations", "excessive liberalization", "extremely high bonuses", "irresponsible loans", "failing control", "regulatory capture", "perverse incentives" , "moral hazard", "too rosy assessments", and "excessive liquidity related to consumerism" (Schneider and Kirchgässner, 2009; Nothwehr and Manning, 2009; Blundell-Wignall, Atkinson and Lee, 2008; Narayan, Ferri and Brem, 2008; Hart and Zingales, 2009; Daron Acemoglu, 2009; 2009).

Neoclassical theory, with its efficient market hypothesis, normal probability distribution of risk, and principal-agent incentive logic, reflect a particular ethical theory. This is the theory of utilitarianism, but in a specific form, namely with a highly subjective interpretation of utility. This, I will argue, is part and parcel of the underlying causes of the crisis (see also Crespo and van Staveren, 2012). In the next section, I want to briefly discuss two other ethical theories, namely deontology and the ethics of care. The reason for doing so is that the ethics of the crisis and financial reform can also be understood in alternative ethical frameworks, which will help to understand what alternative behavioral paths, taken by some actors, are available for successful financial sector reform. The section thereafter will present the results of an exploratory survey among Dutch financial professionals. The survey results suggest that the ethical dimensions of the crisis and reform indeed follow distinct paths, in which distinct ethical approaches can be recognized. The last part of the paper will present two case studies in alternative finance, as a response to the crisis. These case studies show how an ethics of care may translate into a meaningful and economically sound alternative financial structure and behavior. The conclusion of the paper emphasizes that regulation may be important to prevent crises and to guide financial reform after a crisis, but that a caring ethical approach is just as important, precisely because it guides less crisis-prone behavior in finance, and informs financial innovation towards more stable and sustainable finance, supporting the real economy instead of endangering it.

Two alternative ethical theories and the financial sector

Deontology, also referred to as rule-ethics, is concerned with rules which reflect the good, or justice, rather than outcomes. A dominant form of such rules is expressed in the Categorical Imperative, stating that one should act according to that maxim whereby you can at the same time will that it should become a universal law (White, 2009). Or, a more individual-oriented interpretation of its universalist implication: acting to others as you would like others to behave towards yourself (and expect them to do the same). Hence, deontology is not an individualist ethics, as is utilitarianism, but a social and universalist ethics, it is concerned with justice, with what is considered as right for a society as a whole (White, 2009).

In the financial sector, deontology is reflected in regulation: by Central Banks, governments, and the sector itself. Clearly, deontology failed as a moral guidance in the financial sector. Obviously, it is not merely the amount of regulation that matters, but the quality of regulation. From a deontological perspective, financial sector regulation should be thus that it is supported throughout the sector, and hence, regarded as just or fair. Regulation failed in particular in terms of two of the moral connotations listed in section two: excessive liberalization of the financial market and a failing control of banks, partly through regulatory capture. It is clear that the decreased regulation was inadequate to live up to the principles of deontological ethics. Rules that had come into being after the 1929 crisis had been removed through a strong bank lobby in the US (Igan, Mishra and Tressel, 2009), and new rules were not yet made for new financial strategies and products, such as short-selling, credit default swaps and derivatives, even though they were being traded increasingly. Without a stronger commitment to rules, both in terms of rule setting and rule enforcement, in the financial sector, deontology has limited moral capacity to prevent a next crisis.

Unlike deontology, which relies on external enforcement of moral behaviour, the ethics of care helps to understand agents' behavior and firms' strategies from a deeper ethical sense. It is concerned with ethical reflection and deliberation by agents every time where they did have the space to make different choices. The ethics of care is attentive to the inter-personal level, where ethics is concerned with sustaining human relationships and preventing harm to others (Waerness, 2009). In the words of ethicist of care, Virginia Held: "Whereas justice protects equality and freedom, care fosters social bonds and cooperation" (Held, 2006: 15). And it is here where the other moral terms that we have seen in section two will come into the picture, terms concerning hiding of risk, extremely high bonuses and other perverse incentives, construction of securities that no-one understands, too rosy credit ratings, and the consumerism implied in extremely low interest rate policies. These moral dimensions of the crisis have much less to do with regulation than with responsibility of the agents involved, vis-a-vis other agents and organizations. The ethics of care enables a fundamental shift in the parameters of the financial market. "With the ethics of care and an understanding of its intertwined values, such as those of sensitivity, empathy, responsiveness, and taking responsibility, we could perhaps more adequately judge where the boundaries of the market should be" (Held, 2006: 119). This also helps us to seek different roles for the government in relation to the financial market beyond that of protector of rights or rule maker and keeper, as Held rightly argues.

In the ethics of care, preventing harm to others is contextualized. It is not abstract, as the rule of non-intervention or a set of rules based on principles, but inherent in the relatedness of actors. Preventing harm to others therefore requires taking responsibility for the consequences of one's actions, not only as an individual but also through institutions, and responsibility for preventing the system in which one functions to turn into an uncontrollable chaos causing harm to all involved. Care also involves sympathy, in the sense of being able to place oneself in the shoes of others, as Adam Smith already explained – not limited to particular others known to oneself, nor an abstract, generalized other similar to oneself as in the Categorical Imperative – but concrete others whose circumstances are imaginable due to the general information one has about their context (Benhabib, 1987). So, preventing harm to others requires contextualization, in order to be able to know how others are in their concrete situation and what our responsibilities to them would be.

The ethics of care, when applied to the economy is expressed through efforts to minimize harm in day-to-day practices which have possible harmful effects on others, whether these would come from free markets or government regulation or intra-firm self-interested behavior, power seeking strategies or any other behavior in an economic sector. Possible harmful effects of behavior abound because of imperfect markets, risk alongside uncertainty, and a wide variety of behavioral motives including harmful ones. In particular it is uncertainty which so much influences financial markets, which goes beyond risk, because the probabilities are unknown. Keynes, of course, already knew this, as Skidelsky (2009: 75) notes: "Keynes believed that in many situations market participants face irreducible uncertainty. They have no basis on which to calculate the risks they face in making an investment. They are plunging into the unknown." And this condition places any economic sector at any time in transition, as Keynes already noted, rather than jumping from equilibrium to equilibrium, whether by free market forces or state interference. And in transition, rules are often not applicable or have not been established yet. It is this fragility of economic life and human fallibility in economic decision making under conditions of uncertainty, which results in harm and to which government regulation is, although necessary, utterly insufficient (see also Hellwig, 2008, on systemic risk regulation). It is precisely such fragility and fallibility to which a caring attitude responds, by contextual reasoning. And such contextual reasoning is also what Keynes pictured as the most adequate response to financial crises. He stated, as recounted by Skidelsky (2009: 76) that the cures "are not meant to be definitive; they are subject to all sorts of special assumptions and are necessarily related to the particular conditions of the time."

Exploratory Survey among Dutch financial professionals

The dataset contains survey information of 111 male and female financial professionals in the Netherlands, of which 74 (66.7%) women and 37 (33.3%) men[1]. The online survey was carried out in the period December 2010-January 2011, using NetQ. The data were analyzed using SPSS version 15. The sample size as well as the sex ratio are not representative for the financial sector in the Netherlands. The reason is that the sample was drawn through an online survey posted on LinkedIn, using the snowball method starting from a women financial professionals' network. The results should therefore be interpreted as exploratory and not representative for the financial sector in the Netherlands or internationally. The value of the survey lies in the exploration of

[1] In a different paper, I analyse the survey results from a gender perspective.

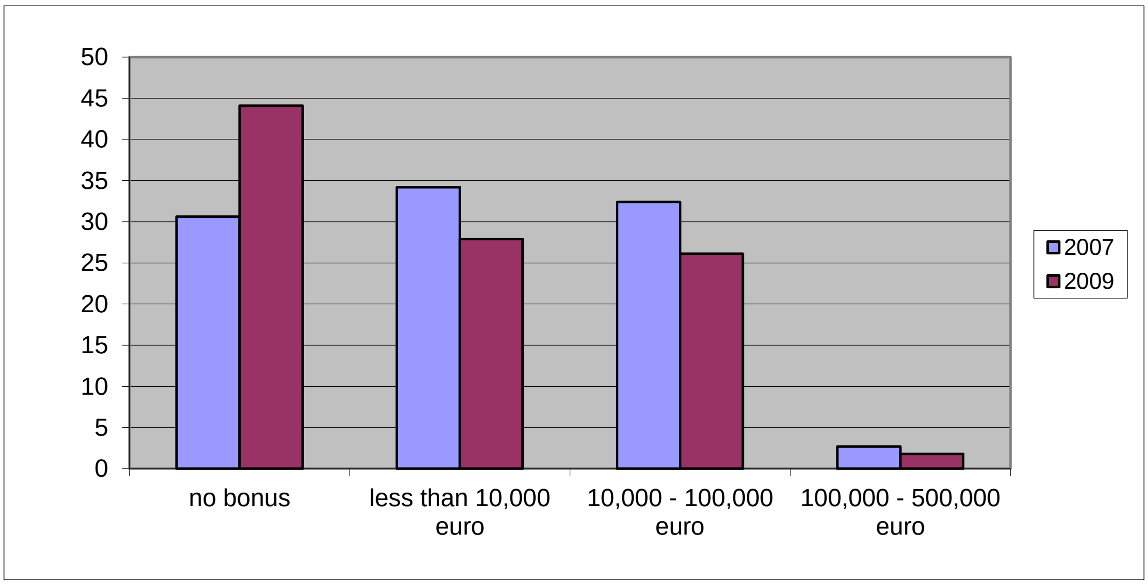
attitudes and views of financial behaviour and governance during the 2008 financial crisis. Hence, its strength is largely qualitative, concerned with how financial professionals view financial behaviour in relation to the crisis, rather than representative of financial behaviour and attitudes.

The key characteristics of the financial professionals included in the survey point out that they earn modest salaries, and bonuses in the range of their salaries, with some receiving up to half a million euro. They all received substantially less bonuses after the crisis.

Bonuses & targets

This section looks into the moral dimensions of actual financial behaviour. A first step is a look into the targets that the financial professionals need to achieve, and how these are related to the bonuses they receive. Almost all respondents need to meet targets (92.8%). For the majority, target levels have remained the same since the crisis, whereas for 34% targets have become higher since the crisis. Apparently, the crisis has not changed the target-focus in the human resource management practices in the financial sector, despite the critiques that have been raised about the perverse effects of such incentives in Dutch banks (Wawoe, 2010). When asked whether there is a clear relationship between target and bonus, 74.7% agrees that this is the case. But when the data on bonuses is analysed more closely, a more nuanced picture emerges. First, there is a strong correlation between the bonuses in 2007 and in 2009 ($p<0.01$). This suggests that bonuses may not be strongly correlated with meeting targets, as it is not very likely that most people have met their targets during the crisis. Second, the correlation between the 2009 bonus and targets is statistically insignificant. Before the crisis, however, the relationship was statistically significant ($p<0.05$). This seems to suggest that the crisis has not contributed to a more effective bonus policy in the financial sector. Instead, there may be path dependency of bonuses, irrespective of targets. Have old rules become entitlements, widely supported because they benefit everyone?

Figure 1. Percentage of respondents receiving a bonus



When asked whether the current bonus system should be adjusted towards long run profitability and/or stability, 90.1% of the respondents answer positively. This suggests that the financial professionals are well aware of the limited effectiveness of the current bonus system for the stability and performance of the financial sector in the Netherlands.

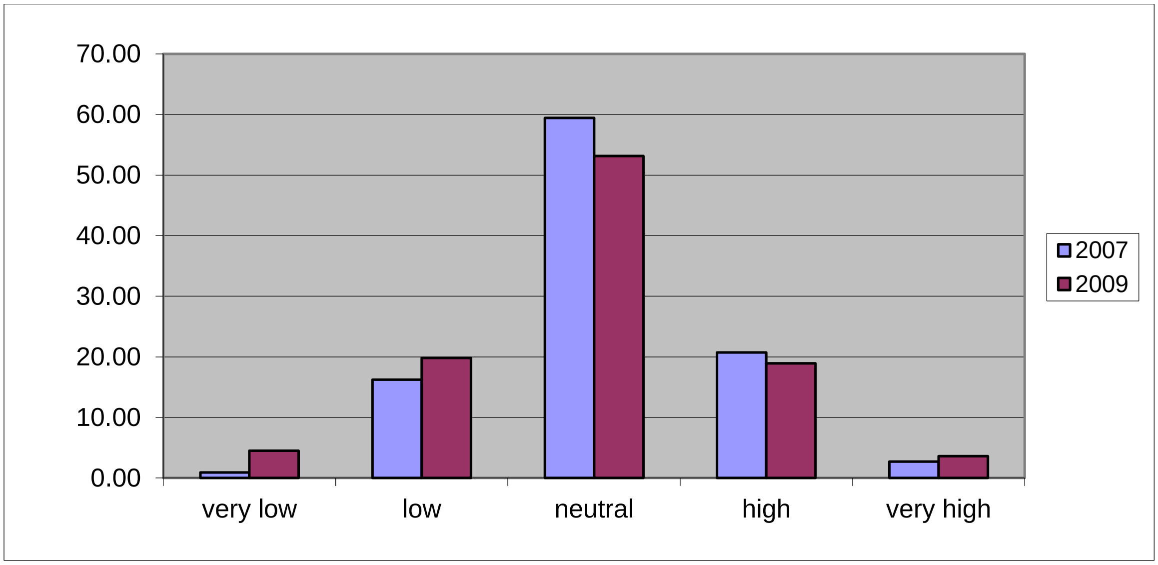
Risk taking

64.9% of the financial professionals state that they adjusted their risk levels downwards when financial markets are in a volatile stage. When risk levels are broken down into five categories, we see that across these categories, the levels of risk have shifted somewhat towards lower levels after the crisis, except for the small group of financial professionals taking very high risks: this category has increased, from 2.7% to 3.6%. The difference in risk levels before and after the crisis is statistically significant ($p<0.01$). Moreover, the change after the crisis has led to a higher spread in risk levels in the group surveyed, as figure 1 shows. When asked whether they think that financial markets are more influenced by risk (known probabilities) or by uncertainty (unknown probabilities), 61.3% state that uncertainty is the dominant factor. This helps to explain the high percentage of respondents taking what they regard as neutral risk levels: they may be aware that there exists no probability distribution for the possible states of the world in finance. This recognition implies that there is little space for uniform decision rules, as in widely used mathematical models. A contextual ethics of responsibility, such as the ethics of care, seems more relevant under conditions of strong uncertainty.

The survey asked specifically about the importance of particular risk-management frameworks. The large majority relies on intuition (94.6%), whereas a small minority states that they follow others (17.1%). Other risk-management frameworks are also important, with formal rules, rules of thumb, fundamentals, and information sharing in networks all being regarded as important by around three quarters of the respondents. Computer models are deemed important by 51.4%. The low share of respondents stating that they follow what others are doing indicates little direct support for Keynes' thesis of herd behaviour. On the other hand, information sharing in networks may also result in herd behaviour, and so may rules set by one's organisation and one's own rules of thumb. Even intuition may lead to herd behaviour, in particular because most respondents combine the various risk management frameworks, so that external and internal information is combined. The high percentage of respondents answering that intuition is an important risk management framework is insightful for the analysis of the crisis. It suggests that what is generally referred to as risk is regarded as subjective rather than as calculable risk, and hence, not so much as risk but indeed, as became clear above, as uncertainty. Most financial professionals seem very much aware, following Keynes, that financial markets are largely characterized by uncertainty.

When asked about the extent of the social environment taken into account, most respondents answered that they combined a technical analysis with a relational context analysis (63.1%), while a smaller group replied that they took the social context into account along with a technical analysis (27.0%). Only 9.9% stated that they rely purely on a technical analysis. Combining these results with the outcomes for risk management, it seems that at least part of the intuitive risk management framework comes from the recognition that social and relational factors matter for financial decision making. This points at an ethics of care approach, in which relationships are the moral drivers of decision making.

Figure 2. Percentage of respondents taking different levels of risk



Whistle blowing

Another moral dimension in the financial sector concerns attitudes toward whistle blowing. 59.5% stated that they have ever blown the whistle, most of them about a policy or a target. But in only 45.5% of these cases, appropriate action was taken. In most cases, the signal was ignored or the whistleblower was told not to pursue the matter further. In 28.8% of the cases, respondents felt that their career was negatively affected by their action. These data indicate that when financial professionals raise their voice against a bank strategy or behavior by management, there is often no adequate response by the firm they work for. It seems that financial firms in the Netherlands generally lack an ethical framework to formulate an adequate response and to adequately protect whistleblowers. Such a framework may either be rule-based, with clearly codified steps to be taken, or framed in an ethics of care approach, with a more open and personal approach. It will be the organizational culture that determines which of these two approaches are likely to fit best in a particular bank. Since 2009, top bankers are held to a code of ethics – referred to as the banker's oath – which will be made obligatory for all bankers by the government in 2012[2]. But an oath will only have the power of contributing to cultural change when it is not regarded as a formality but as informing individual bankers' decisions when moral dilemmas arise in day to day practices.

Products

The respondents were also asked whether they have copied financial products from competitors before the crisis that they would not do anymore after the crisis. 22.5% agreed that this was the case. 50.4% of the respondents said that before the crisis they have advised clients not to buy a particular product. After the crisis, this percentage has increased to 54.0%, a statistically significant difference. Even 88.3% agrees that financial services providers should be more client-oriented, and care more about the personal circumstances of clients when offering them financial services. These results suggest that the crisis may have prompted self-reflection on what products are appropriate for which clients. It may signal an increased awareness of one's personal

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[2] For the Dutch bankers oath see:
http://www.charteredbanker.com/MainWebSite/Resources/Document/magazinefeb10-dutch2.pdf

responsibility as financial professional to serve clients interests not so much in terms of offering them what they want, but advising them those products that best fit their personal situation. This clearly indicates a shift away from rule-based supply by financial professionals, of whatever the firm has on offer, towards a caring supply attitude in which the client's personal context and perceived needs determine which products a financial service provider selects to offer to a client.

Regulation versus responsibility

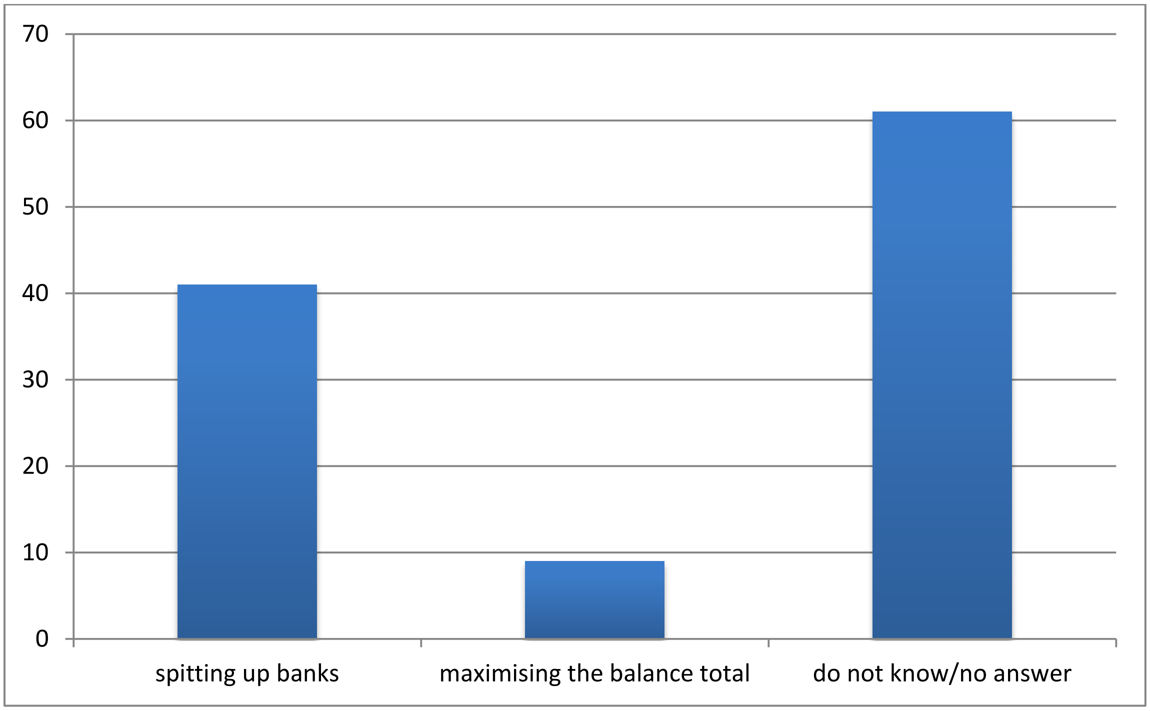
The respondents were also asked about their views on regulation of the financial sector. A majority (55.9%) thinks that the Dutch Central Bank should not have stricter regulation than it has undertaken so far since the crisis. Half of the respondents (49.5%) thinks that the European Central Bank should not implement stricter regulation. They were also skeptical about the effectiveness of Basel III regulation. 64.9% believes that this will not help to prevent a next crisis. 57.7% opposes a bank tax. When asked about their preferences for government regulation or self-regulation, the majority of the respondents (64.0%) prefer self-regulation. The aversion against regulation is even stronger when they were asked about their moral attitude about their own operations: 19.8% favoured rules, whereas 80.2% was in favour of responsibility as the driving moral incentive for their decision making as financial professionals.

Apparently, most respondents believe that they can and should follow their inner moral compass, rather than making the financial sector subject to more regulation. This raises the question about the direction and strength of their moral compass, and suggests that this should become a prominent part of the training of financial professionals. Paradoxically, a majority of

67.5% thinks that the 2009 law of Zorgplicht (Caring Obligation), requiring financial service providers to better inform clients about risks of financial products, has a positive effect on client satisfaction. Apparently, the respondents think that external enforcement of responsible behaviour is helpful for client satisfaction. Perhaps they think that this would force others than themselves to behave appropriately. This interpretation seems to get support from the cross tabulation of Zorgplicht with a preference for responsibility in their own operations. The relationship between these two questions is not statistically significant, implying that their support for the Caring Obligation law is not related to their preferences for responsibility in their own behaviour. It may be, therefore, that they do not trust *other* financial services providers to behave as responsible as they think they behave themselves. Again, this points out that more attention is needed to ethical dimensions of financial professionals' behaviour, in their training, performance reviews, and perhaps also bonus policy.

A majority of 87.4% recognizes that short-term shareholder value orientation has contributed to the financial crisis. This suggests that most respondents think that such a crisis is inherent in the capitalist system. When asked about alternatives, one third (36.0%) answered that they would like to see a reduction in the power of shareholders and more balance with the interests of other stakeholders. Almost no respondent favours nationalisation of key banks (1.8%) while only a small group is in favour of having only cooperative banks (14.4%). Another group favours soft controls based on more social control in the sector – again, a reliance on responsibility and self-regulation. So, although the driving force of the capitalist system – shareholder value orientation – is criticised, nationalization, regulation, and cooperative organizations are not favoured as alternatives. Apparently, most financial professionals believe that a more responsible attitude and a change in business law to balance shareholder interests with those of other stakeholders will be able to prevent another serious crisis.

Figure 3. Percentage of respondents assessing Dutch banks too big to fail

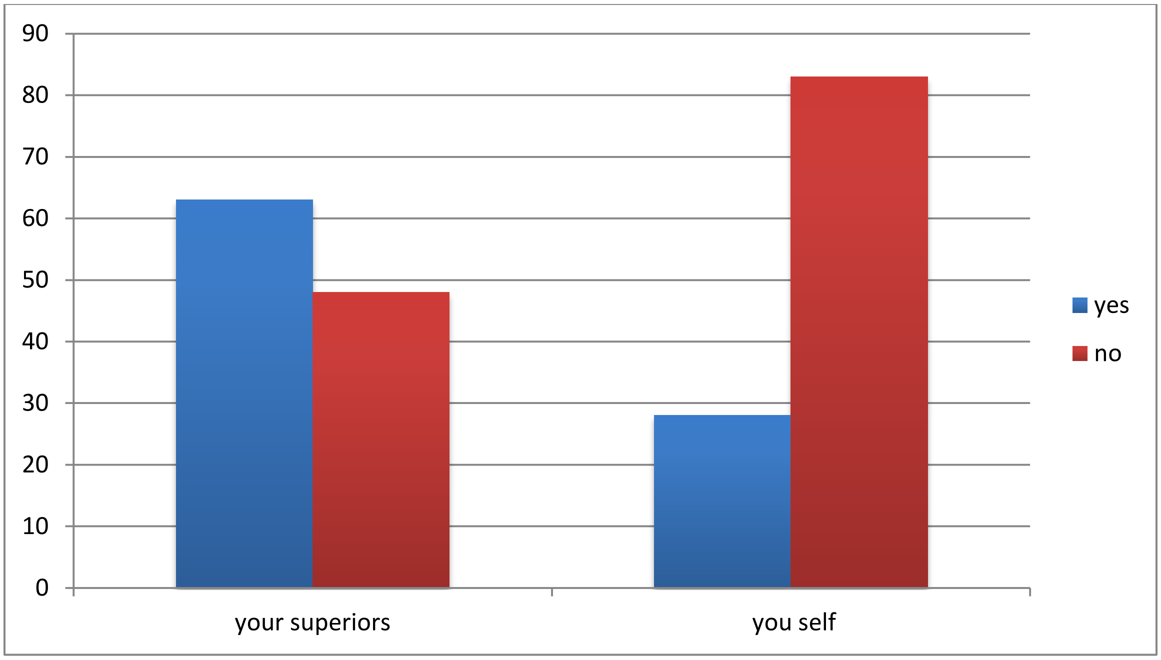


Concerning the top three Dutch banks (ABN Amro bank, ING, and Rabobank), which all have a balance total larger than Dutch GDP, a small majority (52.3%) agrees that these banks have become too big to fail. Interestingly, when asked about a solution, more than half of the respondents (61%) had no answer. 41.0% agreed to split up banks into savings and investment banks, following the policy discussion in the US and UK (Volcker rule and Vickers).

Interestingly, when asked why one of these top-three banks, a cooperative bank, has performed so well despite the crisis, only 10.8% has answered that this had nothing to do with its cooperative structure. 89.2% thinks that the fact that Rabobank is a cooperative bank helps to explain why it continued to perform well during the crisis. So, there seems to be some wishful thinking. On the one hand, a large majority of respondents agrees that short-term shareholder orientation has contributed to the crisis, whereas on the other hand, there is little support for regulation, cooperative banking, and nationalization of key banks. The sector seems to have an unfailing believe in the self-regulation and responsibility of its own actors and institutions. At the same time, a majority of 74.8% thinks that more female leadership in the financial sector would help to prevent a crisis like the current one. This may signal that the respondents have more confidence in women's moral compass than in men's. In the literature on ethics and gender, there is some support for this: men are found to have a stronger tendency to rule-oriented moral reasoning whereas women have a stronger tendency toward responsibility-oriented reasoning, as has been theorized in the ethics of care (Gilligan, 1982; Held, 2006; Tronto, 1993).

Finally, the survey asked about the personal responsibility of respondents and their superiors. 63% of the respondents said that their superiors should have acted more responsibly. A much lower share of respondents agrees that oneself should have responded more responsibly, namely 28%. These results indicate that reliance on the moral compass of financial professionals, male or female, may not be the most effective way to prevent future crisis of the extent we have now. The professionals tend to blame the system and superiors more often than accepting moral failures in their own of behavior.

Figure 4. Percentage of respondents assessing responsibility



Moral perversion in finance?

The survey results indicate that most financial professionals don't believe that regulation can prevent crises and seem to accept the fate of regular financial crises. This attitude obviously undermines a deontological ethics as moral guidance for the sector. Instead, the majority of respondents recognize this and favour self-regulation and personal responsibility. At the same time, they don't believe in measures such as nationalization of key banks, setting up cooperative banks, or appointing more women at the top. They do support a shift of incentives towards the long run, but don't seem to see how this should be implemented, with their aversion of regulation … This leaves us with a paradox: the common opinion in the sector is against regulation, while there is only limited personal responsibility, putting the blame on colleagues, superiors, and the system, while discouraging whistle blowing …

It seems that a better moral foundation for the sector would need to come either from strong external regulation and strict external enforcement, or, alternatively, much better training of financial professionals in professional ethics, in particular in personal responsibility towards clients and firms, and in shaping formal and informal institutions guiding and incentives responsible behavior.

The next two sections will present two examples of such institutional innovations towards responsible financing. They express forms of caring financing, the first one at the macro level, which contributes to higher capital ratios in the financial sector, contributing to a more stable financial sector, and the second one at the micro level, which contributes to a closer link between the financial sector and the real economy and a transition towards a more sustainable economy.

Case study on 'caring capital financing'[3]

This section presents a case study of a new capital funding product that a major Dutch bank has developed in response to the crisis and which has attracted much attention from investors and regulators worldwide. It is an example of a caring financial innovation and was developed by two senior bankers, in the context of regulatory pressure, limited liquidity in a hesitant capital

[3] This case study is based on information released through the media, a presentation for investors, and an interview I held with the two key persons who developed the security at Rabobank's capital funding department, Treasury Rabobank Group, Utrecht, 18th of May, 2010.

market, in a cooperative bank structure with client-value orientation. The case study points out that a caring attitude partly depends on an enabling institutional context.

Rabobank, a top three Dutch bank and market leader in savings, mortgages, and agricultural lending in the Netherlands, has issued an innovative form of senior debt, called the Senior Contingent Note (SCN) as a response to the crisis[4]. The SCN is in first instance a way to raise capital for the bank through bonds. The value of the bond does not appear on the balance sheet unless the bank's equity capital ratio would to fall below 7%. In that very unlikely case the bank's core capital will be strengthened as the bank will receive 75% of the value of the outstanding SCNs. Hence, those who bought the bond will lose 75% of their investment[5]. In exchange for that risk, the interest rate that bond holders receive includes a risk premium.

Rabobank is the only large Dutch bank that did not need state support, that kept a healthy equity capital ratio and its triple A rating throughout the crisis, merely dealing with collateral damage spilling over from other banks that were hit seriously by the crisis[6]. Rabobank is a cooperative bank, so it cannot raise capital through issuing shares, it is not listed on the stock market[7]. Although about 85% of Rabobank's activities are in the Netherlands, about half of its

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[4] The transaction date was 12th of March 2010, at the amount 1.25 billion euro for a 10 year fixed rate senior contingent note priced at an annual coupon of 6.875%. It was twice oversubscribed and sold to major investors across the world.

[5] In the past, convertible bonds were labeled as Tier 2 capital and institutional lenders were often supported in a bail-out (Levinson, 2010). With new SCNs in the new situation after the crisis, it is less likely that regulators will protect these types of capital.

[6] The cost of its bad loans in 2009 was nearly 2 billion euro, which was 0.33% of its balance total of 608 billion euro. On 31 December 2009 its equity capital ratio was 12.5%. Rabobank has always been profitable since its start more than a century ago, including in the crisis years 2008 and 2009.

[7] The bank has 1.8 million members, which is a non-financial membership for any client but involves no claim on the equity of the 147 local banks. It is globally number one in several countries in the food- and agri-business and

capital is raised abroad. The major way in which the bank raises its capital is simply through retained profit, while issuing certificates to its members (Rabobank clients can become member of the member council of their local branch) is another recent innovation of the bank to raise capital and at the same time to involve members more closely as capital providers to the bank. But that is small scale and through the local, independent branches. The SCN targets large investors such as pension funds and globally operating investment funds.

The SCN was not developed at the international branch of the bank, where the financial traders are based, the fast world of short term transactions and the balancing act between long term obligations and short term liquidity. Instead, the new type of bond was developed at the treasury of the bank, as part of the long term funding strategy. The challenge during the crisis was how to get access to liquidity in a drying up market (which in Europe was extra hit by defaulting governments, such as that of Greece) on the one hand and staying true to the bank's conservative capital position (for which it had been criticized before the crisis as being not profitable enough) which had earned the bank its triple A rating throughout the crisis. In a market in crisis risk and uncertainty are the major factors that investors are worried about, following their sentiments. Moreover, during a crisis risks turn into uncertainties, as rating agencies cannot assign any probabilities anymore to the chances of default for institutions or even for individual products[8]. The strength of Rabobank is precisely its prudence – its higher than average equity capital ratio, as compared with most other banks, which gave it a boring

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has 623 foreign offices in 48 countries. The maximum bonus for senior management and executives is 30% of the salary and half of the bonus is transferred only after three years.

[8] The top three international rating agencies, including Standard and Poor's, which together have more than 90% of the market, did not want to assign a rating to the SCN, since they preferred to await new international regulation coming from Basel.

image in the booming years before the crisis. This asset – prudence – was the basis for developing the SCN. The product was developed internally with consultation of a few large investors. Whereas Rabobank initially planned a 100% core capital strengthening with the new product, investors made clear that that would be unacceptable by the market. A different case of Lloyd's in London half a year earlier[9], but with similarities, as well as past cases of defaulting banks across the globe have led to the current 75% ratio of the SCN to be added to the balance sheet in case the bank's equity capital ratio would fall below 7%. The investors run a risk and contrary to shareholders, they do not benefit from more risky projects undertaken by the bank that may bring in more short term profits, instead, they will demand that the bank either increases its buffers or raises the premium on newly issued contingent notes. The interest rate was not discussed at these sounding board meetings with investors, until the last week before the transaction on March 12th 2010 in a meeting with 4 major investors. The interest among institutional investors as well as private investment funds was overwhelming, both nationally and internationally (London, Paris, Frankfurt, New York) so that the transaction of the 10 year fixed rate Senior Contingent Note, priced at an annual coupon of 6.875% was twice oversubscribed, and generated 1.25 billion euro.

So, prudence – by putting the responsibility for risk where it should be, namely the providers of capital – made it possible to find a market for this product. But it was also the pressure coming from regulators that led to its development – without the crisis and its subsequent call for (re-) regulation of banks and financial markets it would not have been

[9] Lloyd's is a listed bank, which failed to raise sufficient capital through issuing new shares. Hence, it issued contingent notes that would be turned into equity in case of pre-defined stress.

developed, at least, not now and not in this form. Regulators in the Netherlands and Europe are discussing a bank tax, equal for all banks, to form a fund that in case of need would become a lender of last resort. However, such a fund does not solve the problem of moral hazard and does not reward conservative banks for their conservative positions and subsequent higher capital ratios. Therefore, a second reason for developing the product was to influence regulation, as both Basel III agreements and European Union law making were and are still in the making. In other words, rather than lobbying against a bank tax, the SCN represents a different type of incentive for banks and by banks, to increase their core capital in case of crisis, but with the great advantage that it reduces moral hazard by providing an incentive for the issuing bank to keep its equity capital ratio up by keeping risks manageable. Whereas in case of a too low capital ratio, the 75% shift of the loan to the balance sheet would imply that the equity capital ratio would be increased automatically, based on the rule implied in the SCN, so that the bank does not (immediately) require financial support by the state, and hence is not a burden on tax payer. This characteristic of contingent capital allows banks to increase their capital ratio in a more effective way than through issuing new shares because the prices of shares are currently very low and demand is reluctant. Moreover, a contingent capital product like SCN would help to reduce the likeliness of another crisis, at least, a crisis caused by too high risk-taking by banks as is the case with the current crisis because it forces banks to keep risks relatively low in order to prevent the equity capital ratio to go down too much: that would lower demand for this type of bond and hence limit the possibility of banks to acquire equity. The SCN can also be seen as a strategic move to influence regulation, which indeed did raise attention from regulators all over the world. Obviously, a single Dutch bank is not going to fight a bank tax, but it does show that there are more ways of capitalizing banks in terms of crisis, and in a more effective way than through a bank tax. This feature of the development of SCN hence can be characterized as one of a long run view, as a concern with financial market volatility and effective responses to this from the banking sector itself – an attitude of responsibility. Not the kind of self-sacrificing responsibility as in stopping a fight at risk of your life, but the kind of responsibility as part of a liberal attitude, accepting the consequences of one's individual actions for the whole, participants (like clients and investors) and non-participants who bear negative externalities (like the tax payer). It is the responsibility that Adam Smith wrote about, that does not constrain markets but rather supports the effective functioning of markets. SCN expresses such responsibility because it is a self-regulating instrument against too high risk positions by banks and prevents costly bail-outs and compensation of clients' deposits in times of crisis. It is, in the end, a mechanism that puts the risk where it should be, namely by the capital providers of banks, rather than its clients or the taxpayer.

Finally, why was it a cooperative bank to develop this innovation? Why not equally big banks listed on the stock exchange, such as ABN Amro or ING? This has only indirectly to do with the cooperative structure of the bank. The idea did not come from the member council, not the local ones, neither from the central membership council. So, as much as the bank is driven by client-value through close contact with its members and other clients, this did not play a role in the SCN. But it was the lack of access to capital through shares that drove the bank's treasury to be innovative and to develop a product that would on the one hand build on its conservative position and on the other hand even strengthen its image in the market as a prudent bank, by providing an extra buffer for its capital ratio. In other words, the other banks did not develop such a contingent note simply because they are too busy to survive under the pressure of shareholders and demands by the state in exchange for financial support. In the words of one of the interviewees: “we do not have the shareholders pressure, which is an enormous benefit” and thereby it also “protects against moral hazard internally” and “pushes to be creative to raise capital if you can’t do it through equity”. This confirms Keynes’ insight that it is the capitalist system based on equity capital which generates the uncertainty and subsequent systemic risk in financial markets, as Skidelsky (2009: 84) reminds us: “Under capitalism, uncertainty is generated by the system itself, because it is an engine for accumulating capital goods whose rewards came not now but later. The engine of wealth creation is at the same time the source of economic and social instability.”

In conclusion, the contingent capital product of Rabobank may be characterized as a caring form of capital financing because it is a form of self-regulation lowering risk of default, while reinforcing the bank’s good rating. This, in turn, lowers the costs of capital funding, which makes it not only a solid product for the bank but also for the financial market, without the moral hazard of shifting risk to clients and tax payers. SCN therefore carries a positive externality as compared to share-based capital funding which has a negative externality – it reduces systemic uncertainty in the financial sector.

Case study of caring consumer-producer financing[10]

[10] The interview was held in October 2011, on the farm.

This is a case study of careful financing at a micro level. It concerns consumers financing energy generation for a producer, with a return on investment paid in consumer goods. Both parties benefit and experience higher advantages as compared to traditional, bank-based financing.

Koos and Monique van der Laan have an ecological milk farm in a small village the west of the Netherlands near Gouda, with 60 cows. They sell the milk, through an association of over 100 ecological milk farmers in the Netherlands, to regular as well as organic supermarkets. Their other products, which are also organic – including meat, apple juice, and walnut icecream – are sold at the farm and to shops and restaurants in the neighbourhood, stimulating the local economy.

They had decided to invest in solar energy for the farm on the roof of the cow shed, during the financial crisis in 2008. They already had taken bank credit and went for an alternative credit opportunity, 'Boer zoekt Buur'[11]. This was initiated by Triple I-S, green energy supplier Greenchoice, and VSBfonds. 27 organic farms and 750 investors/consumers ('neighbours') participated. The project offered shares worth 250 euro each. In return, investors/consumers received six vouchers of 50 euro each, to be spent on the products on the farm of their choice, one per year. This is a return on investment (ignoring inflation) of 20 percent. There are additional advantages for both farmers and consumers. For the farmers: the investment does not require pay back in money, from profits, and hence saves money for other financial investments.

[11] Dutch for "Farmer looks for Neighbour', and a variation in the name of a popular Dutch tv dating show, sold to tv stations across the world, 'Boer zoekt Vrouw' (Farmer looks for Wife').

Instead, the arrangement to pay back in products ensures the farmers a fixed minimum demand and an increase in volume sold.

30 consumers participated in the solar energy investment on the farm by Koos and Monique van der Laan. This resulted in 50% financing of the investment through the project, with the other 50% financed through the famers' savings and a small loan. The disadvantage of the project is that the farmers have a higher administrative load as compared to a bank loan, because of the smaller number of investors. The advantage of this individualized investment relationship is more contact between farmer and 'neighbor', one of the objectives of the project and a means to support sustainable farming through strengthening consumer ties with organic agriculture. This is also enabled through additional caring economic activities such as voluntary work at the farm and the adoption of cows in exchange for regularly updated individualized information about the cow's wellbeing. The additional advantages for the consumer are first that consumers know where their food originates, by visiting the farm in person. Second, they benefit from the price difference in organic products sold in organic or regular shops on the one hand and sold at wholesale prices at the farm. The vouchers they receive are in wholesale value. To give an indication of the price advantage, the table below shows the price differences of several types of meat and other products at the farm and in shops in the Netherlands. The average weighted price advantage is 30 percent.

Table1. Organic product prices, 2012, per kilogram.

Product	**Shop prices of similar organic products**	**Organic farm prices**	**Price difference per kilogram (%)**
Meat loaf	11,00	9,50	- 14%
Entrecote	21,90	23,00	+ 5%
Rib-eye	23,50	19,00	- 19%
Steak	28,50	23,00	- 19%
Tournedos	53,50	35,00	- 35%
Sausage	25,20	13,50	- 46%
Apple juice (1 l.)	1,45	2,00	+ 38%
Walnuts	9,98	6,00	- 35%
Cheese (young)	11,30	13,00	+ 12%
Average weighted price difference			- 30%

Data sources: website De Beekhoeve; website of butcher chain De Groene Weg, Rotterdam; website of regular supermarket Albert Heijn and of organic supermarket Eko Plaza.

In conclusion, the ‘Boer zoekt Buur’ project is one of careful financing, because it reduces pay back risk by providing consumers with vouchers for six years rather than requiring pay back out of volatile financial returns, while in the case of bankruptcy, they may collectively offer voluntary labour for the survival (farm work) and future strategy (management advise) of the farm. The project provides access to alternative investment funds to the farmer, which is highly needed in times of fiancial crisis with credit crunches by banks; it provides a minimum in product sales for the farmer, and next to a return on investment of 20%, a price advantage of 30% for the ‘neighbours’ for trustworthy ecological food products.

Conclusion

This article has provided some empirical support, from the financial sector in the Netherlands, for the use of an ethics of care approach in financial sector reform. Although the survey is exploratory and the two case studies are not representative of financial innovation after the crisis, they do provide an insight in an alternative ethical approach for the financial sector to simply more rules. They point out that given the characteristics of finance today – high uncertainty, high complexity, and a general rule-aversion among financial professionals – an ethics of care may be more meaningful and effective as a guidance in financial sector reform than a deontological ethics, based on rules.

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