The Ethical Challenge of Systemic Financial Distrust

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In one of the opening sentences of his *Meditations on First Philosophy* René Descartes observes that "it is prudent never to trust completely those who have deceived us before" (1996 [1641]: 12). Some 350 years later, Lady Gaga, in her song *Telephone*, agrees: "Trust is like a mirror, you can fix it if it's broke, but you can still see the crack in that [*expletive*]'s reflection!" The near-universal human truth that these two very different thinkers – each in their own idiom – stress is that once it is lost or betrayed, trust is very hard to regain and may never fully recover.

It is this insight that the financial industry has painfully had to confront over the tumultuous last decade. First, there was the *internal* breakdown of trust amongst market participants that triggered, magnified and perpetuated the global financial crisis (Roth, 2009; Shiller, 2008; Krugman, 2013). Second, there was an accompanying *external* breakdown of public trust in those working in the financial industry, its major organizations, and, crucially, the financial system's ability to fairly deliver prosperity. In a 2016 study, only 8% of Americans said that they trust their house-bank or financial intermediary, a figure that used to be well above 50% prior to the crisis (Close, 2016). Another study persistently ranks the financial sector as the least trustworthy industry (de Bruin, 2014; Edelmann, 2016). Perhaps harder to put into figures, but ultimately more consequential is the loss of faith in the economic structure of which finance is an integral part, as witnessed by resurgent populist condemnations of '(financial) globalism' and calls for protectionism and unilateralism. Overcoming

Dans Les Méditations, René Descartes observe qu'« il est prudent de ne jamais faire totalement confiance à ceux qui nous ont déçu auparavant ». Quelque 350 ans plus tard, Lady Gaga, dans sa chanson Téléphone, va dans le même sens : « la confiance est comme un miroir, vous pouvez le réparer quand il est cassé, mais vous pourrez toujours voir la marque dans son reflet ! » La vérité presque universelle qui en découle est le fait qu'une fois la confiance perdue ou trahie, elle est difficile à regagner.

L'industrie financière a dû y faire face avec peine durant les 10 dernières tumultueuses années. D'abord, il y a eu l'effondrement interne de la confiance chez les participants au marché qui a déclenché la crise financière globale. Ensuite, il y a eu une perte de confiance externe du public dans la capacité du système à apporter équitablement la prospérité. La méfiance dans la finance est une préoccupation pour chacun.

internal and external distrust should be a goal for professionals who aspire to work in a prosperous and fair financial industry. But because these breakdowns in trust have the potential to threaten the very existence of a liberal democratic order, distrust in finance is an acute problem that is of *everyone's* concern.

This essay contributes to our understanding of trust in finance. We approach the issue from a new philosophical angle by investigating first the problem of systemic *distrust*. We proceed in four steps: Section two lays the groundwork by offering a philosophically sound account of trust and distrust. Crucially, we demonstrate that distrust is at heart a so-called "thick" ethical concept, which is grounded in the trustee's moral obligations. Section three turns to distrust in the financial system. We distinguish between agential and systemic distrust, and we list some evidence and possible causes. But our goal is more than diagnostic. In section four, we advance proposals for alleviating distrust in the financial system. We present short-term as well as more aspirational ideas, distinguishing three complementary strategies: generating agreement about the obligations of the financial system, introducing reforms to increase its reliability, and communicating improvements.

Trust and Distrust

Trust is everywhere. From the most casual everyday choices to the most agonising and momentous decisions in our lives, we are constantly engaged with assessing whom, what, when and why to trust. Crucially, trust is not just one additional thing to consider – it is almost always a *decisive* concern: As lovers and friends, we end relationships when our trust has been betrayed. As voters and citizens, we do not support a candidate in whose sincerity we have doubts. As consumers and investors, we refrain from purchasing products or shares when we lack faith in the management's truthfulness. Trust relations underpin life as we know it. Without trust, close relationships are inconceivable, democratic politics impracticable, and prosperous market exchanges unworkable.

Some Characteristics of Trust

But what exactly is trust? First, we must distinguish between trust and distrust and trustworthiness and untrustworthiness. Whereas (dis)trust is the *attitude* that we display towards those we *consider* trustworthy, (un)trustworthiness is the property that a trustee must objectively have for trust to be warranted (Hardin, 1996; McLeod, 2015). Thus, we can fail to trust or even distrust those who are objectively trustworthy, and we can trust those who are objectively untrustworthy. With this distinction in mind, let us now confront some necessary aspects that all cases of the form "A trusts B in respect of X" have

La confiance est partout. Comme les amoureux, nous mettons fin aux relations quand notre confiance a été trahie. Comme les électeurs, nous éliminons les candidats pour la sincérité desquels nous avons des doutes. Comme les investisseurs, nous évitons les entreprises dont la gestion ne nous paraît pas sincère. Nous devons distinguer la confiance (méfiance) de la (non) fiabilité: alors que la confiance (méfiance) est l'attitude que nous montrons à ceux que nous considérons comme (non) fiables, la (non) fiabilité est la qualité qu'un administrateur doit objectivement avoir pour être digne de confiance. La confiance est une relation triple entre celui qui fait confiance, celui à qui la confiance est faite et certaines tâches. Faire confiance implique toujours un risque en rapport avec quelque chose de valeur pour celui qui fait confiance. A a seulement confiance en B par rapport à X lorsque A attend que B fasse X. La confiance est basée sur des émotions et des attitudes éthiques.

in common (Baier, 1986; O'Neill, 2002):

1. *Trust is task-focused.* Though we sometimes speak as if there was 'trust *tout court*', trust is to be understood as a threefold relation between a truster, a trustee, and some tasks: When we worry that the average person's trust in bankers is declining, then we of course do not worry about his expectation that his banker will reliably send him flowers on his anniversary, but that she will reliably and faithfully execute those tasks that customers can legitimately expect.

2. *Trust entails risk and vulnerability*. Trusting always involves a risk to something valuable for the truster, and hence vulnerability (Attas, 2016). When I transfer my savings to a wealth manager, I take a risk that trust was misplaced: I may lose my money.

3. *Trust presupposes expectations and reliance*. A only trusts B in respect of X when A expects that B will in fact do X. When I ask my upstairs neighbour to water the tomato plant on my balcony while I am on holiday, but already expect her to forget, then I do not trust her to do it (Holton, 1994: 64).

4. *Trust is grounded in emotions and ethical attitudes*. Trust requires that, when A's belief in B's doing X is frustrated, it is appropriate for A to have certain emotions and attitudes towards B (Jones, 1996). When my slipshod neighbour fails to water my tomato plant, then it is *ceteris paribus* warranted that I am resentful towards her for this omission, and it would be appropriate for her to apologize.

Three Insights About Trust

The aspects identified above indicate that trust is intimately connected to questions of ethics. By its very nature, trust is something that can be betrayed, and when this occurs (and in contrast to cases of mere reliance) morally charged emotions like resentment and blame are in order. Such emotions are *justified* when it is ethically correct to assume that the trustee had a moral duty to do what we trusted her to do. Similarly, we have reason to be regretful when we distrusted somebody and later learn that this distrust was unfounded. So, this is our first insight (Hawley, 2014: 8):

Insight 1*: Trust and distrust (as opposed to reliance) presuppose a moral obligation or commitment between truster and trustee.*

However, the absence of trust is not by itself sufficient for characterising a relationship as one of distrust. While I do not rely on my friend to bring me chocolate if she never does so, it cannot be said that I *distrust* her in this regard. The appropriate response when unexpectedly offered chocolate is thankfulness, not remorse for misplaced distrust. It would be absurd to apologise to my friend for the previous absence of trust in her offering chocolate (comp. Hawley, 2014: 3). This yields our second insight:

Aperçu 1 : la confiance et la méfiance (par opposition à la dépendance) présupposent une obligation morale ou un engagement entre celui qui fait confiance et le trustee.

Aperçu 2 : la méfiance (par opposition à la non dépendance) est le fait de s'attendre à ce que le trustee ne s'acquitte pas de son obligation morale ou de son devoir.

Aperçu 3 : la méfiance systémique est distincte de la méfiance dans un système car elle présuppose la méfiance généralisée entre des acteurs en interaction.

S'il y a méfiance, son existence même contient à la fois une menace et une promesse. La menace est que ceux qui se méfient pensent qu'une obligation morale sera violée. La promesse c'est que ceux qui se méfient croient au moins qu'il y a des obligations morales qui

Insight 2*: Distrust (as opposed to non-reliance) is the expectation that a trustee will fail to perform a moral obligation or duty*.

We started out by considering not merely *distrust* in finance, but *systemic distrust*. One might think that systemic distrust merely is distrust in the financial system, but this is too simple. If an individual distrusts the financial system, this cannot amount to *systemic distrust*. Systemic distrust presupposes that many agents jointly distrust, where this distrust can in turn undermine the system since it emerges from the interaction of numerous agents:

Insight 3: *Systemic distrust is distinct from distrust in a system as it presupposes widespread distrust among interacting agents.*

These insights clarify when there is distrust as opposed to merely the absence of trust and when distrust amounts to systemic distrust. Moreover, if there is distrust, then its existence holds both a threat and a promise. The threat is that those who distrust believe that a moral obligation will be violated. The promise is that distrusters at least believe that there are ethical obligations that can, in principle, be observed. Put more bluntly: financial calamities are not like bad weather – inevitable facts of life that may disappoint us, but about which ethical judgment is nonsensical. The financial system is human-made and changeable, and therefore assumptions about moral obligations (and hence distrust) are apt.

Systemic Distrust in Finance

It's time to connect our philosophical reflection to empirical practice: We saw that people who distrust will:

(A) believe that some agent or institution (the trustee) has some moral obligations or commitments;

AND

(B) expect that the trustee will betray or violate those obligations.

(A) and (B) together suggest the structure for the following empirical diagnosis of distrust: Subsection 3.1 analyses what people – those who mistrust – see as the moral obligations and commitments of the financial system and those in it. What are possible *objects* of a betrayal of trust? In 3.2 we assess the *grounds* for the expectation of non-compliance.

What People Expect from the Financial System

Of course, there is no clear catalogue of obligations that everybody agrees on when it comes to the financial system. Nor need there be complete agreement on this in a pluralistic society. Our moderate goal here is to sketch important values that we think matter to a vast majority of citizens. We do not draw on extensive empirical survey data but trust that our readers, upon reflection, will agree that these are indeed widely-shared expectations. For analytic clarity, we focus on those peuvent, en principe, être respectées. Les désastres financiers ne sont pas comme le mauvais temps – des faits inévitables de la vie qui peuvent nous désappointer, mais sur lesquels un jugement éthique n'a pas de sens. Le système financier est fait par l'homme et peut être changé.

Les gens qui se méfient (a) croient qu'un agent ou une institution (le trustee) a des obligations morales, et (b) et s'attendent à ce que le trustee trahisse ou viole ces obligations. Ainsi, pour établir un diagnostic empirique de la méfiance, nous considérerons d'abord ce que les gens croient être des obligations morales du système financier et jusqu'où ils pensent qu'elles seront honorées. Lorsque les deux sont divergentes la méfiance apparaît. Même s'il n'y a pas de catalogue des obligations clair sur lequel tout le monde est d'accord, les deux points de vue suivants semblent être largement acceptés : (1) l'objectif du système financier de contri-

outcomes that the financial system *as a whole* is expected to produce, and then on the obligations of *individual agents*, notably natural persons and corporations that matter for trust. For these agents, we differentiate between non-compliance that stems from (i) lack of *competence,* or (ii) lack of *motivation*.

Systemic Purpose: Equitable Prosperity

At the most abstract level, the purpose of the financial system is to serve the common good (Hendry, 2013: 46; Shiller, 2012: 7; Steigleder, 2011). What does that entail? Our suggestion is that the financial system must contribute to 'equitable prosperity', which is shorthand for a system that reliably makes people better off whilst ensuring that nobody is treated inequitably. Finance's crucial role for prosperity consists in efficiently allocating capital to productive resources, providing financial services, and managing risk (Boatright, 2013; James, 2012; Santoro and Strauss, 2013).

With regard to equitableness, the obligation is, at the very least, a negative one, namely (i) to avoid contributing to outcomes that are so bad that they amount to *economic harm*, and (ii) avoiding unfair outcomes where massive gains to some cannot be justified in terms of either some ethically relevant criterion (e.g. hard work, talent) or the contribution that inequality makes to overall prosperity (James 2012; Rawls, 1999).

Agents' Obligations: Competence and Motivation

Beyond outcomes, there are moral expectations about agents of finance, their actions, standards of behaviour, and, more generally, their business culture. Assessment of agents is distinct from the moral assessment of structures and institutions: Agents *act*, i.e. they have plans, form intentions and respond to reasons in the pursuit of their aims. When it comes to placing trust in agents, we do not only care about the outcomes they bring about, but also about why and how they do so. We believe agents in the financial system are considered trustworthy by society at large when they meet two conditions:

1) They are capable of performing the function they occupy, where this function is justified in terms of the system's overall purpose.

2) They are motivated in the right way to pursue these goals.

Just to give an example of this dual requirement: As the CEO of a company looking to acquire a competitor, we will trust our M&A advisor only if, first, we are convinced that she is sufficiently competent to counsel us about the industry, corporate finance, and so forth. But secondly, we will only trust her if she is motivated to look out for our interest, as witnessed, for example, by the absence of conflicting mandates, her own investment decisions, and so forth. Both competency and motivation are properties that buer à une prospérité équitable, c'est-à-dire d'améliorer le sort des gens et de ne traiter personne de façon inéquitable. (2) les agents à l'intérieur du système financier doivent être compétents pour exercer la fonction qu'ils occupent et avoir de droites motivations.

Les attentes sont largement basées sur l'expérience passée, nous devons donc prendre en considération les résultats et le comportement dont le public a été le témoin.

Aux yeux de beaucoup, les marchés financiers ont mené à une mauvaise allocation du capital et ont causé la crise financière globale qui a provoqué des réductions dramatiques du bien-être économique général. De même, la promesse de résultat équitable a été ébranlée.

Il y a un sentiment général selon lequel pendant que les gains provenant du boom d'avant crise alimenté par la finance profi-

are not imminently observable, so that we generally seek to establish their presence by reference to past behaviour and current constraints and incentives on action. This, we shall now see, explains the present problem of distrust.

How Past Experience Give Rise to Distrust

Distrust arises if there is the expectation that obligations will not be met. We have identified what the public thinks are the obligations. What are its expectations? We begin by considering outcomes and behaviour the public has witnessed, assuming that expectations are to a large extent based on past experience. In so doing, we focus primarily, though not exclusively, on the 2008-10 financial crisis since it most drastically shaped the public's current perception of financial markets.

Outcomes of the Financial System

Focusing first on the promise of prosperity, it seems clear that this has been called into severe doubt: Rather than facilitate efficient capital allocation, financial markets have in the eyes of many led to a misallocation of capital, including human capital. And instead of distributing and managing risks emanating from the real economy, the financial industry has, at least during the financial crisis, been a source of instability causing dramatic reductions in overall economic wellbeing (Lowenstein, 2010). Thus, the experience-grounded expectation that the system can robustly produce prosperity has been shaken.

How about its ability to deliver equitable outcomes? The first condition here was that the financial system should do no harm. But, to give just one example, IMF and World Bank estimate that as a result of the financial crisis, up to 83 million people more will have to live below the line of severe poverty (United Nations, 2010: vi). More locally, the financial crisis has in many instances had a dramatic impact on the lives of those already worse off, e.g. low-skilled labourers now unemployed. The second component of equity was basic fairness in distributive outcomes. Here too, there is a widespread sense that whilst the gains of the finance-fuelled pre-crisis boom largely benefitted one layer of society, the subsequent costs of the crisis were fully 'communalized' through bank bailouts, jobs cuts and austerity measures, which disproportionally burden those dependent on social assistance and unfairly exempted those responsible for these outcomes. Whether or not these judgments are accurate, they clearly bolster the narrative that "the system is broken".

Behaviour of Agents in Finance

Beyond the failure to live up to the expectations in terms of aggregate outcomes, the financial crisis has also exposed a severe lack of competence among individual as well as institutional agents.

taient à une mince couche de la société, les coûts de la crise ont été complètement « socialisés » à travers des sauvetages.

Quelles sont les perceptions des acteurs financiers ? Distinguons les dimensions « compétences » et « motivation ». La crise financière a mis en évidence un manque de compétence grave : de nombreuses institutions ainsi que les personnes à l'intérieur de ces institutions engagées dans des interactions sur le marché ne comprenaient pas pleinement ce qu'ils faisaient. Même les inventeurs des produits financiers complexes ont finalement perdu la capacité de les contrôler. Il y a non seulement eu des cas particuliers de problèmes légales, mais à un niveau plus général, des segments de l'industrie financière ont engrangé des profits à court terme plutôt que de faciliter la prospérité économique.

At the institutional level, many banks did not comprehend the products they were dealing with. The German Landesbanken, largely state-owned banks that have historically focussed on doing business with small to mid-sized German firms, are an example. Lured by high returns, they started investing in credit default swaps, collateral debt obligations and other structured financial products, blindly trusting the rating agencies' verdicts. As Constantin von Oesterreich, head of the HSH Nordbank, later remarked: his bank was investing "everywhere without being qualified to do so" (The Economist, 2015).

Remarkably, even those who invented the complex financial products that fuelled the financial crisis eventually lost the ability to handle them (Schwartz & Cresswell, 2008). As mortgages were placed in large bundles, claims to which were divided hierarchically and then repeatedly re-sold, even the constructors of these products could no longer gauge their value, though they knew they were risky. Beyond such product complexity, there is also an impairment to manageability and foreseeability from algorithmic high frequency trading that has, in the past, led to 'flash crashes' and arguably increased volatility.

In addition, there have been concerns about motives. By developing and selling such products, parts of the financial industry had alienated themselves from the fundamental social purpose that finance as a profession was meant to fulfil, namely to manage risk and facilitate real economic growth. What these segments of the industry where doing was in fact the opposite: releasing their 'toxic financial products' into the real economy and killing productivity, employment and growth (Stiglitz, 2010).

Beyond this basic failure to meet its social purpose, the public also witnessed the financial services industry display more specific deficiencies of motivation. The recent string of discoveries of fraud on its own is impressive. In 2008, Bernard Madoff was charged with choreographing the largest Ponzi scheme in history (Ionescu, 2010). In 2012, it became public that banks had colluded to manipulate the London Interbank Offered Rate (Libor) for over ten years (Kennan, 2012). The discoveries of often record-setting fraud have become so regular that it seems the industry is corrupt to the core.

But even where financial institutions have stayed within the boundaries of the law, they have often been deemed to have crossed ethical boundaries. A good example is the recent Cum-Ex scandal in Germany, in which local and international banks effectively conspired to receive €31.8bn tax 'refunds' from the treasury on taxes never paid in the first place (Blickle, 2017).

Alleviating Distrust: Proposals for Reform

Il y a en principe deux façons d'atténuer la méfiance : changer les hypothèses relatives aux obligations ou modifier les attentes. En ce qui concerne les hypothèses relatives aux obligations, il est important qu'elles ne divergent pas. Pour cette raison, les agents financiers devraient s'engager à éviter de faire des promesses trompeuses, qui alimentent les attentes irréalistes. Puisque les entreprises individuelles peuvent trouver un intérêt dans de telles règles, si elles sont appliquées conjointement, il n'y a pas besoin d'une intervention de l'État. En même temps, plutôt que de blâmer « les banquiers », les politiciens et les organes de presse devraient identifier avec précisions quelles sont les devoirs et obligations spécifiques que le système financier ou les agents individuels n'ont pas respecté.

There are in principle two ways of alleviating systemic distrust in financial markets. First, one can dispel the assumption of an obligation: if no obligation is assumed, then there can be a perception of unreliability, but no distrust. Arguably, this was the case prior to the advent of modern economic theory and the belief that governments could and should shape the economic landscape. Second, one can remove the expectation that obligations will be violated, which requires convincing people that the financial system is trustworthy.

This section will look at the merits of these approaches in turn. Our proposals are always split into two categories. First, those that could realistically be implemented in the short-term; second, those that are more aspirational. Through this two-tiered approach we hope to provide a comprehensive 'menu of choice', guarding against pure utopianism while not curtailing ambitions by focussing too narrowly on the feasibility constraints of the moment.

Obligations

It matters what obligations the financial system is assumed to have. While we make some substantive (but we hope not outrageous) assumptions about what these obligations are, we want to preface this with a simple, structural idea: for any chance of systemic distrust to recede, assumed obligations need to be jointly realisable, and hence assumptions of different agents within society need to converge. By this logic alone, it is crucial that whatever changes are implemented are the product of democratic procedures. Our proposals here are invitations for citizens and financial professionals to deliberate. With this expectation management and reciprocal engagement in view, we propose the following:

- **Short-Term Proposals**

(a) Forums should be established to discuss the obligations of the financial system, demarcating them from additional obligations society at large has. Such forums could be held from the local level upwards, bringing together professionals, politicians and laypeople.

(b) Financial agents should commit to avoiding deceitful promises, which could contribute to unrealistic expectations about what finance can achieve. Since individual firms may have an interest in such rules, if implemented jointly, this need not require state intervention.

- **Aspirational Ideas**

(a) At a political level, a list should be composed of the obligations the financial system and the agents within it have. This could be done at different levels, with regions or nations adding obligations to a global list. These lists could then guide reforms.

(b) Rather than blaming 'the bankers', politicians and media

La réforme actuelle vise à augmenter la fiabilité du système financier, afin que celui-ci devienne plus digne de confiance. Les faiblesses structurelles sont présentes au niveau macro. Elles proviennent tout d'abord de la présence d'institutions d'importance systémique et ensuite d'un manque de transparence. Des règles plus strictes en matière de liquidités pourraient contribuer à la stabilité et il pourrait être raisonnable de transformer les institutions financières d'importance systémique en des entités plus petites. Des règles additionnelles en matière d'information et un changement dans la procédure pour l'évaluation de la solvabilité des produits financiers pourraient augmenter la transparence.

outlets should be careful to identify specific obligations the financial system or individual agents have failed to meet. As informed debate requires knowledge, better educating students about the financial system may also be an important long-term goal to reinstate trust.

Actual Reform

While there might be disagreement about the precise obligations, those mentioned in 3.1 and 3.2 clearly seem to be part of any reasonable set. On this assumption, the financial system, at least prior to the 2008-10 financial crisis, was not reliable in meeting its obligations, so it was not trustworthy. In order then to effectively and permanently alleviate distrust, there needs to be actual reform to make it more reliable. Our analysis of the origins of the failure of the financial system suggests that there are primarily three sources of unreliability, namely:

(i) structural weaknesses, such as the presence of systemically relevant institutions;

(ii) a lack of competence, such as an inability of asset managers to comprehend the complex products they were dealing with and;motivational shortcomings, such as short-term profit seeking.

A comprehensive strategy should address all three components.

Structural Weaknesses

We suggested that in contrast to agents, trust in systemic institutions is based foremost on outcomes. This subsection considers the financial system at the macro-level. Increasing reliability primarily requires increasing the system's ability to absorb shocks to its components (Goldlin & Mariathasan, 2015). One aspect of this is the presence of systemically important institutions, whose failure could quickly impair the whole system. Another concern is whether market participants are really able, in times of crisis, to quickly evaluate the creditworthiness of financial products and institutions. This form of transparency is vital for maintaining business between banks. In the crisis, it was primarily the collapse of trust in the interbank-lending market that caused havoc in the real economy as credit became unavailable to firms (Krugman 2013).

- **Short-Term Proposals**

(a) To increase the resilience of the financial system, more stringent liquidity rules should be introduced in accordance with each institution's susceptibility to systemic impact (Admati & Hellwig, 2014). The more equity capital financial firms have, the longer they can absorb losses and the lower the likelihood of contagious effects.

(b) Additional disclosure rules could help increase transparency. While it is a task for experts to determine what kind of information should be published, the aim should be to make it easier to reliably evaluate the creditworthiness of financial products and institutions.

Un comportement de prédateur de la part des institutions financières envers les clients pauvres, tels que le chargement par les banques de frais excessifs en cas de retard, devrait être interdit. Une telle mesure pourrait atténuer la méfiance de deux façons : en premier, elle changera la perception aux yeux du client. En second, en tant qu'exemple de prise en compte de la vulnérabilité du client, elle peut aider à mettre en place une culture moins étroitement axée sur le profit.

Plutôt que de purement proscrire certains produits, la charge de la preuve dans quelques domaines à haut risque devrait être inversée. En utilisant les règles actuelles pour l'approbation de nouveaux produits pharmaceutiques, les entreprises financières devraient alors être obligées de démontrer que les bénéfices attendus des nouveaux

(c) Specific, stricter rules should be developed for institutions that are deemed systemically relevant to ensure that they are in a strong position to absorb even pronounced shocks (IMF, 2011).

- **Aspirational Ideas**

(a) If possible at reasonable cost, all systemically relevant financial institutions should gradually be transformed into entities that are not too big (or interconnected) too fail. Such entities not only constitute an inherent weakness, but also create adverse incentives for risk-seeking behaviour (firms know they will be saved).

(b) The way the creditworthiness of products and firms is assessed should be re-examined. There might, for example, be a case for reducing the epistemic weight assigned to credit ratings (de Bruin, 2017) or for changing incentive structures to ensure impartiality.

Lack of Competence

There are two ways to ensure that an agent is competent to accomplish a given task. One can train her to carry it out, or reduce the skill-level required. Valuable products might be complex, but complexity in finance (as in law) is, also, always in the private interest of those who can outsmart others.

- **Short-Term Proposals**

(a) A non-profit institution akin to consumer advice centres should be created with the expertise to advise firms on risks involved in complex financial products. Firms have incentives to train their employees so that they are aware of all risks involved in products they handle, but might lack the expertise to identify risks.

(b) A study should be commissioned to identify products, trading practices and business models that increase the complexity of financial markets, evaluating benefits and costs. The aim is to acquire data on the basis of which to decide (at the political level) which activities to disincentivise or curtail. For example, existing rules on spoofing, layering and front-running in high-frequency trading should be refined to reduce the danger of excessive volatility.

- **Aspirational Ideas**

(a) At a political level, a decision should be made on how to weigh the benefits of highly complex financial products against the risks they give rise to. Complexity in some areas can likely be considerably reduced at little or no cost to social productivity and welfare.

Motivational Shortcomings

It would be neither fair nor productive to place blame for motivational shortcomings solely on individual agents. The structures in which they are embedded matter as they shape norms as well as incentives (Murdoch, 2015). In addressing motivational shortcomings, we distinguish between narrowing a trust gap – by making unreliable behaviour less attractive – and bridging a trust gap – by changing cultural norms (Attas, 2016).

produits l'emportent sur leurs risques. L'atténuation de la méfiance nécessite un changement dans les attentes. Tandis que les attentes du public peuvent s'adapter au fil du temps si le système financier reste fiable, les attentes sur les marchés financiers sont souvent auto-réalisatrices, d'où il est d'importance vitale que les changements soient communiqués rapidement.
Propositions à court terme : imposer un moratoire sur les fonctionnaires voulant travailler dans l'industrie financière ; établir (ou renforcer) des instituts de recherche gérés par l'État afin d'acquérir une expertise publique sur les marchés financiers.
Idées à plus long terme : imposer une séparation stricte entre les régulateurs financiers et les professionnels de la finance (avec pour modèle les relations avocats–juges) ; étant donné les biais dans l'octroi des financements, réguler le financement externe de la recherche académique plus étroitement et introduire un code d'honneur pour les universitaires.

- **Short-Term Proposals**

(a) To curtail reckless behaviour, financial firms could be obligated to share in their customers' risk. For example, Mian and Sufi (2014: 171-184) advocate shared-liability-mortgages, where monthly payments shadow movements in the market value of a property while the amortisation schedule is fixed. Such mortgages could be made obligatory for borrowers with low creditworthiness.

(b) Predatory behaviour by financial institutions towards poor customers, such as the imposition of excessive overdraft fines by banks, should be prohibited. Such a measure could alleviate distrust in two ways. First, it will alter the perception of consumers. Second, as an example of taking vulnerabilities of consumers into account, it may help create a less narrowly profit-driven culture.

(c) Criminal prosecution should be reinforced, with individual agents being held responsible where there was clear illegal behaviour. There has been a sharp decline in convictions for fraud in favour of *deferred-prosecution agreements* (Radden Keefe, 2017), which creates a perception (among the public and finance professionals), that one can get away with breaking the rules in finance.

- **Aspirational Ideas**

(a) Rather than merely outlawing certain products, regulators should shift the burden of proof to providers in some high-risk areas. Taking current rules for the approval of new pharmaceuticals as a guide, financial firms might then need to demonstrate that the expected benefits of new products outweigh their risks (Allen, 2013).

(b) A moderate financial transaction tax could be introduced. This has been proposed e.g. by Darvas and Weizsäcker (2009). Plausibly, such a tax would primarily target highly speculative short-term investments that have little economic benefit. Similarly, some regulators (e.g. the Japanese Financial Service Agency in 2017) have proposed 'speed limits' on high-frequency trading to reduce volatility.

Communication

Reforms of the financial system matter, but are not necessarily sufficient. Alleviating distrust also requires changes in expectations. While the public may adapt its expectations over time if the financial system continues to be reliable, communication is needed. Since expectations are often self-fulfilling in financial markets (Farmer, 2014), it is vital that changes can be communicated quickly, so that the public can adjust its expectations. A sensible aim would be to establish a group of experts who can evaluate progress and are able to reach the ear of the public.

This was historically the role of academics, public regulators and politicians. However, trust in these groups has also declined (Edelmann, 2017: 6,11). There are two plausible

L'analyse philosophique était nécessaire pour déterminer l'anatomie de la méfiance ; nous avons ensuite mis l'accent sur les attentes normatives que les sociétés ont à l'égard des résultats que le système financier produit et du comportement que les acteurs adoptent dans ce secteur. Plus loin, nous avons expliqué quels développements historiques ont donné naissance à des doutes profonds sur la manière dont le système financier remplit ces attentes ; finalement, nous avons examiné comment reconstruire la confiance publique dans la finance, en étudiant la gestion des attentes et des obligations, la réforme institutionnelle, et les pratiques de communication. Vaincre la méfiance dans la finance, comme le fait de reconstruire la confiance dans une relation, nécessite de faire des ajustements peu à peu plutôt qu'un geste exceptionnel. Mais (en revenant à Lady Gaga) il y a de l'espoir : un miroir cassé peut ne plus

explanations for this. First, there is a perception that there are few competent experts. The fact that few economists predicted the 2008-10 financial crisis has contributed to this impression. Second, publicised conflicts of interest have led to doubts about the impartiality of experts: many financial regulators formerly worked in finance; banks provide grants to economists; high-profile politicians have delivered pricey speeches at investment banks.

- **Short-Term Proposals**

(a) Employment moratoria should be imposed on public officials who want to work in industry. Similar restrictions should be imposed for those who wish to switch jobs in the other direction, but possibly gradually, given the need for expertise in regulation.

(b) State-run research institutes focussed on establishing expert knowledge of financial markets should be established (or strengthened). The state can only claim credibility if it does not need to rely on outsiders who may face conflicts of interest.

- **Aspirational Ideas**

(a) There should be a strict separation between financial regulators and professionals in finance. While an exchange of ideas should be encouraged, fraternisation as well as a change in employment across the divide should not. The relationship between judges and lawyers could serve as a guide.

(b) Given empirical evidence of *funding bias* (Krimski, 2013), external funding of academic research should be regulated more strictly. A code of honour could encourage academics not to accept favours from those who might have an economic interest in questions relating to their research.

Conclusion

We began this essay in the lofty heights of philosophical reflection about distrust, and ended it in the messy lowlands of practical proposals. But we see no reason to apologize for this. To (freely) rephrase a famous Kantian dictum: Theory without practice is empty; reform without reflection is blind[1]

To recap: our philosophical analysis was necessary to determine the anatomy of distrust. Based on this, we focused on the normative expectations that society at large has of the outcomes that the financial system should generate and of the behaviour agents of the financial system should display, as judged by their competence and their motivation. We then explained which historical developments and current features have given rise to widespread doubts that the financial system lives up to these normative expectations. Finally, we have chartered the terrain of how to rebuild public trust in finance,

1 The reference here is to Kant's expression "Gedanken ohne Inhalt sind leer, Anschauungen ohne Begriffe sind blind." (Kant, 2009 [1787]:B75), literally translated as "Thoughts without content are empty, intuitions without concepts are blind."

jamais produire le même reflet, mais une réparation prudente peut transformer une fissure en quelque chose de précieux : un aimable rappel de sa fragilité fondamentale.

looking at expectation and obligation management, institutional reform, and communicative practices.

In fact, our colourful range of proposals is as it should be. Overcoming distrust in finance, like rebuilding trust in a relationship, requires piecemeal adjustments on many fronts, rather than grand one-off gestures. But (and to come back to Lady Gaga) there is also hope. A broken mirror may never provide the exact same reflection, but in time, careful mending and frequent polishing can turn a crack into something valuable: a gentle reminder of fundamental fragility.

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