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CHAPTER 7

HUMAN AND SOCIAL CAPITAL GONE INTO THE DARK SIDE: THE CASE OF XXI CENTURY'S FINANCIAL SYSTEM

Mikel Larreina and Leire Gartzia

ABSTRACT

In the last decades, many of the most talented and promising young graduates in the developed economies have joined the financial industry. Simultaneously, ill-designed incentives' schemes have favored the development of a culture in which excessive greed, free-riders' behavior, unreasonable appetite for risk, and short-term decision making have endangered the economy and, potentially, have laid the foundations for financial, economic, social, and environmental crises.

In this chapter, we review current challenges in the financial industry from the lens of human and social capital. We examine some of the factors that allowed unethical behavior and a short-term financial focus in the financial sector, examining how compensation and an extremely competitive culture became key elements that favored greedy and manipulative behavior and ultimately generated socially harmful human

and social capital in the financial sector. Finally, we discuss the emergence of a number of game-changers (namely, Brexit, FinTech, the growing relevance of ethical standards, and the increasing participation of women and millennials in the industry) that might represent potential promotors of change and help restructure and reshape the financial industry.

Keywords: Finance; social capital; greed; excessive compensation; crisis

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INTRODUCTION

In recent times, many bright university graduates and postgraduates have been attracted by the potential benefits that working in some segments of the financial sector could bring about. Among others, very lavish compensation schemes, the status of an intellectually challenging industry, and a sense of community in which the *Masters of the Universe*[1] could do as they pleased. Our perspective here is to explore how these trends are particularly visible in the financial industry, which has become a *free-rider*, generating negative externalities, and creating disequilibrium between the benefits gained by the sector, and the large burdens the rest of the society pay. In a sense, the current financial system's social capital largely increases entropy and avoids respecting constraints, what would go against what is normal or even advisable (Russ, 2016).

Widespread bonus-seeking strategies have disregarded the very systemic risks they contributed to create and eroded moral standards, building a strong culture of greed among employees in the financial sector. A particularly aggressive "macho" culture developed, where factors beyond economic reward were also relevant: feelings of personal achievement, power, and dominance. Simultaneously, these conditions let financial firms recruit the kind of talent they demanded: bright and ambitious individuals for

whom "career opportunity comes first" (Ipsos Mori, 2011, p. 23). Focusing in one of these cultural artifacts (i.e., compensation schemes), large increases in compensation in the financial industry were supposed to be an efficient market response to a new economic environment. Yet, these rewards were disproportionate, guaranteed in advance and even paid for failure. As such, excessive compensation paved the way to the financial crisis that begun in 2007 (Banking Standards, 2013; De Larosière, 2009; National Commission, 2011).

In the current chapter, we develop arguments about how greed and self-centered compensation systems characteristic of the current financial system have developed a form of social capital in large firms (and in the financial industry more broadly) that create large short-term value for employees, for their companies, and for the industry, while provoking severe social harm. We argue that, while the unethical and competitive environment that has characterized the financial sector has seemed to be extremely effective in the short term, it has set the foundations for severe socioeconomic and environmental problems in the long run. This perspective challenges the generally positive view of human behavior in organizational performance, suggesting a more negative understanding of social capital in the financial sector, which has served to increase entropy and justify unethical behavior with the prevalence of favored greedy and manipulative behavior.

Given the centrality of the financial sector in our society and economy, we argue that reshaping the financial system and its unethical culture is a necessary step for social advancement and the development of the *homo sustainabiliticus* (Russ, 2014). Although this is a formidable challenge, we identify three events in early 2017 (i.e., Brexit, the development of FinTech, and investors' activism in ethics and sustainability) that, together with emergent changes in the workforce nature such as the steady incorporation of women, have become growing concerns for the

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current *statu-quo* and may have a disruptive effect in the financial services industry.

In terms of sections, this chapter is organized as follows. First, financial crises and particularly the crisis of 2007–2008 are analyzed from the critical perspective of how it was embedded in a broader cultural system that allowed unethical behavior and a short-term financial focus. Then, we draw on social identity and social capital theories to examine how compensation and an extremely competitive culture in the financial sector became a key element that favored greedy and manipulative behavior. We then connect this overgrown industry with its inability to deal with relevant social problems and finally point to the fundamental changes in the financial system that potentially disruptive events may foster.

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THE IMPACT OF FINANCIAL CRISES AND THE COLLAPSE BEGUN IN 2007

The financial system is critical for the current functioning of our societies. Thus, economic recessions deriving from financial crises are generally deeper and more protracted (Bordo, Eichengreen, Klingebiel, & Martinez-Peria, 2001; Reinhart & Rogoff, 2009; Romer & Romer, 2014) and have an "*enormous human and economic cost*" (Camdessus, 1998, p. 2). The recent global crisis, which has left depression-level unemployment in many countries of peripheral Europe and a combination of low growth and deflation or extremely low inflation in most developed economies, is not unique; the 1929 crash and the Great Depression being the clearest precedent.

Intellectual arrogance and lack of historical perspective contribute to the building of bubbles: the history of banking and other financial institutions is full of examples of "manipulative conduct driven by misaligned incentives, of bank failures born of reckless,

hubristic expansion and of unsustainable asset price bubbles cheered on by a consensus of self-interest or self-delusion" (Banking Standards, 2013, p. 16). Financial bubbles usually have "remarkable similarities" (Reinhart & Rogoff, 2009, p. 404) led by "animal spirits" (Akerlof & Shiller, 2009), what would make "utilitarian" keeping memories of previous failures (Galbraith, 1955). In these past bubbles, market participants, regulators, and politicians also failed to learn the lessons of the previous history, under the underlying premise that "this time it is different" (Reinhart & Rogoff, 2009). The large interval between major financial crises means that most people involved are no longer in the industry when the following crisis occurs.[2] Reduced intellectual interest in understanding financial crises in foreign countries may mean that coetaneous lessons from other regions are not learned[3] neither; despised as the product of being "still learning" (*The New York Times*, 1997).

A major body of academic research has analyzed the recent crisis in depth, stating that the financial system became too complex and leveraged before the crisis, with a number of weaknesses that proved fatal: unethical behavior and lack of values; misaligned incentives; weak governance; lack of transparency; poor management of associated risks; and excessive dependence on credit ratings agencies, among others (Banking Standards, 2013; De Larosière, 2009; Financial Stability Forum, 2008; French et al., 2010; Johnson & Kwak, 2010; Larreina, 2012; National Commission, 2011; Sánchez Ferrero & Yanes Luciani, 2008; Trichet, 2008). Before the collapse of 2007–2008, bankers believed "that they were infallible [...], blinded by their own genius" (Augar, 2010, p. 4). In fact, the emergence of the *Masters of the Universe* created a new social group praised for its "ingenuity and creativity" (Brown, 2007, p. 4), lavishly compensated, and which enjoyed close connections with politicians and regulators.[4] Likewise, before 2007, a majority of citizens in developed economies enjoyed an unusual sense of prosperity[5] and consumed

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excessively,[6] paying little attention to the building up of risks, and expecting regulators to control systemic risk.

When the financial instability (Minsky, 1992) became evident with a cascade of bankruptcies, governments agreed to "do everything necessary [...] to repair our financial systems" (G20, 2009), basically large bailout plans[7] financed with public debt. This backfired shortly after, when markets pressed governments to quickly balance their budgets, in the middle of a deep recession. In Ireland, for instance, the so-called "cheapest bailout in history" (Carlswell, 2008) led to the virtual bankruptcy of the country (Connor, Flavin, & O'Kelly, 2010; Kelly, 2009) and to request aid from European partners (Taoiseach, 2010). While several European countries were excluded from debt markets and needed to borrow from their partners, the simultaneous adoption of austerity plans sent Europe down into a spiral of suffering, unable to escape the liquidity trap, which was also another push toward the abyss for the global economy (Krugman, 2010; Tilford & Whyte, 2011; Varoufakis, 2016). Further failures in dealing with the Eurozone's sovereign crisis imposed unnecessary harm in the citizens (IMF, 2013a, 2013b; Tilford & Whyte, 2011) and have even been called criminal (Varoufakis, 2016).

AN INDUSTRY BLIND TO WARNING SIGNS BEFORE THE CRISIS

A common concern in the context of the financial crisis is whether it could have been avoided; or its consequences, mitigated. Since 2005 at least the excesses of valuation of the US housing market (in terms of both quantities and prices) were known to bankers (McDonald, 2009) and to some economists (Krugman, 2005a, 2005b; Rajan, 2006; Roubini, 2006, 2007), although most analysts and economists disregarded them. When Rajan said that "economies may be more exposed to financial-sector-induced

turmoil than in the past" (Rajan, 2006, p. 1), he was considered "misguided" (Johnson & Kwak, 2010, p. 103). Mainstream opinion was that financial markets would provide the stability the world needed, assuring that "banking systems today, at least in the advanced economies, may not be all that vulnerable" (Kohn, 2004, p. 20).[8] Over-optimism was common until 2007. That year, Barclays' CEO claimed that "markets are increasingly safer, more reliable, and less volatile" (Barron & Gómez, 2007), while the IMF deputy managing director said at Davos that "the world now has the 'luxury' of worrying about mispriced financial markets" (Lipsky, 2007).

Authors whose findings were at odds with this positive view were ignored. This included warnings that financial markets had become more interlinked and vulnerable to problems experienced in other markets (Cetorelli, Hirtle, Morgan, Peristiani, & Santos, 2007), or that the rise of large multinational banks and the consolidation process was systemically risky (Beck, Demirgüç-Kunt, & Levine, 2006) creating institutions "too-big to fail" (Dowd, 1999[9]). As argued, the problem "was not that no one warned about the dangers; it was that those who benefited from an overheated economy — which included a lot of people — had little incentive to listen" (Rajan, 2010, p. 1). Similarly, proper investigation was unusual after the crisis, as if conducted "then, you would find the culprits" (Roubini, 2011).[10]

The tendency to ignore the potential consequences of such a culture and to deny potential social risks was also present among relevant leaders and decision makers within the system. Former Fed chairman Alan Greenspan (in office from 1987 to 2006) became soon a top-class oracle,[11] to whom both the industry and the media looked respectfully for guidance. His view that the growth of the financial industry was indispensable for the real economy became ubiquitous. Greenspan described derivatives as "especial contributors to the development of a far more flexible, efficient, and resilient financial system than existed just a quarter-

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century ago" (Greenspan, 2002, p. 2) and disregarded the "possibility of a chain reaction, a cascading sequence of defaults that will culminate in financial implosion" (Greenspan, 2002, p. 3) linked to excessive leverage,[12] which was "remote."

Greenspan wrote that "since markets have become too complex for effective human intervention, the most promising anti-crisis policies are those that maintain maximum market flexibility — freedom of action for key market participants [...] many critics find this reliance on the invisible hand to be unsettling. As a precaution, they wonder, should not the world's senior financial officers seek to regulate this huge new global presence? But regulation inhibits freedom of market action; undermine this freedom and the whole market-balancing process is put at risk" (Greenspan, 2007, p. 489).[13] This position, maybe inadvertently, takes for granted the advantages of the *homo technologicus* (Longo, 2001), refusing to see, for instance, the severe market disruptions that automatic algorithms have provoked (Bank of England, 2016; CFTC, 2015; SEC, 2010). Interestingly, Greenspan "was shaken by the revelation that dealers in credit default swaps were being dangerously lax in keeping detailed records of [their] legal commitments" (Greenspan, 2007, p. 490), what proved that market players sometimes take stupid decisions and do not even act in their own interest, not to say in the public's. Later, Greenspan recognized, to be "in a state of shocked disbelief" (Greenspan, 2008).

More recently, Greenspan has explained his failures as a problem of economic forecasting, a discipline that, according to him, is unable to determine whether an unsustainable bubble exists (Greenspan, 2013). This is not what the National Commission on the causes of the financial and economic crisis in the United States found, as they concluded that "the crisis was avoidable," and due to, among other factors, lack of appropriate surveillance and the elimination of previous regulation[14] (National Commission, 2011, pp. XV–XXVIII), that

in the past had "prevented crises" (Gorton, 2012). Their report points to the "Federal Reserve's pivotal failure to stem the flow of toxic mortgages [...] was the one entity empowered to do so and it did not." The Commission paraphrases Shakespeare, "the fault lies not in the stars, but in us"; but some of us are more responsible than others: "more than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congresses, and actively pushed by the powerful financial industry at every turn, had stripped away key safeguards, which could have helped avoid catastrophe." Then, it is no wonder that the "regulators could have clamped down on the excesses in the run-up to the crisis. They did not" (National Commission, 2011, p. XVIII).

All over the world, regulators failed to recognize and respond to the problems of the financial system (Banking Commission, 2013; De Larosière, 2009; HM Treasury, 2010). The Icelandic parliamentary commission on the crisis[15] went further in denouncing the criminal negligence of regulators and supervisors, stating that "there was reason for concern" (Rannsóknarnefnd Althingis, 2010, p. 3), but regulators failed to fulfill their tasks properly. Thus, "the Board of Governors of the Central Bank of Iceland must therefore be considered negligent" (Rannsóknarnefnd Althingis, 2010, p. 158). The Icelandic government was also accused of similar unforgivable failures in their duties: "contingency plans for protecting the financial system of the country, and other fundamental interests of state and the nation, were unacceptable" (Rannsóknarnefnd Althingis, 2010, p. 14). These failures were the result of a political bias toward "kinder and gentler" surveillance[16] (Pitt, 2001), and ideology-led economic research praising the financial industry.[17]

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SOCIAL IDENTITY AND SOCIAL CAPITAL IN FINANCE

The prevailing business culture in the banking industry described above, constrained by financial industry norms, openly favored competitive and dishonest behavior that was reinforced in several ways (Cohn, Fehr, & Maréchal, 2014). Employees and regulators working in the financial sector were not excluded from these influences, and in fact were strongly affected by them, to the extreme that a critical underlying reason for the financial collapse was the expansion of greed among workers in the financial industry (James, 2007; Johnson & Kwak, 2010; Smith, 2013).[18] Greed produced two main behaviors: deception and fraud, in case of low moral standards, and bonus-seeking procedures disregarding collateral risks. Indeed, the hope of holding a future position in a financial firm where compensation would be very high was very common among skilled financial workers and the regulators' top staff. Philippon and Reshef (2012) found that US regulators could not attract or retain highly skilled financial workers due to the wage premium they would receive in the private sector. The same was true in other regions. In Iceland, for instance, one third of the regulators' employees went to work for the banks (Ferguson, 2011). Expectations of using *revolving doors* also explain soft attitudes in supervision: for some top officials (including political leadership), the hopes of holding a future position in a financial firm, where compensation would be extravagantly high, could be an incentive not to exert too much pressure on them.

In general terms, social capital can be defined as an "investment in social relations with expected returns" (Lin, 1999, p. 30). This investment can be done by individuals or by a group whose members may also *appropriate* the social capital created by the group (Bourdieu, 1980). As such, the financial sector can easily be considered a group in which social capital is relevant. According to Lin (1999), there are four elements that improve the profitability of investing in social relations: it facilitates the flow of

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information, it exerts influence on the agents responsible for taking decisions, it certifies the individual's social credentials, and it reinforces identity and recognition, both at the individual and group level. As such, much of the literature relating to organizational performance reveals a positive view of human and social capital and people management, with the largely generalized assumption that people are the key element in organizations to achieve competitive success, and that investing in social relations (hence, increasing expected returns) is a desirable goal.

When social capital is analyzed at the group level, research has focused on how certain groups develop and maintain more or less social capital as a collective asset, and how such a collective asset enhances group members' life chances (Bourdieu, 1980; Lin, 1999). Importantly, social capital is given the merit to question the individualizing notions of self-interest of economic theory (Nahapiet, 2011). Acknowledging the influence of social and political factors on individual behavior is therefore critical in this context, as it serves to better understand the effects of the financial culture on those who worked in the financial sector. Organizational cultures and systems define what will be considered appropriate organizational behavior, and which are the "*rules of the game*" to be respected in each organizational context. The notions behind this viewpoint are well established in the organizational behavior literature, and the importance of institutions and organizational values in shaping people's attitudes and behaviors are equally well established through the connection between social psychology and economics, under the premise that "*people often think, feel, and act as society members*" (Bar-Tal, 2006, p. 344).

Social identity theory (Tajfel & Turner, 1979, 1986) is rooted in these approaches, being an influential theoretical position within social psychology. This theoretical approach is largely concerned with how people identify with and behave as part of social groups (including organizations). As Tajfel and Turner (1986)

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demonstrated, people need to belong to a group that is meaningful for them in order to secure a strong sense of wellbeing. Within the organizational context, social identity theory would establish how groups and individuals define their identity in relations to the members of their own social group (e.g., position within the organization and sector) as well as the larger cultural context of which they are part of (e.g., national identity; Phinney, 1990).

Social norms are critical for this phenomenon, as they signal appropriate ways for the internalization of individual attitudes toward other social groups. Social normative research examining manipulated forms of social norms has repeatedly shown that people strongly adhere to social norms when evaluating target groups (Crandall, Eshleman, & O'Brien, 2002). For instance, previous research has shown that changing the norm about the expression of prejudice with a single confederate expressing antiracist views can have a dramatic effect on people's tolerance for racist acts (Blanchard, Crandall, Brigham, & Vaughn, 1994) and gay-related attitudes (Monteith, Deneen, & Tooman, 1996). More recently, an Israeli University conducted an experiment in a middle size town in Israel, where voters are particularly right-wing and mostly oppose any dialogued solution to the conflict with Palestinians; researchers could moderate the citizens' view of the conflict through paradoxical thinking intervention (Hameiri, Porat, Bartal, & Halperin, 2016).

These studies demonstrate the importance of social and organizational norms in shaping individuals´ behavior and values and suggest that, accordingly, the greedy and competitive behavior that has characterized financial sector workers may have been potentially influenced by social and political attitudes. This influence has been particularly marked for men, who still constitute the majority of the workforce in the financial sector and are more often likely to engage in unethical and competitive behavior at work compared to women (for a review about sex differences in management see Eagly, Gartzia, & Carli, 2014). The pressures to act in stereotypically masculine and competitive ways have been

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shown to be stronger when those in relevant decision-making positions are also men and behave in stereotypically masculine ways (Gartzia & van Knippenberg, 2015), which is characteristic of the financial industry. As Knights and Tullberg put it, masculinity is particularly exacerbated in the financial sector: "to be an in-group member means that you need to join in the dominant masculine discourse […] and never challenge or question any kind of remuneration however excessive they may appear" (Knights & Tullberg, 2014, p. 512). For instance, when new rules to control the sector forced compensation to be public, instead of the feelings of shame linked to having excessive privileges that could have occurred, there was a run-for-higher-pay, as it was perceived to be a sign of manliness in an industry where the greatest fear is to fail to be a "real man" (Knights & Tullberg, 2014).

The evolution of the financial industry in the last decades created a group of talented "intellectual elite" (Beunza & Stark, 2004), fundamentally male workers who had developed a strong bond of stereotypically masculine social relationships that reinforced the greedy culture described above, and further moved its members away from the needs of the society they are supposed to serve. Such absence of ethics and social values have been underscored as the main weaknesses of our current financial system (Gomez-Bezares, Ansotegui, & González, 2014) and thus a change in the culture of financial firms has recently become a priority for the most advanced regulators (Davidson, 2016). Research on social capital has suggested some tools (Leydesdorff, 2007; Russ, 2016) that can be useful for this development, including stronger moral standards as basic units to go beyond the main weaknesses of our current economic system (Russ, 2016). Such developments might help to soften the "*greed is good*" belief that is generally characteristic of the financial system, but in practical terms dishonest and fraudulent behavior is still excessively common, with many financial workers acting recklessly and pretending to ignore that the consequences of their actions have a

devastating impact on the life of others. As we will discuss in the next section, this might be largely associated with the disproportionate and unique compensation system characteristic of the financial industry.

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EXCESSIVE COMPENSATION IN THE FINANCIAL INDUSTRY: A BAD INCENTIVE FOR SOCIAL DEVELOPMENT

In contemporary motivation theories there is remarkable consensus that many work activities are not dependent on tangible rewards and that external incentives such as money, prizes and tokens can actually negatively influence intrinsic motivation (for a review, see Deci, Koestner, and Ryan, 1999). Yet, research has produced a wide range of studies focusing on the strong effects of tangible rewards on employees´ behavior (see Carton, 1996; Cameron & Pierce, 1994), such as the incentives' schemes that are characteristic of the financial sector. These effects have been widely illustrated in studies within the operant literature (Skinner, 1953), which have generally established that "extrinsic rewards can control behavior. When administered closely subsequent to a given behavior, rewards were reliably found to increase the likelihood that the behavior would be emitted again, an effect that persisted as long as the reward contingency was operative. When rewards were terminated, the likelihood that the behavior would be emitted eventually returned to the pre-reward baseline" (Deci et al., 1999, p. 627). In relation to this, organizations often implement these pay methods for influencing employee behavior, increasing their motivation toward organizationally desired behavior (Davidson, 2016; Robbins and Judge, 2013)[19].

In the financial sector, ill-designed compensation schemes providing extreme incentives have been systemic (De Larosière, 2009; National Commission, 2011). The European Banking Authority

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(EBA) issues an annual report analyzing the *high earners* in the financial industry (those paid 1 million euros or more). In the period 2010−2014, over 32 billion euros were paid to at least 3,800 different individuals that classified for this status. Table 1 displays the number of high earners and the total amount paid to them each of these 5 years, an amount that greatly exceeds the lending capability of major Development Banks. These large amounts in compensation in the financial industry were supposed to be an efficient market response to a new economic environment: larger value creation by financial employees would result in larger corporate profits and larger bonuses. Theoretically, financial workers would have an incentive to be more efficient and create more value: the promise to obtain bigger bonuses if they did so. However, compensation was not always performance-based (Banking Standards, 2013, Cuomo, 2009; De Larosière, 2009) and it was clearly disconnected from the creation of value for the corporation[20] or for the society.[21] In addition, tangible rewards have not always been associated with specific behaviors and outcomes. As some authors have put out, "there is no clear rhyme or reason to the way banks compensate and reward their employees" (Cuomo, 2009), with rewards that have been paid for failure

Table 1. High Earners, Aggregated Data. European Economic Area.

	No. of High Earners	Amount Paid	Average/Employee
2010	3,435	7,528.79	2,19
2011	3,175	4,807.87	1,51
2012	3,530	6,627.26	1,88
2013	3,178	6,021.94	1,89
2014	3,865	7,379.92	1,91
Total	17,183[a]	32,365.77	1,88

Source: Own research with EBA data. Million €.

[a]The number of high earners in Europe will be between 3,865 and 17,183 for the period 2010−2014.

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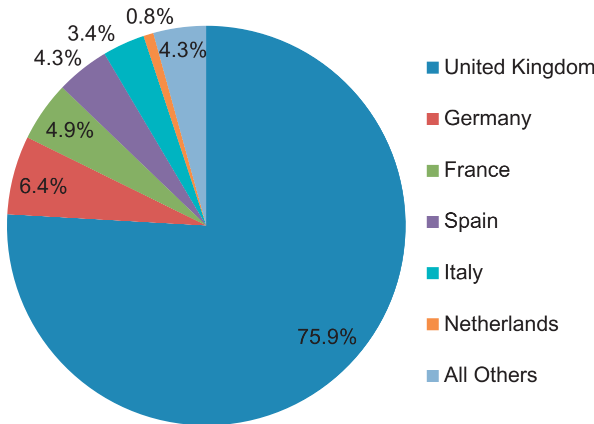
(Banking Standards, 2013) and were guaranteed in advance (De Larosière, 2009).

As a comparison, there were around 60,000 additional financial employees in Europe which can have "a material impact on the institution's risk profile" (EBA, 2016), with an average wage of 200,000 euros. All other employees in the sector, slightly below 3 million people in Europe, had an average compensation of 52,000 euros. Interestingly, the City of London is unrivaled in Europe in terms of compensation to financial employees: more than three quarters of the total amount paid to high earners in all the European Economic Area (the EU plus Norway, Iceland and Liechtenstein) was paid by the British financial industry (see Figure 1). London-based high earners are also around 75% of the total, and these figures have remained stable across the five surveys conducted until October 2016. This may shed some light in the special relevance of this geographical context as well as its influence in the European financial system.

As in the United States, compensation policies in Europe have been generous for high earners: "the variable remuneration

Figure 1. Amount Paid to High Earners, 2010–2014. European Economic Area.



Source: Own source, based on data from EBA (2012–2016).

awarded, in many cases roughly equals half of the amount paid out to shareholders" (EBA, 2016, p. 7); with bonuses amounting to 127% of their fixed salary in 2014. Briefly, financial high earners have been often overpaid (Philippon & Reshef, 2012). Disconnection from the real world may be behind some of the extreme cases of bonus pocketing, affecting bailed out institutions,[22] even in countries that went bankrupt themselves due to these bailouts.[23] Consistent with these trends, highly motivated, ambitious people in the financial industry often gave priority to rewards and individual interests, prioritizing work, commitments to colleagues and industry-connected events to their personal lives and less economically rewarding activities, such as ethical behaviors that were in opposition with the aggressive policies developed within the sector (Knights & Tullberg, 2014). Besides, their decisions, often oriented to maximizing their own bonus, frequently had very harming consequences for their institutions and the society. Indeed, over-compensation was not associated with positive outcomes[24] (Banking Standards, 2013), and it was often creating problems for the countries that had bailed them out by injecting taxpayers' money.[25] Although high earners only received 3.5%–5% of the total compensation (being around 0.1% of the financial employees), these trends influenced the cultural identity of the whole sector, which developed *short-term greed*[26] (Smith, 2013).

It can be argued that high earners´ behavior is largely explained by failures in corporate governance allowing executives to influence their own compensation and that of their staff, extracting rents from shareholders (Bebchuk, Fried, & Walker, 2001). Thus, executives, analysts and traders are paid more than is optimal for the shareholder, or other stakeholders, while trying to camouflage this excessive compensation (Bebchuk, Fried, & Walker, 2002). Investors' concerns have been limited,[27] as they benefited from the abnormal profitability of the financial system (Lepetit, 2010), derived from "the existence of an (implicit or explicit) safety net"

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(European Commission, 2011, p. 15). Philippon and Reshef (2012) found that these economic rents can explain 30% to 50% of the wage premium of this sector in the United States, which largely explains why talented young individuals have chosen to work in this sector despite holding degrees in other areas.

Excessive compensation might create a wider problem: the call effect. The flow into financial services of talented individuals attracted by the high pay might not be desirable in social terms, given how they use their abilities. In relation to this, Philippon (2007) wondered about the overall efficiency of the allocation of human capital to finance. As the higher wages obtained in finance are determined by a flawed institutional context, it has created a *bubble* of human capital in this sector, with talented people whose innovations can be destructive for the society. Likewise, Kneer (2013) found a brain-drain effect negatively affecting most manufacturing sectors (depriving them of the "best and brightest"). In short, the social return of these talented individuals might be higher if they were employed in other sectors (Baumol, 1990).

We should note here that, as explained before, motivations beyond monetary rewards are also relevant for explaining individual behavior (Akerlof & Shiller, 2009; Amabile, Dejong, & Lepper, 1976; Deci & Cascio, 1972; Maslow, 1949; Zuckerman, Eysenck, & Eysenck, 1978). The compensation schemes and the job-related features in finance (e.g., status, power, and instrumental goals that serve self-interest) influence job-seekers attracting to the industry knowledgeable and skilled talent that put their career lives first (Ipsos Mori, 2011, p. 23), precisely the kind of talent financial firms want to recruit. In fact, decisions in this industry might be more frequently career-driven and influenced by pay than in other sectors. These motivations are often associated with individual career progress, the general culture of competition and the psychological need for "controlling others in pursuit of the instrumental goals of performance, productivity, and profit" that is characteristic of employees in the financial sector (Knights & Tullberg, 2014). In relation to

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this, it has been argued that individuals do not tend to go into the financial industry unless they are "highly motivated and ambitious" (Ipsos Mori, 2011).

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MANIPULATION IN THE FINANCIAL MARKETS

The aforementioned greedy behavior and the reckless bonus-seeking activities have influenced the functioning of markets beyond merely favoring excessive risk-taking and the build-up of systemic risk, becoming a socially shared norm within the sector. As we will see in this section, a large fraction of the financial system has committed illegal activities: not only individuals, but large teams and even entire organizations have been involved in systematic market manipulation and fraud. Both retail and large investors[28] have been cheated when dealing with financial institutions, and led to buy "*shitty*" products (US Senate, 2011), on which the selling firms would make a large profit.[29] As Akerlof and Shiller (2015) put it, these institutions were "phising for phools." When dealing with retail clients of financial services, misconduct has included the provision of misguiding advice and the selling of inappropriate products (OECD, 2011). Among many examples of fraudulent practices, we can cite mis-selling subordinate debt instruments to illiterate elderly clients (Larreina, 2012), opening millions of unauthorized accounts (Hensarling, 2016), shamming consulting fees (SEC, 2011), fundamental failures in the commercialization interest rate hedging products (FSA, 2013), mis-selling mortgages (USDC Kansas, 2016), or mis-selling payment-protection insurance (FCA, 2014). Large investors have not been spared, as they are "the large fishes in the pond" (Smith, 2013), waiting to be *phised*. Despite their large investment positions, frequently they *had little familiarity with the product* (US Senate, 2011), and were misled into ruinous operations (Smith, 2013).

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The whole market has also been manipulated in several occasions. At the London *Forex market* (the largest foreign exchange market), systematic manipulation forced clients to pay inappropriate prices (FCA, 2014).[30] The Forex traders involved put their institutions' "interests ahead of the interests of its clients, other market participants and the wider financial system" (FCA, 2014, p. 3), in the search of a higher bonus. These traders used electronic messaging services, chat rooms, to communicate with traders at other firms;[31] as they worked together for committing fraud, they were the "A team" or "the musketeers." They kept their behavior confidential: a trader questioned whether a prospective new participant would "tell [the] rest of [his] desk stuff." Another trader commented "don't want other numpty's in mkt to know [about information exchanged within the group], but not only that is he gonna protect us like we protect each other…" (FCA, 2014, p. 16).

Another "shocking […] collusion between banks who are supposed to be competing with each other" (European Commission, 2013) occurred in 2013 and 2014. A handful of large banks fudged their contributions to benchmark interest rates, manipulating the Libor and Euribor, which determine millions of contracts (ECB, 2014; European Commission, 2013). Besides, some large international banks had participated in illegal cartels in interest rate derivatives denominated in euros and yens, exchanging commercially sensitive information (European Commission, 2013).

Many of these fraudulent deals were culturally enacted and based on the view shared by the staff and the senior management that if the clients come to operate in the market without proper understanding, that is their problem. As a former investment banker put it: "the big argument for why it was ok to sell someone something without full disclosure or without telling them your intention, was this idea that everyone is a big boy. If they come to play they deserve what is coming to them. Even if there is a sense of deception, or a sense of misleading them" (Smith, 2013

minute 20). Hence, to many clients, their financial advisors are very similar to the archetypal snake-oil seller of the XIX century Far West. And these clients happen to be "charities as the Red Cross, every university's endowment, teachers' pension funds, governments… [they] are the biggest fish in the market. They have hundreds of billions of dollars of assets and are investing with Wall Street" (Smith, 2013 minute 22).

When exposed, these frauds are defined as "wholly inappropriate behaviour […], not meeting the high standards that we set for ourselves" (Diamond, 2012), and firms "deeply regret our breaches of US law" (Branson, 2009). In these occasions, frauds were presenting as not reflecting the culture of the company, arguing that traders operated "on their own benefit" and that action to stop these malpractices was immediate when senior management was informed (Stumpf, 2016). Then, firms would "leave no stone unturned" in the search for finding abuses, and when found "would make it right [for the affected] customers" (Stumpf, 2016). This simplistic approach, however, can be problematic; reality is much darker as these practices were "endemic" (Hensarling, 2016) and resulted from a widespread culture of "short-term greedy" (Smith, 2013), of crony and casino capitalism (Krugman, 2004). These concerns have led some professionals to think that "insider trading was part of their job description" (SEC, 2012) and to "routinely cross the line into trading on confidential information" (Lattman & Protess, 2013; SEC, 2013).

Note also that malpractice should not be merely attributed to bonus-seeking behavior: aggressive sales objectives,[32] pressure from managers to meet them, and inadequate monitoring are frequent in the industry (Hensarling, 2016). Fraudulent schemes keep running for years (Maloney, 2016), to the point that some large banks are described as "criminal organizations" (Hetzer, 2015). Reputational risk is clear, as the sector "became synonymous with flawed business practices" (Salz, 2013, p. 83). The culture of the financial firms depends, among other factors, "on the

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narratives that circulate in a firm that explain what the firm is trying to achieve, how it will be achieved and why it is important" (Davidson, 2016). The prevailing narratives made the financial system seem wilder and more ferocious with the uninformed client than a casino (Smith, 2013). In the terms of social capital (Lin, 1999), we can think that the social ties within financial firms and financial centers, which connect managers to their staff, and workers from different companies to each other (and also those that connect external lawmakers, regulators and supervisors to the industry) influence individual and group decisions (Akerlof & Kranton, 2010; Beunza & Stark, 2004). The previous examples allowed the reinforcement of identity and social recognition, the creation and development of a culture of greed, fraud and lack of responsibility for their actions. In fact, a large majority of senior bankers recognize "significant cultural problems" in their industry, and almost four fifths believe "it would benefit from cultural change" (Salz, 2013, p. 82).

As we explained before, these cultural problems are closely consistent with the prevalence of discourses of hegemonic masculinity that characterize the financial sector, whereby stereotypically masculine practices and identities associated with competition, ambition and instrumentality are particularly salient (Lewis, 2014). As Knights and Tullberg (2014) put it in their analysis of masculinity in this context, "it is in the financial sector [...] where some of the most extreme manifestations of unadulterated masculine discourses are performed and perpetuated" (p. 513). In this competitive, male-dominated context, male managers and employees are culturally pushed to secure their sense of identity and meaning through visible success and an achievement of the highest levels of pay, even if that requires anti-social values. This cultural competitiveness is related to the "rational, efficient, and singularly uncritical pursuit of goals and objectives" that is expected from a real business man and is "handed down from above [...] in pursuit of

the instrumental goals of performance, productivity and profit" (Knights & Tullberg, 2014, p. 503).

AN OVERGROWN INDUSTRY BEYOND ITS OPTIMAL SIZE HIDING THE MAIN PROBLEMS

Taken together, the harm of the abovementioned practices and cultural norms to the wider society go well beyond the losses inflicted by rogue traders, the wages paid to greedy individuals (from CEOs and top managers to financial analysts), or the cost of manipulation. At the broadest level of the dark side of social capital in the financial industry, "there is a conflict of interest between society as a whole and the private owners of financial institutions […] if things go well, the firms' owners and managers claim the profits, but if things go poorly, society subsidizes the losses" (French et al., 2010). An operational and efficient financial system is necessary for a proper functioning of the real economy. Nevertheless, it has evolved into "an overgrown financial sector that did more harm than good" (Krugman, 2009), holding an excessive economic role (Larreina, 2008). According to a European report, "the European banking system has reached a size where its marginal contribution to real economic growth is likely to be nil or negative" (ESRB, 2014).

As Turner (2009) put it, "not everything a financial system does is socially useful; and it would be better for society if they got smaller." This is why when the G20 promised that they would not allow a "return to banking as usual" (G20, 2009), many expected that the industry would be downsized, among other radical changes. On the contrary, it has been protected in many jurisdictions, likely due to "its industrial policy significance — its contribution in terms of jobs, GDP generation and taxes paid" (Europe Economics, 2011), including indirect contribution via "multiplier" effects. In this sense, and according to Russ (2016),

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this decision would be a mix of three of the approaches to the human species: *homo economicus*, *homo politicus,* and *homo technologicus*. Unfortunately, it is precisely the fourth approach (*homo sustainabiliticus*) the one that seems missing, and one could argue whether the other three approaches are taken short-sightedly.

In line with these concerns, current financial crises and the problems of the welfare state cannot be dissociated from the web of tax havens and tax holes that allow wealthy individuals and multinational corporations to avoid paying taxes (Shaxson, 2011) and camouflage risks. Our overgrown financial system allows "the mega-rich to use complex offshore structures" to own property and other assets, "gaining tax advantages and anonymity not available to average people," through a "well-paid industry" controlled by the largest global banks and providing "shelter to money laundering or other misconduct" (ICIJ, 2013). As the deepest economic recession since the Great Depression is still on its way in early 2017, our societies have spent almost nine years dealing with the failures of a financial system still in bad shape: "Banks in advanced economies face a number of cyclical and structural challenges, […] particularly in Europe and Japan, […] almost a third of the European banking system remains weak" (IMF, 2016). Meanwhile, inequality has increased (Piketty, 2013), social safety nets and welfare states are under siege in many areas (Varoufakis, 2016), extremism is in the rise even in developed countries, and our society is running out of time to deal with other social problems beyond the financial system.

Unfortunately, political response to our society's various fundamental problems has been neglected, somehow hidden in the short-term economic and political agenda. Examples of these problems include the incapability to reach the Millennium goals, climate change and the destruction of the environment, the proliferation of nuclear weapons, or the spread of poorer labor conditions despite technical progress. For instance, climate change

is considered a "Tragedy of the Horizon" (Carney, 2015) and a real danger which the financial system chooses to ignore (Jeucken, 2004). Indeed, environmental disasters and climate change are a great threat for financial stability and should also be a concern for Central Banks and regulators.[33] Nevertheless, as the typical policy-horizon is often reduced to a 2–3 years horizon (for monetary policy), and only in particular cases lifted to a decade (for financial stability), future disruptions are not taken into account. As some have pointed out, "once climate change becomes a defining issue for financial stability, it may already be too late" (Carney, 2015), and the resulting disequilibria will radically reshape our financial system.

Market participants seem to be unaware of these social and environmental concerns, and regulators seem to be delaying indefinitely the adoption of measures to prevent this risk.[34] This is not a surprise, as the financial crisis has shown that markets may be completely wrong about the existence of problems, their size, and their solutions. As some have argued, these challenges cannot wait and should be addressed as soon as possible before their consequences are irreversible (Elliot, 2008; GFDRR, 2015; Jackson, 2009; Klein, 2015; Stern, 2006). Authors as Attali (2009) had forecast a number of crises to happen simultaneously in the short term, and the question of whether we are resilient enough to endure them, remains. The relevance of addressing these challenges is represented in different types of discourses within our society, including political, social and religious forces.[35] Even if the market could theoretically solve the cited problems in the long run, there are increasing odds that damages, for instance, to the ecosystem will become irreversible before these market corrections happen, a risk that most citizens would like to avoid. As such, it seems necessary to change the theoretical framework and sociocultural foundations that are characteristic of economics, and, more importantly, our economic policies (Elliot, 2008; Jackson, 2009; Russ, 2016; Stiglitz, Sen, & Fitoussi, 2009).

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If achieved, such changes may also redefine the role of technology in finance. In recent times, flash-crashes provoked by automated systems without human supervision have severely disturbed markets several times (Bank of England, 2016; CFTC, 2015; SEC, 2010). A reflection on how to integrate instant automatic response with time-consuming human analysis, and the risks for our society of let-alone financial algorithms is still needed. Cyber attacks have also been relevant in this industry,[36] while "there has historically been less focus on failures or incidents that might originate from malicious intent" (IOSCO, 2016). As such, therefore, the *homo technologicus* may have important negative externalities in finance. There is a threat that artificial intelligence "outsmarts financial markets," what is worrisome as "the long-term impact [of Artificial Intelligence] depends on whether it can be controlled at all. [...] little serious research is devoted to these issues" (Hawkins, Russell, Tegmark, & Wilczek, 2014). If a singularity affecting Stock Exchanges or other markets occurred, we would face a black swan[37] without the adequate tools for safely dealing with such events.

OTHER FUNDAMENTAL CHANGES IN THE INDUSTRY: THE CHANCE FOR A NEW BEGINNING

In this chapter, we have discussed the many challenges that the financial sector is facing, with a focus on the negative factors that allowed individual, group and political unethical practices and a short-term financial focus in the sector. As we have argued, a number of influences that favored the build-up of this social capital on the dark side also prevented its control, and the adoption of most proposals aiming to limit it (as the Tobin tax, for instance). As some have explained, the financial debacle has not been "severe enough" (Cassis, 2011) to provoke a radical reshaping of the industry, unlike what Klein (2008) found in other shocks.

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Indeed, changing the financial culture will not be easy[38] and will take time, given that culture is very resilient. Yet, "if firms don't change their mindsets, then they will run a very significant risk that old habits of behaviour will repeat themselves" (Davidson, 2016). Furthermore, the excessive political influence of this industry (through for instance lobbying[39] and revolving doors) has delayed addressing its structural changes. Hence, a financial system that should be rethought (Rocard, 2011), remains essentially the same, with bankers "going back to the old ways" (Lagarde, 2010) and whose "failings […] undermine confidence in the system and put its integrity at risk" (FCA, 2014).

A critical aspect that might help move toward the required cultural transformation regards changes in compensation policies (Carney, 2014), eliminating rent extraction and better aligning incentives with the objective of firms and the broader objective of the industry and the society (De Larosière, 2009; European Commission, 2009). This realignment will quite likely deteriorate the instrumental attractiveness of this industry for young talents, allowing other industries to recruit a larger number of talented students too.[40] Simultaneously, the reform would show that the regulators' new approach of holding senior management accountable for the culture in their firms is right. These changes would likewise require profound changes in the cultural definition of financial systems and organizations, going beyond competitive, success-focused discourses to a more socially concerned and ethical approach where chasing the highest levels of economic reward and pay is not a central motivation.

As mentioned earlier, we should note that "*powerful interests*" may "*impede*" and "*resist*" a financial reform, and would even "fight against their loss of power and resources" (French et al., 2010). Among those resisting more fiercely any fundamental change, we can expect to find the governments of countries and regions where the financial industry "is critically important" to the local "economies and budgets" (Dinapoli & Bleiwas, 2011).

For instance, if governments laud how "the City of London has risen by [the financial industry's] efforts, ingenuity and creativity to become a new world leader" (Brown, 2007), no much pressure for a significant transformation of the industry may be expected. Opposition to radically reshaping the financial industry may also come from lobbyists that claim that "international financial centres produce a whole host of socially useful functions" (Europe Economics, 2011).[41] Despite these concerns, it may be expected that some disruptive conditions will also become important in the modern economy and financial system, which might represent a potential change and help restructure the financial context.

The first potentially disruptive trend for the current financial industry is the British decision of leaving the European Union (with a potential negative impact in the City of London). If eventually the United Kingdom decides to leave the European Union (a formal communication is expected in March 2017) and the negotiations end with a *hard Brexit*, excluding London from the single European market,[42] a large fragment of the London's financial center[43] could be relocated toward other destinations in the EU or Switzerland (Frankfurt, Paris, Dublin or Zurich as the most likely places to benefit from it). This relocation, together with the end of the *British exceptionalism* in regard of financial regulation, could be accompanied of a downsizing of the sector. In a report about London's financial industry in 2005, it was estimated that almost one quarter of "*City-type*" activity in Europe would be lost if London's financial cluster did not exist (Halushka et al., 2005). Besides, the tighter regulation to be found in other European locations is likely to lead to an outflow of human capital from the financial industry to other sectors (Philippon & Reshef, 2009), what, given the negative externalities mentioned in this chapter, could be interpreted as a positive outcome.

Another potential game-changer is FinTech, a segment of the financial services industry that "uses technology to provide innovative services and products to consumers and small businesses"

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(Committee of Financial Services, 2016). This segment may potentially affect the long-term structure of the financial services industry (Bruno et al., 2015), including, for instance, online lending platforms where small lenders and borrowers may meet, and reduce to some extent the role of financial intermediaries. This is a new segment, which may turn finance (marginally, moderately or radically) toward a collaborative industry, and which may have a number of lending models from partnering with banks, to one-to-one lending, or to crowd-funding. According to a Deloitte-World Economic Forum report on the future of financial services, innovation in this sector can be predicted to happen first (and have the largest impact) in banking and insurance, "where the greatest sources of customer friction meet the largest profit pools" (Bruno et al., 2015). For the time being, successful innovations are platform based, data intensive, and do not require much capital: features corresponding to the blockchain. FinTech will likely still need skilled people with deep understanding of risk valuation, but this knowledge could be "hired" on demand, in order to analyze a particular borrower's application. Even if the impact of FinTech is milder and there are no "stand-alone businesses" in the field but rather existing institutions adapting the new technology, a transformation of the system will occur (Angermayer, 2016). Experts on the field predict that "there will no start-ups in this sector destroying the established banks," but it may allow the smartest banks to apply the technology to gain market share at the expense of less innovative banks (Angermayer, 2016; Harris, 2016).

An extraordinary development related to FinTech has occurred in the field of virtual currencies like bitcoin.[44] Bitcoin and other crypto currencies[45] are based on the blockchain protocol, a "tamper-proof data structure" (Hayes & Tasca, 2016). It is a public ledger, kept in multiple computers in the network, which is visible to anyone interested; participants have a copy of the blockchain where they can verify every transaction, which has been indelibly recorded to the blockchain thanks to the computing

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power of users which process the payment. These so-called miners are rewarded for their work in settling the transaction (solving a cryptographic puzzle, what validates the transaction) with new bitcoins.[46] The blockchain is, in some sense, trustless, meaning that users do not need to trust their counterparties or the central clearing house, but just the protocol software system. As fraud would theoretically be "prohibitively expensive," participants trust the system: anyone who wants to record a false transaction would need to "compete against other miners who are acting honestly (or trying to fake a different transaction)" (He et al., 2016).

Bruno et al. (2015) think that disruption in the financial system is not going to be a one-time event; on the contrary, *the internet of money* is already setting a continuous pressure to innovate, and it is affecting client behavior and the industry's business models. Regulated financial institutions will quite likely adapt to these new reality by using blockchain technology and the potential of data produced by connected devices. The blockchain can be used for transactions denominated in fiat currencies, recording accurately the identities of the participants; as distributed ledgers technology can improve the efficiency, reach and choice of payment and transfer methods. Furthermore, the blockchain could significantly reduce the cost of international transfers, especially small remittances, and shorten the time for settling transactions in financial and real estate transactions, thereby improving back office functions of financial intermediaries (Bruno et al. 2015; Eagar, 2016; He et al. 2016; Swan, 2015).

The third main driver of change is the growing relevance given to ethics and sustainability-related issues in finance, in view of the events occurred so far. Previous scandals and crimes are creating growing demands for transparency and ethical standards. At the same time, there are growing concerns that "green finance cannot conceivably remain a niche interest over the medium term" (Carney, 2015). Likewise, activist investors are increasingly more relevant (Owen, 2016) and have started not to accept the

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bewildering behavior of some *Masters of the Universe*.[47] Beyond this, the growth of responsible investment is expected to continue (KPMG, 2015). Investors can put the social and environmental impact of their investments first, with instruments like microfinance funds or investment funds applying ESG[48] screening techniques. Nevertheless, fund managers tend to be more sensitive to ESG issues due to their personal perceptions and context than to an explicit goal of value creation[49] (Przychodzen et al., 2016).

Connected to the previous changes, as the financial sector becomes less competitive and working conditions are less extreme, we should see a growing number of social groups with a more diverse profile entering the financial labor. For example, the number of women is likely to expand in decision-making positions of the financial sector, following the trends observed in other work domains. Because men are generally less ethical than women and tend to display communal leadership styles that take social and interpersonal factors into account to a lower extent (Eagly et al. 2014; see also Gartzia & van Engen, 2012), their incorporation to decision-making roles might likewise bring about changes in the functioning of the sector, going beyond its current markedly masculine nature (Knights & Tullberg, 2014). Meta-analytical studies examining ethical beliefs and decision-making have shown that women tend to support ethical business practices to a greater extent than men (Borkowski & Ugras, 1998; Franke, Crown, & Spake, 1997). Also, the number of women in decision-making positions is associated with more positive social outcomes and greater ethical business practices (Boulouta, 2013), as well as less corruption (Dollar, Fisman, & Gatti, 2001; Swamy, Knack, Lee, & Azfar, 2001). Bearing these findings in mind, incorporating more women and stereotypically feminine values in the financial world and in particular in political and economic positions of power would potentially serve to attenuate current discourses of masculinity and competitiveness and fit better with the challenges in this context.

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Within this shift toward a more sustainability-friendly financial sector, the role of the new generations is also critical. Millennials are attracted to work for organizations "that demonstrate a commitment to sustainable business practice" (PWC, 2010). According to PWC, more than 80% of millennials said that they "would leave an employer whose corporate sustainability values no longer met their own" (PWC, 2010). This would directly confront a financial industry whose motto could be "*après moi, le deluge,*"[50] used to deal with career-driven professionals, motivated and ambitious, for whom compensation typically was a sufficient incentive. This new generation can address "the heart of the issue, [...] that there is a need to rebuild and transmit across institutions a sense of vocation, a need of being part of the system rebuilding" (Carney, 2014). Hence, this would eliminate the factors which strongly influence past and current employees´ behavior in many financial institutions (the development of excessive greed, free-riders' behavior, or the unreasonable appetite for risk), end the era of widespread unethical behavior in the financial sector, and realign the financial industry toward being again an auxiliary sector to the real economy. Furthermore, this phenomenon can also deal with the herd behavior which partially explains the current trend toward ESG investment in the investment fund industry. A profound change in the interest of investors could incentivize ESG investments and provide long-term value to fund managers favoring ESG-sensitive portfolios.

These changes could be mutually reinforcing, as the commitment of financial intermediaries' executives will be critical for addressing the issue of the environmental impact of finance, which would likewise be an appealing factor for the youngest generations of men and women. The aforementioned disrupting factors in the financial system such as FinTech or the Brexit could also provide the opportunity to rethink financial services, modifying the established *statu-quo* and generating new dynamics within the system. Ideally, all these factors would create a new culture that

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helps bring the human and social capital in the financial industry *back to the light*. A new identity of financial work might develop, with a stronger pride in serving the society and dealing with its main challenges, rather than short-term greed. These changes would require building new networks of women and men with embedded ethical values and a culture of shared norms that give stronger consideration to the costs to clients and the society. Similarly, compensation systems would have to be revised so that they are less dependent on tangible rewards and disproportionate economic incentives that strongly reinforce bonus-seeking behavior and penalize ethical standards. In relation to this, the emergence of distributed financial activities as peer-to-peer lending may also give investors more tools to select socially responsible projects, and the reduction in the role of financial intermediaries might likewise help reduce market manipulations.

As in many other domains, it will be how we use (and adapt to) these emerging realities what will make a difference. Our societies may use these opportunities for good, better including our ecological and ethical preferences in financial decisions (Floridi, 2014), instead of accelerating the disconnection of the financial market from reality. Too much time has been wasted in the last decades, and solutions cannot be delayed much more: the time-window for tackling with social challenges and other broader ethical issues seem to be quickly fading away (Klein, 2015), whereby a revised financial system will be needed to live up to this challenge.[51]

NOTES

1. After the self-referring phrase of the financial trader who is protagonist of Tom Wolfe's *Bonfire of Vanities*.

2. Hence, the evolution of the research and teaching in Finance may be worrisome. Already in the 1970s, it was "*less acceptable among*

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economists to admit ignorance of mathematics than to admit ignorance of history" (McCloskey, 1976 p. 9). Since then, this trend has intensified.

3. The knowledge about the Japanese liquidity trap was instrumental in Bernanke's success in dealing with the crisis at the Fed, while ECB's president Trichet delayed effective response.

4. In the United States, *from 1999 to 2008, the financial sector expended 2.1 billion dollars in reported federal lobbying expenses; meanwhile, individuals and political action committees in the sector made more than one billion dollars in campaign contributions* (National Commission, 2011, p. 18). In Europe, *revolving* doors have been common between top government officials and banks.

5. This was compatible with many discontents in developed and emerging nations (Stiglitz, 2002).

6. James (2007) characterized English-speaking developed nations as suffering from *affluenza*, a mental disorder defined by placing a high value on money, possessions, appearances, and fame (and making them top priorities). Other developed nations' societies became increasingly afflicted by this phenomenon.

7. More than 100 EU banks — representing about a quarter of the EU banking assets — have directly received State aid, amounting to just over 5% of EU GDP (European Commission, 2014). In many cases, public debt was issued so that the needed capital could be raised. In the period August 2008-February 2014, "*the EU Commission received 440 requests to provide state aid to financial institutions in peril [it] did not object to the vast majority (413)*" (ESRB, 2014).

8. This was the dominant opinion: "*poor bank management is by no means confined to developing countries [...] but lapses in sound practices do appear to be more pervasive in developing countries, in large part because bank owners and managers lack strong incentives to act prudently*" (Camdessus, 1997, p. 3). As we knew later, incentives to act prudently were also missing in developed economies.

9. Note that, in some cases, short quotations in the text are not followed by information about specific page citation because they refer to one-page documents or visual documents without pages format.

10. In 2011, the US Federal Housing Finance Agency initiated litigation against several banks for frauds and securities law violations; 18 cases

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have been concluded in September 2016 with an aggregated settlement of 21.7 billion US $, with two more cases still in the courts (FHFA, 2016). In 2016 the US Department of Justice was preparing large fines for banks which contributed significantly to the crisis (Deutsche Bank, 2016), while Europe is lagging behind in penalizing malpractice linked to the real estate bubble (fines have been imposed on other manipulations like Libor, Euribor, or Forex).

11. Despite being proud of "*mumbling with great incoherence*" (Greenspan, 2007).

12. Both excessive leverage and OTC derivatives were major contributors to the crisis (National Commission, 2011).

13. Similarly, when Ponzi schemes boomed in Albania, President Berisha said that "his inaction was a sign of the Government's commitment to the free market" (New York Times 1997). The Albanian Finance Minister replied that "you must have the courage to accept that during [your] complete governing, these pyramid schemes, which you trumpeted as the free initiative of the market economy, occupied and paralysed the Albanian economy" (ATA, 1997).

14. According to Chesterton (1929), you shouldn't take a fence down until you understand why the previous owner put it up.

15. Iceland was among the first countries to conduct a deep and thorough investigation on the crisis (Boyes, 2009). The collapse of the three Icelandic banks and the plunge of the Icelandic krona left the country in "ruins" (Sigfússon, 2010).

16. Pitt himself acknowledged this failure later (Pitt, 2009).

17. See Dorgan (2006) and his praise of the *Irish remarkable success story*, better described as a fiscally irresponsible policy based on attracting business to Ireland through unfair competition on taxes.

18. Explaining the crisis through the mispricing of risk, leverage, shadow banking, etc. was "*like saying the Titanic sank because too much water came in*" (Welby, 2014 minute 44); the fundamental reason for the crisis was the unethical greedy behavior that directed it towards its iceberg.

19. Other pay structures include piece-rate pay (paying only for what an employee produces); merit-based pay (paying for individual performance based on appraisal ratings); or profit-sharing plans (compensation depends on the company´s profitability).

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20. Goldman Sachs paid bonuses in 2008 that doubled its profits (Cuomo, 2009).

21. Lehman Brothers' CEO pocketed 500 million euros in salary and bonuses in 2000–2008, while the company followed the path towards the most harmful failure up to date.

22. Four top managers at Lloyds Halifax received four million pounds for their performance during 2009, a year in which the British bank lost 6.3 billion euros and was partly nationalized.

23. The Irish bank AIB, whose bailout (and that of some others) put Ireland's economy against the ropes, forcing to cut down wages throughout the economy, pretended to pay €40 million in bonuses for 2009 performance, engendering undisguised rage among taxpayers (Kelly, 2010). Irish Minister of Finance prevented the payment, saying that "I'm not using taxpayers' money to pay these bonuses" (McGee, 2010).

24. Just one example among many: in January 2008, Société Générale lost 5 billion euros due to the bonus-seeking investment behavior of one of its traders, apparently without the knowledge of his superiors (Delhommais, 2008). The young trader took a risky position of 50 billion euros, as he wanted to get a bonus of more than one million euros. The French bank's secret undoing of its giant position triggered a global plunge in stock markets as fear spread through the markets for three days. The bank lost 10% of the positions' value.

25. The Swedish Finance Minister described the attacks on European currencies as *wolf pack speculation of currency traders* (*The Guardian*, 2010).

26. Large institutions in the financial industry were supposed to be *long-term greedy* (Grant, 1999), seeking to conduct profitable businesses with their clients in the long run, creating partnerships and win-win strategies (for which, the survival of your client is necessary). This culture was replaced by *short-term greed*, where clients are just perceived as vehicles for annual bonus maximization (Klein, 2012).

27. Many investors have also been too greedy. Their *appetite for high yield* and the illusion of low risk, combined with little or no supervision, let irresponsible practices flourish in the financial system.

28. Being considered a professional investor may be negative if they lack the appropriate understanding about the instruments or the services

involved. Some market participants may feel attracted to predatory trading on naïve, or unprepared clients.

29. Mis-selling is *a failure to deliver fair outcomes for consumers*, including providing misleading information or recommending unsuitable products (FSA, 2013b).

30. When discovered, five large banks were fined over 1.1 billion £.

31. These communications are not necessarily inappropriate, but *the frequent and significant flow of information between traders at different firms increased the potential risk of traders engaging in collusive activity and sharing, amongst other things, confidential information* (FCA, 2014).

32. Targets that cannot be achieved negatively impact behavior and create a culture of anguish in which mis-selling is much more likely (Davidson, 2016).

33. Disordered migrations, natural catastrophes, systemic failures and economic crises, among other factors, will generate financial instability in the future, unless climate change is limited drastically.

34. As they did with systemic risk before the 2007–2008 crisis.

35. See for instance Pope Francis´s discourse in 2015, arguing the following: "there are too many special interests [...] trumping the common good and manipulating information so that their own plans will not be affected [...] finance overwhelms the real economy. The lessons of the global financial crisis have not been assimilated, and we are learning all too slowly the lessons of environmental deterioration. [...] As long as production is increased, little concern is given to whether it is at the cost of future resources or the health of the environment [...] businesses profit by calculating and paying only a fraction of the costs involved. Yet only when the economic and social costs of using up shared environmental resources are recognized with transparency and fully borne by those who incur them, not by other peoples or future generations can those actions be considered ethical" (Pope Francis, 2015).

36. Finance is the second sector (after the government) with more confirmed data losses due to data breaches (Verizon, 2016).

37. A main failure of current theory is the *predictability* of future scenarios; we concentrate on things we already know, failing to take into account what we don't know (Taleb, 2007). We are not prepared for

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unexpected events that may alter the whole scenario (the so-called *black swans*).

38. As Upton Sinclair is frequently quoted saying, *it is difficult to get a man to understand something if his salary depends upon his not understanding it.*

39. In the period 1998-June 2016, Finance-Insurance-Real Estate has invested more than 7 billion US $ in lobbying in the US Congress. This represents 16% of the total amount lobbied in this period (CRP, 2016).

40. Some countries have imposed new taxes on bankers' bonuses, which would discourage looking for large bonuses (Le Monde, 2009).

41. This opinion seems to be flawed, as it does not compare these positive contributions to our society and economy, with the also real negative impact of the financial industry's actions.

42. What may happen if the British side of the negotiations imposes barriers to the mobility of people. The four freedoms of the European Union (freedom of movement for goods; services; capital; and people) are a single block that inspires the whole European project, and it is unlikely that any deal limiting the freedom of movement for people but keeping the single market would be accepted by the countries remaining in the European Union.

43. Key financial industry segments could be followed by auxiliary sectors, what given the relevance of physical presence in the financial center may increase the flight to a new financial center.

44. This term is commonly used but misleading: the ECB or the IMF do not regard them as full forms of money nor as defined in economic literature, or legally (ECB, 2016; He et al., 2016), at least for the time being. Virtual currencies are digital representations of value, not issued by a central bank, credit institution or e-money institution; which in some circumstances can be used as an alternative to money, and be accepted as a means of payment. Nevertheless, in October 2015, the Court of Justice of the European Union ruled that transactions to exchange traditional currencies for units of the "bitcoin" virtual currency (and vice versa) are exempt from VAT *under the provision concerning transactions relating to 'currency, bank notes and coins used as legal tender* (CJEU, 2015).

45. A category within virtual currencies which uses techniques from cryptography to preserve the anonymity or pseudo-anonymity of users.

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46. To be more precise, only the miner who solves the puzzle faster than all the others receives the new bitcoins.

47. *Shareholders' revolts* have started to be frequent in some quoted companies. In the 2016 annual general meeting of BP, 60% of the shareholders voted against the report on the remuneration of the CEO and top managers (BP, 2016). Shockingly, the CEO made it clear that the vote was not binding.

48. Environmental, Social, and Governance.

49. Przychodzen, Gómez-Bezares, Przychodzen, and Larreina (2016) found that financial professionals conducting ESG screening seem to prefer short-term decision-making. This might indicate that their behavior is influenced by what is *trendy* and not by fundamental reasons.

50. *After me, comes the flood*", implying that "*I don't care what happens after I'm gone*.

51. Both the Pope and a Central Banker highlight the essential role of finance in fighting climate change (Pope Francis, 2015; Carney, 2015).

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