

**The humbling of the Scottish banking industry during the financial crisis: *hybris*,
financialization and some Aristotelian responses.**

Abstract: Both large international banks in Scotland suffered enormous setbacks during the financial crisis that began in 2008, caused by vainglorious overreach. The definitive historical work on one of them is titled 'Hubris'. This paper examines the hubristic nature of both companies at the peak of their 'success' and considers the relationship between that and the phenomenon of financialization. It concludes with some reflections on Aristotle's economic and moral philosophy and how things might have turned out differently if the banks' managers and shareholders had thought about his ideas more carefully.

(Speaking notes)

Purpose and outline

Purpose is to summarize very briefly the facts of the two cases I want to discuss – the case of the implosion of the Royal Bank of Scotland, at one time in the early 2000s the largest bank in the world by market value; and the case of the rapid growth and speedy collapse of the Bank of Scotland. Both happened during the financial crisis that began in 2008.

I also want to set out the process of financialization of western markets and society, and argue that this was an important aspect of the context within which these two banks overreached themselves.

I will then look at how different conceptions of *hybris* affect my argument and relate it to the subject of this conference.

I then focus on Aristotle, because I believe his ways of thinking offer some ways of understanding what happened at these banks, before offering some tentative conclusions.

Before joining the university in 2017 as a researcher in philosophy, I was CEO of Scottish Financial Enterprise, the body that represents the financial services industry in Scotland, which is quite big and the biggest outside London in the UK. I worked with both these banks, and many other companies, during the financial crisis, and will draw on some of my own experiences in this presentation.

HBOS/Bank of Scotland

Beginning with HBOS, the ugly name of the company that emerged from an ambitious merger between the Halifax Building Society and the Bank of Scotland. Halifax was a financial company founded in 1853 as a mutual – a membership organisation – to lend money and to act as a safe place for savers to put theirs. Bank of Scotland was founded in 1695, only a year after the founding of the Bank of England. It still exists, making it one of the oldest banks in the world. When the companies merged, becoming HBOS, it was part of a wave of consolidation in the financial industry, creating bigger and bigger companies. But the mutual nature of Halifax was lost – a cultural loss to the country and to the economy, in favour of a shareholder-based structure.

As Perman sets out, the outcomes were a sales-driven culture, overseen by a CEO recruited from Asda, a very large supermarket business. This led to a dominant focus on making money in financial markets through trading, a development we will come back to as it is key feature of financialization of the economy.

Like the rest of the industry, senior people were paid a lot of money. When things went wrong, it was because of these things but, most of all, bad banking practice. In his foreword to Ray Perman's book, the former UK Chancellor of the Exchequer, Alistair Darling, says that primary responsibility for the bank failures of the financial crisis rested with the Boards of those banks. He also says that banking is 'not rocket science' and that the failures were caused by the abandonment of basic, well-understood principles of how to run a bank.

The bank ran out of money in 2009 and was bailed out by the UK taxpayer, as part of a move by government to prevent the whole banking system collapsing. That cost about £30 billion. It was taken over by Lloyds, another UK bank, and remains a subsidiary of that group. Halifax is also a subsidiary of that group, so the two parts of HBOS remain connected but operate separately.

There has been extensive investigation and analysis of what happened. Perman's book is the most readable but there are reports by the UK Parliament and financial regulators. Public opprobrium has been visited on the senior leadership but no prosecutions have taken place. One of the people involved, James Crosby, surrendered his

Knighthood, the designation 'Sir' in the UK honours system, the most visible example of dishonouring, undertaken voluntarily, in his case.

A few indicators of hubris, in the generally accepted modern meaning of that word:

- Bruce Pattullo, interviews by RP (p. 29), says ambition is to be the 'best-performing bank', not in Scotland, or the UK, but 'anywhere'.
- CH. 12, 'A Clash of Cultures' - experience and understanding was jettisoned, with no realisation of the loss.
- *Cloaca Maxima* is the name of Lord Stevenson's private company, through which salary was paid. I heard him once saying the whole crisis was of liquidity, not banking. Signs of hubris?
- HBOS moved into glamour lending, to high rollers like Philip Green. Not bypassing rules but could they remain unaffected by the praise and profile?
- BoS policy of 'staying at the table' - analogy drawn from gambling – gambling based on hubris?

Royal Bank of Scotland (RBS)

RBS was founded in 1727 –another very old bank. During the 1990s, the era of financialization, it expanded aggressively in the UK and grew rapidly internationally, at one point becoming the 'biggest bank in the world'.

It changed from being a Scottish, or British bank, to one being a supra-national entity in the globalised economy – an international bank that happened to be based in Scotland, as someone once described it to me.

Like HBOS, it collapsed because of bad banking practice – it lent far too much money on bad terms and embarked on a gigantically hubristic (in the modern sense) takeover of the Dutch international bank, ABN-Amro.

The bailout by the UK taxpayer was the largest in the world, by some measures, and RBS remains mainly owned by the UK government. No prosecutions have taken place but the former CEO, Fred Goodwin, received a lot of public vilification and dishonour and his knighthood was forcibly removed.

Some examples of hubristic behaviour:

- Goodwin wanted RBS to be the biggest bank in the world – bigger than Barclays and JP Morgan.
- “It is the story of how an over-mighty Chief Executive, corporate vanity rooted in patriotic pride and global ambition, misguided management, regulatory failure, and epic political hubris, all combined to produce a calamity.” (Martin, p.9).
- Goodwin in denial, like Stevenson
- Gogarburn building – story about design
- Obsession with details eg Christmas card
- p.232 - ABN Amro discussion moved without thought to ‘can we do this’ rather than ‘should we do this’.

Financialization

‘Financialization’ has become something of a portmanteau term, sometimes used to refer to the huge growth of the financial services industry in recent decades, sometimes to refer to more fundamental changes in the way an economy is measured and conceptualized. Professor John

Kay, in his book 'Other People's Money', in my view the best book written about the financial crisis and its causes, summarises the concept as follows:

"The finance sector today plays a major role in politics: it is the most powerful industrial lobby and a major provider of campaign finance. News bulletins report daily on what is happening in 'the markets' – by which they mean securities markets. Business policy is dominated by finance: the promotion of 'shareholder value' has been a mantra for two decades. Economic policy is conducted with a view to what 'the markets' think, and households are increasingly forced to rely on 'the markets' for their retirement security. Finance is the career of choice for a high proportion of the top graduates of the top schools and universities."

That is the social change. Within the financial industry, it creates some particular impacts which, I think, make hubristic behaviour more likely and perhaps inevitable. These include the diminution of the value attached to human relationships (an obvious conflict with Aristotle); the reshaping of business structures around financial markets rather than customers and economic purpose; and the exaltation of the role of the trader in those markets.

These changes were all taking place within the ascendancy in economic and political policy of market fundamentalism. The idea took powerful hold that markets lead, in general, to the best outcomes, if the objective is economic growth; and finance is the perfect setting within which marketisation can prosper, because everything can be made commensurable by numbers and mathematics. This facilitated a big shift, to use the famous dichotomy of Tönnies and Weber, from the personal and social to the structured and managed.

The restructuring focused on shareholder value and trading, at the expense of mutuals and partnerships, both business models based more on *Gemeinschaft* than *Gesellschaft*.

Risk becomes financialized and the unknowable – what might happen in future – becomes (it was wrongly believed) 'manageable'.

And, anticipating our discussion of Aristotle, exchange value dominates at the expense of use value.

This is the context within which the Scottish banks grew too rapidly and then imploded.

Hybris in context

N R E Fisher in his 1992 book characterises *hybris* as other-regarding: “..a serious assault on the honour of another, which is likely to cause shame, and lead to anger and attempts at revenge.” (p.1). He challenges the understanding of the term which has flowed into general usage, derived from dramatic sources and interpretations, and which is reflected in the title of Perman’s book and in the text of Martin’s. In both specific contexts, and in the reporting and analysis of the financial crisis in general, the interpretation rejected by Fisher holds sway – when the word is used, the author is describing an Icarus-like overreach, a failure to recognise the boundaries of the proper and proportionate, driven by vainglorious ambition. Wray (2016) rests on this popular idea of hubris, quoting a definition of it as “‘excessively self-confident, presumptuous, blindly ambitious, or other-wise lacking humility’

Wray's definition sums up how the concept is deployed in business literature and in the industry. 'Deal fever' is a jargon phrase used in the city of London for people who can't see the folly of what they are pursuing.

'Ambition' is seen as a virtue in modern business. Perhaps it always has been. Ambition in a market-based set of judgements about success, especially when financialized, means beating the competition and showing growth in financial value, not in other kinds of value. What are the limits of acceptable ambition and when does ambition become hubristic?

Kay notes that the ‘success’ of the RBS bid for ABN-Amro is an example of what economists call ‘the winner’s curse’. In any judgement of value, some people will value it too low, and lose out on the deal, and some will value it too high. Any winner has, by definition, paid more than the average judgement of the asset’s value. In that particular case, the curse was brought about by this misjudgement but also the hybriistic nature of the whole undertaking. The desire to succeed at the perceived expense of Barclays and other competitors was the main driver, many commentators have argued, of the whole misguided enterprise.

Turning to Fisher's description of hubris as based on intent to dishonour, I suggest that beating the competition, for RBS, was a form of dishonouring them and, in that sense, it fits with Fisher's view.

Aristotle

Douglas Cairns has pointed out the dispositional nature of *hybris*, challenging Fisher's interpretation of it as primarily related to actions of dishonour. Aristotle's most extensive treatment of *hybris* is in the *Rhetoric*, which is a guide to speaking and persuading. It is to be expected, in such a context, that Aristotle would focus on the practical aspects of how *hybris* is exhibited and discussed but Cairns argues convincingly that he does so from a dispositional grounding of the concept: "...as a desire to please oneself by demonstrating one's own superiority..." rather than grounding it in a desire to affect another person through some action.

HBOS corporate governance very elaborate and detailed but it didn't work – shows you can't overcome character? Took very detailed and expensive advice, partly to reassure externals. But the element of character in governance cannot be entirely erased, as the detailed rules around what it takes to be a 'fit and proper' person in UK regulation show.

In the *Rhetoric* and in the *Politics*, Aristotle identifies the young, the rich and the powerful as susceptible to the development of hubristic tendencies. Being rich and being powerful are, undeniably, characteristics of senior people in very large banks in modern economies. The power can be illustrated by the fact that RBS used to handle, every day, one pound in seven in the UK economy. The wealth has been widely documented.

Many have commented on the rapidity of growth at HBSO and RBS. The CEOs at the two banks, Fred Goodwin and Andy Hornby, were perceived to be relatively young when they took up the jobs. But I think it is stretching a point to suggest that Aristotle's analysis of why youth should be susceptible to *hybris* can be applied literally to the age profile of those leading the banks. There were plenty of grey hairs on both Boards. It is also reasonable to note the youth of the institutions in the form they had assumed. Both companies had hundreds of years of history behind them but they were newcomers as risk-taking, growth-driven, international banks. But, again, I think it is stretching a point to draw on Aristotle's discussion of youth and *hybris* in this context. He is, as in his ethical writings as a whole, talking about the individual soul and its character, and extrapolating that approach to the institutional level is problematic and beyond the scope of this paper.

The situation is different when it comes to wealth and power, which the leaders of both banks had in spades.

I also follow Professor Cairns in putting *hybris* in the context of Aristotle's treatment of justice and recognizing it as an example of injustice. The relationship between how we acquire and dispose of wealth in modern economies and Aristotelian justice is the main focus of my research. Aristotle's ideas of justice, and how we can act justly, have real relevance to the examples of HBOS and RBS. In particular, I want to argue that senior people at both banks, at and others, displayed the *hexis*, or state of character, connoted by the demonstration of *hybris* in their actions; and, again following Professor Cairns, that it is a form of *pleonexia*, or the desire for more than one's share, motivated not by the material or social gain that might follow, but by the desire for getting more than others for the sake of that objective alone.

Aspects of financialization immediately raise questions in the minds of Aristotelians.

In his analysis of economics in Book 1 of the *Politics*, Aristotle distinguishes between exchange value, facilitated by money, and use value, which embodies important things like the purpose or end of a particular object or commodity. It is part of Aristotle's metaphysics that the purpose of all things is a matter of primary concern and one of his criticisms of commerce is that it can mislead people into believing that money should be accumulated for its own sake, for its exchange value, rather than as a transient repository of use value. Financialization is the complete triumph of exchange value. Aristotle comments that money, unlike other things, has no intrinsic use value and, for that reason, it can be desired without limit. There is never enough. The behaviour of people in the banks we are discussing confirms that and financialization both facilitates and celebrates it.

The exaltation of the role of the trader is a big contrast with Aristotle's (and Plato's) scepticism of the moral value of trade; the celebration of making money from 'muppets' (to borrow a term used by the infamous Goldman Sachs trader 'Fabulous Fab' Turre), that is, people with less inside knowledge than the trader; and, of course, the removal of relationships between people

as a basis for organising human affairs conflicts with Aristotle's understanding of the *polis* as the setting within which individuals can achieve a eudaimonic life. One big consequence of this has been the relative decline of socially-based private sector financial provision, such as company pensions and pooled risk insurance and even, more recently, the notion of long-term employment based on reciprocity between employer and employee – the 'gig economy'. At the macro level, fiscal arbitrage, which is standard practice, contradicts any notion of the Aristotelian *polis*. This is where you adjust financial arrangements to trade off one tax against another, to save money. Kay: "Fiscal arbitrage is a means of taking money out of the pockets of the public and transferring it to advisers, traders and the firms that employ them." (p.123).

The exaltation of the role of the trader and transactions has been at the expense of agency-based models, where someone sells their service as a client's representative. Such models depend to a far greater extent on personal relationships and trust.

The belief that financialization allows risks of all kinds to be managed among super-informed and super-clever market actors has been shown to be false. As Aristotle reflects in his ethics based on the recognition that all situations requiring choice are different, the world is more complicated than such theories allow.

I think there are 4 aspects of Aristotle's philosophy which, if brought to the Board tables at both banks, would have led to better decisions (though I don't claim they would have been seen as such by the financial markets at the time).

Following Professor Cairns's assessment of Aristotelian *hybris* as a kind of injustice, Board members might have considered whether they were acting justly in what they were doing. They might have considered Aristotle's conception of general justice, and asked themselves whether their actions were lawful and whether the laws were justly made, and whether a *phronimos*, a person of practical wisdom, would consider their actions just in those terms and with an awareness of the broadness of the Greek idea of *dikaiosune*. Perhaps they would have concluded that what they were doing was OK, in those terms. But if they applied themselves to Aristotle's approach to particular justice, or the exercise of the virtue of justice in its own right, in a particular set of circumstances, they might have considered where the enormous profits they were making

were coming from and the fact that someone, somewhere was losing in proportion to their gain, and whether that loser was being treated justly. Perhaps they were distracted by thinking only of exchange value. If they then considered, after the crash, Aristotle's description of rectificatory justice, they would surely have concluded that they owed compensation to the many people who saw their savings disappear when the shares they had held for many years in the belief that they were safe lost nearly all of their value.

Boards might also have reflected on Aristotle's well-known insight into the social nature of the human being. A good life – a eudaimonic life – can only be lived in relationships with others. The downgrading of personal relationships in favour of financialized trading and the relentless focus on measurements derived only from monetary value would surely have concerned them.

If they had looked at the Politics, they may have wondered about the complete domination of exchange value as the lens through which success was calculated and measured. Exchanges in financial markets, if one believes they operate efficiently, involve winners and losers. Aristotle's idea of exchange was based on making needs and desires commensurable – his famous use of houses and shoes as products with different ends but made commensurable in exchange through the medium of money. Both the housebuilder and the shoemaker can meet their needs through exchange but the value to each of them of what they gain is not just the exchange value.

And perhaps both Boards might have considered the extreme practicality of Aristotle's approach to ethics. He observes that wise people proportion their expectations of knowledge and understanding to the topic in question – we cannot expect to have knowledge of ethics in the same way that we have knowledge of, say, mechanics or mathematics. Perhaps they could have seen a connection between that insight and the approach of business to risk, which seeks to think in structured ways about what is unknowable – namely the future. If they had thought it important to consider questions such as 'are we acting justly?', they could have put in place structures, as they did to such an extensive degree with risk, to address such questions. They could then have taken Aristotle's intensely practical ideas about ethical thinking and implemented them through these structures. They could have considered how to develop their capacities to consider such questions through habituation; they could have noted the value

attached by him and by Plato to the act of deliberation, in its own right; and they could have considered his particularism – his recognition that all situations are different and codes of practice and books of rules – which they largely followed, in fact – are no substitute for the exercise of practical wisdom.

This is all very easy to say after the event. But Aristotle is not a newcomer to our understanding of how to manage human affairs, so I think it is reasonable to conclude that if they had followed even just a few of these ways of thinking, things could have turned out differently.

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