**Ethics and the Financial Crisis: Why Incompetence is Worse than Greed**

**Boudewijn de Bruin**

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Willie Sutton, the notorious bank robber, was once asked why he kept robbing banks. "Because that's where the money is" was his terse reply. While true, his remark is also unsatisfactory: by stating only a general truth he fails to provide insight about his specific case. Particular events require particular explanations, not merely generalities.

In Ethics and the Global Financial Crisis Boudewijn de Bruin argues that the idea of epistemic virtue is necessary to explain the social and economic function of financial institutions, which in turn provides a standpoint from which to criticise the behaviours of individuals and institutions in the financial sector in recent years. The epistemic virtues that de Bruin proposes start with the love of knowledge. This is complemented by epistemic courage: the willingness to pursue knowledge in the face of resistance or disdain from others. In addition, de Bruin lists epistemic temperance (or appropriate scepticism), epistemic justice (or open-mindedness), epistemic humility (the opposite of hubris) and epistemic generosity (the willingness to share one's knowledge with others).

Epistemically virtuous people seek to adopt true beliefs, but they also recognise real constraints on the pursuit of knowledge: sometimes there will be insufficient evidence to acquire true beliefs; in other cases the resources required to gather sufficient evidence will be too onerous given one's other goals. De Bruin acknowledges that people who work in the financial sector are not engaged in the pursuit of knowledge for its own sake in the same way as those who undertake basic research in the universities. He rightly insists, however, that if those who work in the financial sector lack knowledge, it is likely that their other goals will not be met, resulting in a loss of welfare, not just for themselves but for society more widely.

What can financial institutions do to promote epistemic virtues among their staff? De Bruin suggests three management actions: first, virtue-to-function matching, for example managers should ensure that roles that require their holders to be open-minded are filled by individuals who exhibit (or are willing to acquire) that epistemic virtue; second, there should be organisational support for virtue, that is management structures should encourage virtuous behaviour instead of frustrating it; and third, there should be organisational remedies against vice, such that internal actions by management must counter epistemically unvirtuous behaviour when it is discovered.

I share de Bruin's view that the best way to think about the importance of virtuous behaviour in financial institutions, and the best way to cultivate such behaviour, is by reference to epistemic rather than moral virtues. I also welcome his desire to resist simplistic views and stereotypes of financial practitioners. It is not sensible to judge the character of the many thousands of people who work in the financial services industry based on the behaviours of those few whose incompetence and venality has been exposed.

The book, nevertheless, has two problems. First, for someone who extols the love of knowledge, de Bruin might have demonstrated a greater level of engagement with some of the financial issues he discusses. He writes:

"A casual glance at the popular literature on the global financial crisis reveals a careless disdain for investigation amongst consumers, finance practitioners, overseeing authorities, journalists and politicians. Few people bothered to read the prospectuses that came with mortgage-backed securities, to do the research that financial due diligence requires, or to engage in more than superficial search behaviour about suitable house loans" (p.77).

There is good reason, however, why such prospectuses remained largely unread. As Gary Gorton and Bengt Holmström have argued, for debt markets to function efficiently they rely upon the "information-insensitivity" of debt instruments. That is, they rely on a shared ignorance among buyers and sellers regarding the *precise details* of the instrument being traded, which presumes a shared agreement that these details are not material to the price of the transaction. In this instance, ignorance is a characteristic of the market in steady-state.

Financial due diligence did not require traders and risk managers to be experts in the detail of these securities. What it required was an understanding that if and when residential property prices fell in the US, the market for mortgage-backed securities would rapidly become illiquid as a consequence. It was the lack of anticipation of a run on liquidity that was the problem, not the small print of the prospectuses.

This examples is indicative of the second, larger problem. De Bruin's description of the epistemic virtues is made timely by his suggestion that the financial crisis was caused by lack of competence. This connection generates a sense of relevance and urgency about his book. However, de Bruin's explanation of the "why" omits a detailed description of the "how": the precise mechanisms by which the lack of epistemic virtue became a material cause of financial failure. His best example - the uncovering of the Madoff fraud - is well described. But Madoff's activities, however deplorable, did not cause the financial crisis.

Lack of epistemic virtue in the financial services sector probably did contribute to the financial crisis in a number of important ways. To go beyond the generalities, however, would require a detailed application of those same epistemic virtues, and in particular the courage to pursue knowledge despite what de Bruin sees as the public's disdain for anything other than simple morality tales.