Thinking faith
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St Thomas Aquinas and the Temple of Mammon

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It emerged last week that a 31-year-old Parisian trader, ostensibly on a frolic of his own, cost Société Générale nearly 4.9 billion Euros. Joe Egerton, who has advised on financial regulation since 1986, suggests that London may be better protected than other financial centres thanks to a system of regulation which looks and feels like St Thomas's virtue ethics.


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Jerome Kerviel is not the first trader to damage a major bank. There are a number of examples in London, although significantly all from the 1990s. In February 1995, Barings was destroyed by losses in the derivatives markets caused by one trader, Nick Leeson. In 1996, Deutsche Bank paid investors in its unit trusts several hundred million pounds to compensate for unauthorised speculative investments made by Peter Young. On 28 November 1997, J P Morgan caused the FTSE to fall 38 points in the last seconds of trading by selling more shares than were required to unwind a position, thus getting out of the need to pay £475,000 to a counterparty. Two employees were accused by the regulator of lack of integrity and convicted by its tribunal after the regulator's QC had pointed out the losses caused to large numbers of innocent investors by the fall in the index. In December 2000, Equitable Life was forced to close its doors as a result of years of paying bonuses and giving costly guarantees on a scale that was strongly criticised by Lord Penrose's subsequent report.

Between 1997 and 2001, the Financial Services Authority (FSA) progressively took over the regulation of the City. Since then, there has been only one major corporate failure – Northern Rock; and that was brought about by a defective business model, not individual traders. There is a balance to be struck between security and vitality in any commercial market, so the FSA cannot deliver a failure-free environment. While there are lessons to be learned from Northern Rock, if absence of disaster is a good measure, the FSA has so far done rather better than the predecessor regulators in dealing with the City.

This is not, I think, just good luck. It is certainly not a result of more (and increasingly complex) rules. The FSA has reduced the number of rules drastically – on at least one occasion provoking protests from the regulated that they actually wanted the FSA to preserve detailed regulation! The FSA – and indeed the City's success – is, I suggest, a result of the FSA introducing what it calls "principle-based regulation".

What is "principle-based regulation"? Go into the FSA's statement of principles for individuals and you immediately find a set of positive injunctions: [i] 1. Act with integrity. 2. Act with due skill, care and diligence. 3. Observe proper standards of market conduct. 4. Deal with the FSA and other regulators in an open and cooperative manner. There is also a set of principles for firms[ii], starting again with "Act with integrity", and including in Principle 6 "treat clients fairly".

Look in the Summa Theologiae of St Thomas Aquinas, and you find a series of virtues – including justice, truthfulness, diligence... There is a further similarity – after discussing a virtue, St Thomas goes on to identify the vices opposed to it; similarly the FSA gives examples of what it is to act without integrity or due care and skill. Thus the FSA cites as an action opposed to integrity "deliberately misleading or attempting to mislead" [iii], echoing St Thomas's comment that seeking to cause another to have a false opinion is "not a species of lying, but its perfection"[iv]

This is a major shift from the old rule-based approach – a practitioner cannot just look at a set of rules, and tick a box. It is necessary to ask whether an action is consistent with the principles or virtues that the FSA espouses. There are of course rules – but these rules are secondary to the Principles in the FSA rule book just as they are to the virtues in the Summa.

The FSA also appears to have been successful, especially in the City, in communicating a message that individuals are personally responsible both for their actions and of those of their subordinates – another strong Thomist point. It is entirely clear in the current Société Générale case that there were warning signs. This was also true of the City debacles of the 1990s. The regulator alleged that those responsible for managing Peter Young failed to respond to warning signs. From my knowledge of what happened at J P Morgan, JPM lacked the safeguards other investment banks had in place to prevent the sort of overselling that occurred. In this case, nobody seemed to have asked whether there was proper management of a profitable division. In the Barings case, senior management had not questioned what was going on as long as Leeson was making lots of money. In the Equitable case, Lord Penrose's report revealed fundamental failure on the part of the Board.

The senior managements in the companies that were damaged or destroyed had done nothing criminal. Their failure was that they had simply not asked the questions that would have revealed what was going wrong at an early stage. All of these are failures in acting according to virtues by individuals or even understanding what these virtues require.

The approach of senior management was very much like that of the Pharisee in the Temple: 'God, I thank you that I am not like other men—robbers, evildoers, adulterers—or even like this tax collector. I fast twice a week and give a tenth of all I get.' (Luke 18.11). That is to say, "I have ticked all the boxes." In every single case, senior individuals simply failed to understand what the virtues such as prudence require. The subsequent complaint against them was either that they had not done not an examination of what was going on, and they had not properly engaged in the activity of judging their own judgment[v], or, if they had, they had felt comfortable with something that should have made them feel queasy, that is they lacked the appropriate understanding of principles or virtues. They also lacked that important understanding of a hierarchy of objectives, in which making a profit is only one, an understanding that is a central characteristic of St Thomas's Aristotelian account of the virtues.

We may of course today find in harsher market conditions people being put under pressure to produce results, leading to short cuts, not giving enough time and care to solve problems, even to deliberate dishonesty. Such is the frailty of human nature. However, to the extent that the FSA has succeeded in inculcating the principles or virtues, the effect of such failures is likely to be limited as the principles or virtues guide most firms and most individuals.

There really is a difference between a system in which the only way of measuring success is money made and rules are seen as constraints to be got round and a system in which there is a shared understanding of the principles or virtues that should govern conduct, even if on occasion individuals fail through weakness of will to do what they know they should. Whether the FSA consciously followed St Thomas or whether it unconsciously responded to the revival of virtue ethics over the last half century - a case of practical men being the slaves of a long dead philosopher[vi] - is of no great importance. What matters is a real achievement of the FSA, to displace – at least in the City if not in some retail markets – the error that regulation can be a substitute for ethics and to inculcate the glimmering of a recognition of the fundamental requirement to acquire the virtues and to act in conformity with them.

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[i] http://fsahandbook.info/FSA/html/handbook/APER/2/1
[ii] http://fsahandbook.info/FSA/html/handbook/PRIN/2/1
[iii] http://fsahandbook.info/FSA/html/handbook/APER/4/1
[iv] Summa Theoligiae IIa IIae Q110 Art1
[v] Human rationality is the ability voluntarily to engage in judging our own judgement (St Thomas, De Veritate 22) St Ignatius of Loyola gives us a process to do this in the Spiritual Exercises - The Examen.
[vi] I am of course repeating Keynes: *The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.* Canonised saints, of course, are by definition **not** defunct.