

*How can we Accelerate
the Rebuilding of Trust
and Confidence in
Financial Services?*



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Introduction: A Question of Trust

If trust in financial services is lost, the most important fabric which holds economies and societies together is torn.

*Larry Elford, Director
of the Canadian Justice Review
Board of Canada*

It is no secret that the Global Financial Crisis of 2007/8, the 'Great Recession' that followed and the myriad of economic and socio-political aftereffects of these events have severely eroded public trust in the financial services sector. The UK's record-low-levels of savings and engagement with financial services points to the persistence of this lack of confidence; a harsh reality that must be of grave concern to policymakers and regulators.

The financial services sector's very existence is dependent upon retaining customers and building business, and therefore public faith in the ability of financial institutions to deliver on their promise to hold and return their customers' investment is not only important but vital to the industry. The term 'credit' is derived from the Latin 'credere', literally meaning 'belief in', and financial services institutions are dependent on public faith in their ability to deliver on their promise and in their capacity to hold and return their customers' investments.

With trust in the financial services sector severely dampened by successive failures and high-profile incidents, a new generation of competitors in FinTech and cryptocurrency are increasingly being considered as viable alternatives to the traditional banking system. While these services are still very much in their infancy, they are still reliant upon the credit system, upheld by the public's faith. Trust, therefore, on the part of all stakeholders, policymakers and regulators, industry and consumer bodies, businesses small and large, and consumers themselves, is integral to the prevention of future systemic crises as well as the safe, stable and efficient "business as usual" workings of the financial system on a day-to-day basis. Trust is not just the first line of defence in bolstering the resilience of our financial system; it is the very oxygen on which its survival depends.

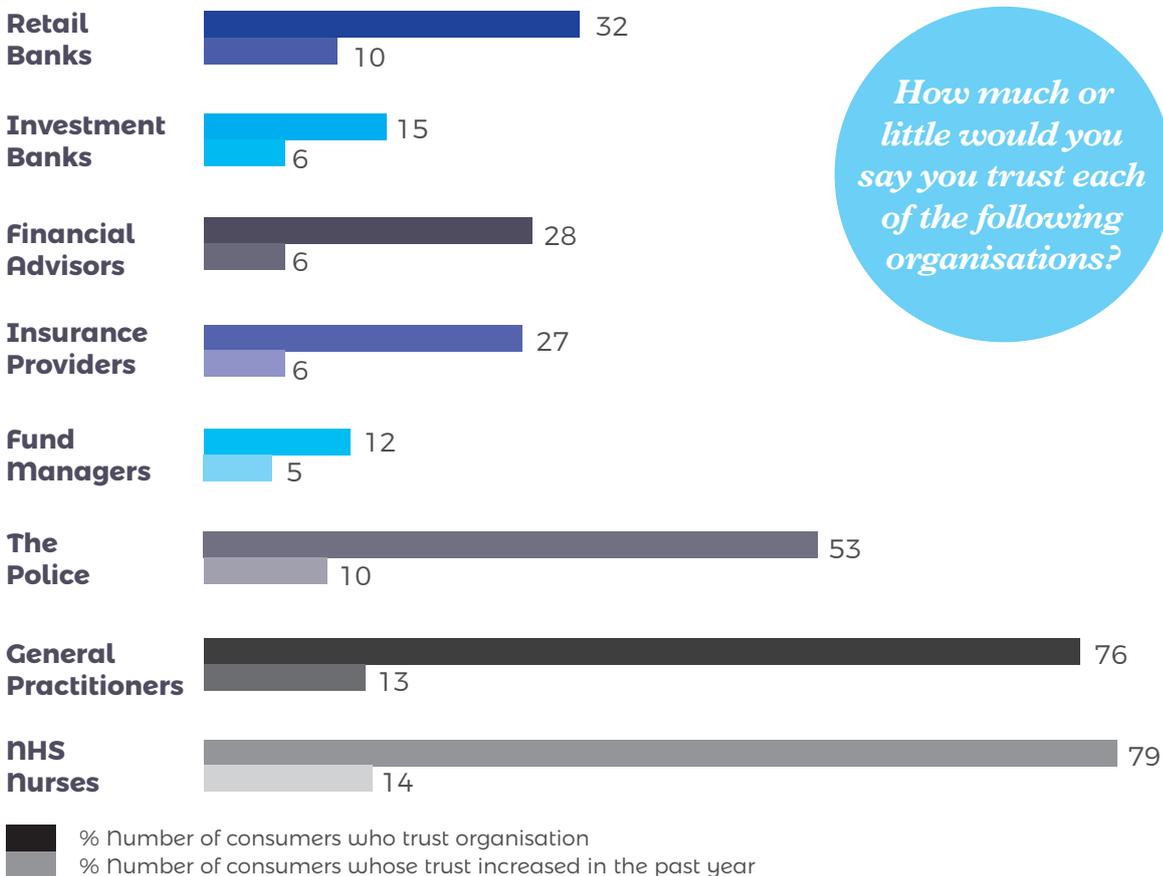
Trust in regulators and policymakers under whose watch the Global Financial Crisis occurred has also been severely damaged, despite the best efforts of these public servants to ramp up consumer and investor protection in recent years. Not only has faith in financial services institutions been eroded by past undesirable events, so too has the public's confidence in the regulators' capacity to control these institutions.

A recent survey conducted by PwC found that 57% of respondents believed that reforms to regulation, implemented since this financial crisis, were not enough to guarantee that history would not repeat itself.¹

The evidence points to a dangerous disconnect between a sector that depends on public trust to function correctly. It is imperative that actions are taken to remedy this.

The financial services sector includes a range of organisations such as retail banks, investment banks, financial advisers, fund/asset managers, pension companies and insurance providers who all suffer from the lack of consumer confidence in the sector. The graph below breaks down the variations in the trust in different financial organisations, illustrating that the public has the lowest trust in fund managers: only 12% of consumers trust them, closely followed by investment banks, financial advisers and insurance providers. Additionally, just 5% of consumers trusted fund managers more in September 2018 than was true a year earlier.

How trust in financial services firms has been eroded



Source: Stylianides, G. 'Stand out for the right reasons How financial services lost its mojo - and how it can get it back'. PwC UK. Available at <https://www.pwc.co.uk/assets/pdf/fsrr-consumer-survey-final.pdf> (19 September, 2018).

Given the enormity of the task laid at the feet of regulators and officials in terms of enshrining better outcomes for everyone who engages with the sector, the onus of responsibility for the financial well-being and security for the individual is gradually shifting from the state to the citizen.

¹ Stylianides, G. 'Stand out for the right reasons How financial services lost its mojo - and how it can get it back'. PwC UK. Available at: <https://www.pwc.co.uk/assets/pdf/fsrr-consumer-survey-final.pdf> (19 September, 2018).

This is particularly tough in the current climate - characterised by time deprivation, mobile lives, the gig economy, zero hours contracts and “the squeezed middle.” Today, financial security is more challenging for governments to provide than ever before. It is becoming clear that if people want financial security, they will need to make use of a transparent and responsible financial services sector on which they can rely to provide them with the wealth creation and preservation they need.

Against this ‘sink-or-swim’ backdrop, it is vital that the financial services sector gets its house in order, and is seen to be acting as a safe pair of hands, upon which consumers and the business community can rely. Without this confidence, it would be irrational for anyone, or any institution, to put their faith in a sector that has historically fallen short of required standards on an all-too-frequent basis.

Recent surveys indicate that these historic failures have had long-term consequences for how the public think about and act towards the financial services sector. A YouGov Omnibus Survey conducted in 2017 found that, while the British public is generally confident in the competence of the high-street banks that they use (67%), they are highly sceptical towards those banks’ motives. Only 36% of those surveyed said they would trust their banks to act in their interests². In Italy, France and Japan, this level of scepticism was found to be greater still.³ It is evident that the memory of past failures still impacts the public’s regard for the FS sector.

The Transparency Task Force (TTF) recognises that there is a need for a financial services industry that is truly trustworthy and can be relied upon

to deliver fiduciary responsibility. We believe that “progress begins with pragmatism” and have therefore commissioned a study to compile and catalogue various financial crises and incidents that have undermined confidence in the sector.

Aim of this review

The TTF has commissioned this report to serve as a point of reference for policymakers, regulators, academics and financial services professionals to reflect upon the trust deficit consequences of financial crises, malpractice and poor market conduct. This reference should enable them to take a proactive approach to self-regulation, fiduciary responsibility and the prediction of future issues in the traditional and established parts of the market as well as the newly-emerging areas such as cryptocurrencies.

The report provides a comprehensive review of the major events that have impacted the UK financial services sector since the introduction of the Financial Services Act in 1986, when Margaret Thatcher’s government originally sought to regulate the financial services industry. The Act itself used a mixture of governmental regulation and self-regulation and created a Securities and Investments Board presiding over various new self-regulating organisations. The report will also examine the causes of the various crises⁴; the remedies that stimulated recovery; how public trust was affected and whether these crises were preventable.

It is the TTF’s hope that our examination will provide useful insight for the Financial Conduct Authority’s (FCA) Discussion Paper on Duty of Care and will point to the need for persistent and purposeful policymaking to fix the trust deficit problem.

² Palenicek, J. (2017). ‘Most Brits trust banks but don’t think they work in customers’ interests. YouGov. Available at: <https://yougov.co.uk/news/2017/05/19/most-brits-trust-banks-dont-think-they-work-custom/> (25 August 2018).

³ Ibid. Palenicek.

Methodology & Chronological Review of the Great Crises

The report is divided into sections that tackle the questions of preventability and stakeholder trust in the US and UK. First, the savings and loans crisis of the mid-80s to mid-90s will be explored to provide an initial point of reference. Next, the Dot-Com Bubble is examined, as this demonstrates an important example of how consumer investor optimism, trust, operational ambition and speculation can dramatically inflate the value of an emerging asset or sector at each respective stakeholders' peril. Sticking to chronological order, the study then reviews the 2008 Financial Crisis and the Great Recession that followed. This episode and its aftermath significantly affected and continues to affect, stakeholder trust in the financial service sector. Its causes and preventability have long been discussed by commentators, policy makers and academics. Following this, the study will take a view on the current European Debt Crisis. This monetary union created the prime economic conditions for debt accumulation but also failed to provide a viable alternative to the tools individual nations formerly used to combat an economic decline in the event of a recession. This crisis illustrates how policymakers, financial services firms and regulators damaged public trust in the financial services sector by mismanaging fiscal policy.

Furthermore, some consideration is paid to 'rogue actors', such as Toshihide Iguchi, Jerome Kerviel, Kweku Adoboli and Bernard Madoff. This section will examine these cases and demonstrate how the publicity of lone actors can significantly damage public trust in the wider financial services sector's ability to self-regulate and provide adequate oversight, by effectively humanising institutional systemic failure. These

individuals were widely referenced in the global press, increasing the exposure of the financial services sector to the public's ire. Finally, the last section of the report will tackle the issue of public mistrust in emerging areas of financial services and technologies, such as cryptocurrencies, due to the secretive and opaque nature of these new niche markets.

Each section of this report is composed of sub-sections that provide a concise summary of a well-known crisis and the causes of that particular event; discussion as to whether this crisis was preventable or not; an analysis of the effect that this failure had on the public's engagement with financial services; an appraisal of the long-term effects that mistrust has had on various stakeholders and, for each crisis, a case study example of a specific financial brand that bore the brunt of the failure.

This report will show the key factors that damaged public trust in the financial services sector and how the collective memory of these events has caused an erosion of confidence. By classifying these crises into 'preventable', 'possibly preventable' and 'unpreventable', we aim to outline where it may have been possible to avert such failures and provide a point of reference for financial services institutions and its professionals to halt recurring negative cycles of behaviour and ethics in the case they re-emerge in the future. Notably, understanding how public trust has been damaged can provide an important benchmark of reflection for the financial services sector to understand that their actions have long-lasting reputational consequences for their industry and accompanying participants.

Literature Review: Trust Equals Full Stakeholder Buy-in by All Parties Involved

Several scholars highlight the importance of trust and in the financial services sector. Robert C. Merton argues that trust has played a foundational role since the origins of banking – with the notion of “my word is my bond” – determining the essence of banks regarding their safekeeping and depository functions⁴. Lynne G. Zucker, a researcher in the sources and production of trust, notes that ‘trust’ is a set of expectations shared by all parties involved in an interaction, such as a financial transaction⁵. Therefore, for the public to place its trust in various financial services, the entire industry needs to declare and adhere to the expectations of this consumer audience.

Since trust is fundamental to any successful global economy, Diane Coyle argues that, without a foundation of trust, the financial services sector effectively has no value. This is because every financial transaction requires one party to trust the other as a counterparty, especially as companies are increasingly valued by their intangible assets⁶.

Luigi Guiso counters that the recent decline in public trust is not due to a lack of confidence in the banks but arises because of the public’s perceptions of deception and

misbehaviour. Stories about financial scandals, such as Libor fixing, dominate both the front page and business pages in the global media, and this negative publicity compounds the erosion of trust in financial services⁷. Rogue trading examples such as Bernie Madoff’s Bernard L. Madoff Investment Securities LLC Ponzi scheme vehicle deceived a multitude of stakeholders. It is interesting to note that research shows that the geographical areas with a high share of Madoff victims today have the lowest trust towards financial services⁸.

Angus Armstrong contends that faith and trust need to be restored in banks to stimulate economic activity. He argues that low levels of trust will be consistent with bank vulnerability, which will lead to less finance-for-risk investment in profitable investment projects and consequently stagnant or low economic growth⁹.

In assessing how public trust has been affected since the beginnings of regulation in 1986, the preventability of events also needs to be analysed. The decline in public trust correlates to the extent of preventability: if a crisis could have been avoided, then it is likely to create greater frustration leading to a sharper decline in public trust than if the incident was non-preventable.

4 Thakor, R & Merton, R. (2018). ‘Trust in Lending’. Available at: <http://robertcmerton.com/wp-content/uploads/2018/07/Trust-in-Lending-June-2018-11B&R-w24778.pdf> (25 August 2018).

5 Zucker, L. (1985). ‘Production of Trust: Institutional Sources of Economic Structure, 1840 to 1920’. Available at: <http://digitalassets.lib.berkeley.edu/irle/ucb/text/irle0277.pdf> (28 August 2018).

6 Coyle, D. (2011). ‘The Economics of Enough: How to Run the Economy as if they future matters’. Princeton University Press. Available at: <https://www.jstor.org/stable/pdf/j.ctt7t047.8.pdf?refreqid=excelsior%3A551c1d2f4507dbf24b1bf911dafc83cc> (24 August 2018).

7 Vanston, N. (2012). ‘Trust and reputation in financial services’. Government Office for Science. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/289064/12-1090-dr30-trust-and-reputation-in-financial-services.pdf (24 August 2018).

8 Armstrong, A. (2012). ‘Restoring Trust in Banking’. National Institute Economic Review. no. 221. pp. 4-10. Available at: <https://www.jstor.org/stable/pdf/43498697.pdf?refreqid=excelsior%3A48e2b84263570ee84a5b0334c37e0e03> (27 August 2018).

9 Ibid.

Consumers must trust financial services providers for two basic reasons: information asymmetry and efficiency impediments.

Consumers commonly lack the expertise of financial services providers, so they must “rely” on those providers to accurately ascertain their needs, and then provide products/services that are fit for their purposes.

Consumers are often unable to acquire the expertise to design and execute their own financial transactions; consumers are engaged in making an optimal choice in the minimum amount of time necessary to do so. For example, they are not able and willing to become experts on world economics to select a travel currency and price the exchange. They must rely upon foreign exchange service providers to provide accurate pricing.

*Paul Bates, Barrister,
Outer Temple Chambers*

1) Savings and Loan Crisis (1986-1995)

The Savings and Loan crisis stemmed from various financial services institutions gambling with the system-created odds they faced. When these bets turned sour, and it became clear that the institutions would collapse, instead of disclosing this failure to the public and acknowledging its unsustainability, the U.S. government launched what was effectively perceived as a full-scale cover-up. The proverbial ‘sweeping under the rug’ that came with the ever-increasing regulatory forbearance measures meant that this collapse was altogether more disastrous than it might have otherwise been. Much like the sovereign

debt crisis of 2007-12, policymakers delayed (and therefore intensified) the result of unsustainable activity (lending in the case of the Savings and Loan crisis and borrowing in the case of the sovereign debt crisis).

Rogue traders acting for personal benefit and self-interest are generally unpreventable factors for financial institutions to control as it concerns the actions of an individual, like a ‘bad apple’ police officer. Even though proper controls and procedures can constrain the impact of their behaviour and protect clients from loss, news of unethical behaviour by individuals creates significant public distrust. This is partially due to the media attention their negative actions garnered, along with the notoriety that accompanied the global commentary around the respective scandals. Some may argue that Hollywood may have played a part in encouraging this fame somewhat by glamorising such financial crimes, as exhibited by Jordan Belfort in Martin Scorsese’s *Wolf of Wall Street*, Nick Leeson in *Rogue Trader* and even the original Wall Street movie directed by Oliver Stone¹⁰.

What happened?

The Saving and Loan Crisis began in 1986 and reached its peak at the beginning of the 1990s, after years of deregulation which allowed Saving and Loan Associations (S&Ls) to lend long-term at fixed rates, using short-term funds. During the 1970s, stagflation and slow growth devastated the S&Ls, so that they were losing \$4 billion per

¹⁰ Friedlander, W. (2013). ‘Does ‘Wolf of Wall Street’ Glorify Criminals? Yes.’ *Variety*. Available at: <https://variety.com/2013/film/columns/does-wolf-of-wall-street-glorify-criminals-yes-1201016401/> (27 August 2018).

year by 1982¹¹. This triggered President Ronald Reagan to introduce a series of deregulation programmes. Misguided federal deposit insurance rates and rising interest rates caused the failure of 1,043 out of the 3,234 S&Ls. Since many institutions had been allowed to sell their customers uninsured types of certificates with higher interest rates than regular deposits, their failure destroyed the life savings of many Americans. Reagan's deregulation programme enabled S&Ls to make large, high risk loans. Assets increased by 56% as a result¹². When these S&Ls encountered liquidity issues, the government permitted them to remain open and continue to make toxic loans to put off the inevitable systemic collapse. The subsequent cost of bailing out the Federal Saving and Loan Insurance Corporation (FSLIC), which insured the deposits in failed S&L's, reached \$160 billion, costing US tax payers \$132 billion¹³.

Why?

The inevitable collapse of the S&L institutions was caused by a combination of inflation in the late 1970s, and an unexpected rise in interest rates as high as 21.5 percent¹⁴. The institutions were unable to respond to the spike in interest rates because the federal government set an interest rate cap on the S&L institution's deposits. With the saving and loans organisations being prevented from raising their

interest rates, they could not compete with other financial service institutions. Consequently, savers withdrew their capital because the interest rates were too low, leaving the S&Ls without funding.

In effect, the entire S&L legal and regulatory structure was built to encourage and facilitate home ownership. In so doing, it introduced rigidities into the system that were sustainable in the benign economic environment of the decades following the end of World War II. The massive economic disruptions caused by the two oil price shocks of the 1970s pushed this structure to the breaking point. This event highlights how important it is for regulators to enable institutions to adapt to changing competitive market forces¹⁵.

This crisis provoked Reagan to deregulate the savings and loans sector and pass the Depository Institutions Deregulation and Monetary Control Act in 1980¹⁶. Although intended to alleviate pressure on the sector, this exacerbated the problem as the deregulation of the S&L institutions gave them the capabilities of banks, without the same governance, according to Kenneth Robinson from the Federal Reserve Bank of Dallas. For example, they could invest directly in commercial, corporate and business loans equal to 5 percent of their assets; as well as make real estate loans without

¹¹ *The Alert Investor*. (2015). 'Here's what the major interest rate cycles since the 1970s have looked like'. *UK Business Insider*. Available at: <http://uk.businessinsider.com/every-interest-rate-cycle-since-1970s-2015-12?r=US&IR=T/#march-1972-to-late-august-1973-1> (27 August 2018).

¹² Villchur, E. (1990). 'Reagan Set Table for Savings and Loan Orgy.' *The New York Times*. Available at: <https://www.nytimes.com/1990/08/23/opinion/l-reagan-set-table-for-savings-and-loan-orgy-892090.html> (27 August 2018).¹³

¹³ Ely, B. 'Savings and Loan Crisis.' *The Concise Encyclopaedia of Economics*. Available at: <https://www.econlib.org/library/Enc/SavingsandLoanCrisis.html> (26 August 2018).

¹⁴ Amadeo, K. (2018). 'How Congress Created the Greatest Bank Collapse Since the Depression'. *The Balance*. Available at: <https://www.thebalance.com/savings-and-loans-crisis-causes-cost-3306035> (26 August 2018).

¹⁵ Yago, G & Barth, J. (2004). 'The savings and Loan Crisis: lessons from a regulatory failure.' *Milken Institute*. Available at: <https://www.milkeninstitute.org/publications/view/230> (28 August 2018).

¹⁶ Robinson, K. (2013). 'Savings and Loan Crisis.' *Federal Reserve History*. Available at: https://www.federalreservehistory.org/essays/savings_and_loan_crisis (27 August 2018).

regard to location¹⁷. Despite being less regulated, the saving and loans industry was unable to compete in the financial industry so they carried out more risky investments and aggressive lending, leading to huge losses and their inevitable collapse¹⁸. The excessive and rushed deregulation contributed to the escalation of the crisis. As Dale Steinreich argues, regulation and legislation to solve an issue can make economic conditions not better, but worse¹⁹.

Was it preventable?

At the very least, the magnitude of the damage from the failure of the saving & loans institutions could have been constrained. Charles Keating's fraud and the bankruptcy of the FSLIC should not have come as a surprise given the lack of regulation and public policies since the 1930s which had predetermined the outcome. Policymakers were aware of the imminent crisis, given the fact that many of the policies implemented at this time were made in a desperate attempt to postpone addressing the worsening situation. If the banking systems had adopted a more flexible approach, the S&L banks could have adapted to the economic conditions suitably and deregulation would not have been necessary. Arguably, Charles Keating's actions were unpreventable; because the government cannot control every individual. However, his actions were facilitated by a lack of regulation and senators who were willing to work

with him, instead of stopping him.

The failure of the S&L institutions was a regulatory and government failure rather than a market failure. The government forced S&Ls to assume excessive interest rate risk exposure and minimized their credit, creating a deterioration in the long-term trust for the Republican party and US government²⁰. However, after the crisis, the S&L institutions placed importance on maintaining a favourable political environment. Between 1992 and 2008, political campaign contributions from the financial sector nearly tripled, for both the Democrat and Republican parties²¹. This demonstrates the S&L institutions efforts to improve relations between themselves and policymakers to elicit government support at the expense of the public purse.

Especially in times of crisis, confronting the hard truth is critical. Transparency and honesty is the only way to minimise the damage to reputation and trust along with frequent updates on progress to repair the situation. The speed in which a response comes when news breaks is a defining moment of perception from the wider public.

*David Hannam, Co-founder,
SharesInside*

¹⁷ Slifer, D. (2008). 'And the walls came tumbling down: deregulation and the current financial crisis.' *Illinois Business Law Journal*. Available at: <https://publish.illinois.edu/illinoisblj/2008/11/10/and-the-walls-came-tumbling-down-deregulation-the-current-financial-crisis/> (28 August 2018).

¹⁸ *Ibid.*

¹⁹ Steinreich, D. (2014). 'The Savings and Loan debacle twenty-five years later: a misesian re-examination and final closing of the book'. *Quarterly Journal of Austrian Economics*. vol. 17, no. 2. pp. 154-178. Available at: <https://mises.org/library/savings-and-loan-debacle-twenty-five-years-later-misesian-re-examination-and-final-closing> (29 August 2018).

²⁰ Kaufman, G. (1995). 'The U.S. Banking Debacle of the 1980s: A Lesson in Government Mismanagement'. *Foundation for Economic Education*. Available at: <https://fee.org/articles/the-us-banking-debacle-of-the-1980s-a-lesson-in-government-mismanagement/> (3 September 2018).

²¹ McCarty, N. et al. (2010). 'Political Fortunes: On finance and its regulation'. *Daedalus*. Available at: https://www.princeton.edu/~nmccarty/REVISED_Daedalus.pdf (3 September 2018).

How was trust affected?

According to a Gallup survey, the savings and loan crisis combined with the recession of the early 1990s “saw confidence in banks tumble from 51% in 1987 to 30% in 1991.”²² Only 30% of the public expressed a ‘great deal’ or ‘quite a lot’ of confidence in banks in 1991.²³ The decline in public trust was a combination of the requirement of taxpayers to finance the bankruptcy of the FSLIC, without an understanding of why the crisis occurred and the misconduct of five US senators - the “Keating Five,” who profited from the risky and unsustainable behaviour of S&Ls. Despite working within the legal framework, Charles Keating made millions of dollars through risky investments that defrauded the people who had invested in his companies: Lincoln Savings and Loan and American Continental Corporation. Keating gave five senators \$1.5 million and in return they put pressure on the Federal Home Loan Banking Board to overlook the suspicious activity carried out by these companies. Consequently, the trust for banks plummeted when thousands of Americans lost millions of dollars in the institutions they had trusted with their savings²⁴.

Moreover, investors lost faith in financial services product providers who seemed to have manipulated the public and regulatory stakeholders to benefit themselves, as during the S&L crisis they sold risky and uninsured bonds to customers and fuelled an unsustainable commercial real estate bubble. This

selfish behaviour proved that this specific area of the financial services sector was not looking after their investors’ interest or acting responsibly with the public’s money²⁵. Perhaps this is a prime example of how a Duty of Care approach to regulation could be beneficial.

The public only learnt about the crimes of the “Keating Five” eight years after they had been associated with the saving and loans industry. Despite being the most prolific, this scandal was not isolated, and many more individuals benefited from taxpayer funded support. Moreover, regulators and politicians happily ignored the crimes of individuals, such as Charles Keating, for personal gain. This implied to American citizens that their interests were not the focus of banks or the Government, eroding their trust in these institutions. If the “Keating five” had faced harsh, appropriate punishments for their crimes, faith may have been restored in the government; however, Keating only served four and a half years in jail as his conviction was overturned in 1996. The five senators were only subjected to minor sanctions, due to Congress’s propensity to protect its own, and two of the senators even went on to run for President of the US²⁶. Despite the fall in trust and confidence in banks in the early 1990s, according to a Gallup poll, trust was restored in the late 1990s and early 2000s to 44% due to the response to 9/11, greater accessibility to credit and prosperous economic growth²⁷.

²² Dugan, A. (2015). ‘Confidence in US Banks Low but rising.’ Gallup. Available at: <https://news.gallup.com/poll/183749/confidence-banks-low-rising.aspx> (29 August 2018).

²³ Ibid.

²⁴ The Daily Take (2014). ‘Charles Keating and the Lessons of the Savings and Loan Crisis.’ The Daily Take. Available at: <https://truthout.org/articles/charles-keating-and-the-lessons-of-the-sl-crisis/> (29 August 2018).

²⁵ Nocera, J. (2014). ‘Lessons Not Learned.’ The New York Times. Available at: <https://www.nytimes.com/2014/08/23/opinion/joe-nocera-lessons-not-learned.html?rref=collection%2Ftimestopic%2FSavings%20and%20Loan%20Associations> (29 August 2018).

²⁶ <https://terpconnect.umd.edu/~jneri/Econ330/files/ch11apx1.pdf> (29 August 2018).

²⁷ McCarthy, J. (2016). ‘Americans’ confidence in Banks still languishing below 30%.’ Gallup. Available at: <https://news.gallup.com/poll/192719/americans-confidence-banks-languishing-below.aspx> (29 August 2018).

Case study: Goldome Bank

Previously named the Buffalo Savings Bank, Goldome Bank collapsed in 1991 after it struggled in the 1970s with interest margins that were almost zero. The fall of New York State's largest saving institution illustrates the impact of the saving and loans crisis on banks in the US. The Federal Deposit Insurance Corporation (FDIC), which insured Goldome, lost around \$930 million from closing the bank. Like all S&L institutions, Goldome was affected by the higher interest rates and ineffective banking regulation in the 1980's, but also due to the absence of an effective business strategy. This caused the bank's expenses to rise more than profits from rapid expansion and government double-dealing. Regulators facilitated this through the approval and assistance which enabled Goldome to acquire weaker New York

savings banks and expand into new markets, particularly Florida²⁸. The US government convinced Goldome to buy three troubled savings banks in return for special treatment on its accounting. The FDIC agreed to make up losses on loans made by the New York City banks, while also allowing Goldome to use a special accounting method to handle their bad assets. However, in 1989, President George H.W. Bush changed the federal requirements, which revoked the support they had promised to Goldome and left it too large to support itself²⁹. The collapse of Goldome was partially due to a poor, overly aggressive business strategy, combined with the assistance of federal regulators who expanded the bank's power and encouraged their risk taking. This illustrates how the collapse of this savings bank was preventable since it was a deliberate business strategy, backed by Government regulators.

2) Black Wednesday (1992)

The European Exchange Rate Mechanism (ERM) was a precursor to the currency union that is in existence in Europe today. The theory was similar; tie the pound and other currencies to the Deutsche Mark, a strong and stable currency, and this will be mutually beneficial. In the years leading up to 1992, the ERM successfully maintained low inflation in the UK, but ultimately, it prolonged recession and economic hardship. This culminated in the dramatic events of Wednesday 16th September, where interest rates were rapidly raised by John Major's Government to attract investors in a failed bid to maintain control. The Euroscepticism that arose from this

failure can be directly associated with the 2016 vote for Brexit. Black Wednesday broke the Conservative Party's connection to the EU and inspired loyalty in the Sterling³⁰.

Regulatory fiddling with accounting procedures, such as recognition of fictitious "regulatory capital", was particularly troublesome. If companies intited such distortions on their own, they would rightly be accused of fraudulent deception.

*David M. Rowe, Ph.D., President,
David M. Rowe Risk Advisory*

28 Quint, M. (1991). 'Goldome closed and split between rivals'. *The Times*. Available at: <https://www.nytimes.com/1991/06/01/business/goldome-closed-and-split-between-rivals.html> (3 September 2018).

29 Schroeder, R. (1991). *Goldome leaves behind a valuable lesson demise of the savings institution shows how, and how not, to run a bank*. *The Buffalo News*. Available at: <https://buffalonews.com/1991/06/09/goldome-leaves-behind-a-valuable-lesson-demise-of-the-savings-institution-shows-how-and-how-not-to-run-a-bank/> (3 September 2018).

30 Carl, N, Dennison, J and Evans, G. (2017). 'An Explanation for Brexit'. Available at: https://s3.amazonaws.com/academia.edu/documents/54039726/Brexit_Working_Paper.pdf?AWSAccessKeyId=AKIAIWOWUYGZ2Y53UL3A&Expires=1537358946&Signature=0u19PCdBN6sLnAt%2BwlwlltinOqs%3D&response-content-disposition=inline%3B%20filename%3DAN_EXPLANATION_FOR_BREXIT.pdf (3 September, 2018).

What happened?

While the US was facing the effects of the saving and loans crisis, the UK economy suffered due to the events of September 16th, 1992: Black Wednesday. The UK crashed out of Europe's European Exchange Rate Mechanism (ERM), after the pound failed to stay within the lower boundary of the carefully fixed rate. Consequently, the UK Government announced a rise in interest rates from 10 to 15% to attract traders to buy sterling³¹.

Why?

The narrow bands of the ERM underestimated the system's vulnerability to speculative attacks; exhibited by the success of George Soros, a currency speculator who made \$1 billion by betting against the sterling's survival³². Public trust was eroded in the financial services because, while the Bank of England reserves were depleted by £17.4 billion, George Soros was able to profit from the crisis through short selling; adding to his personal fortune and suggesting an underlying trend in the suspicious activities of bankers.

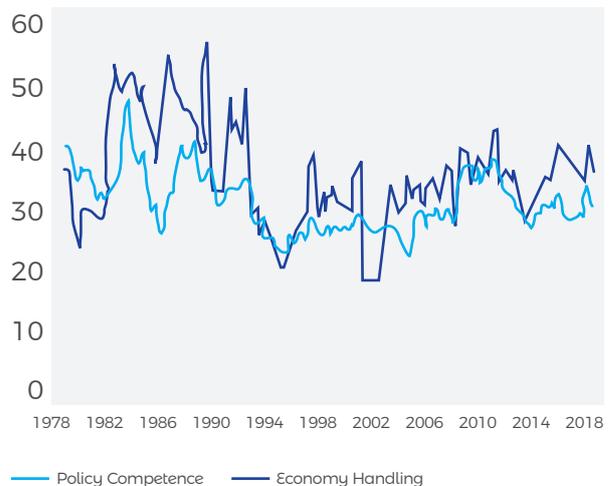
Was it preventable?

Black Wednesday damaged the Conservative Party's reputation for economic competence and the John Major government was forced to surrender to the power of financial speculation. Larry Elliot argues that the pound entered the ERM at too high of a rate, as the Treasury's rushed to get Britain into the mechanism meant that the economics of membership were not fully thought through. The UK was one of the weakest currencies in the ERM and the UK's inflation rate

was three times as high as that of Germany, signalling that it was a risky time to enter the mechanism as the UK and Germany required different monetary policy³³. The Treasury ignored the advice from Karl Otto Pöhl, the President of the Central Bank of Germany, that it was too dangerous to contemplate entry, indicating that Black Wednesday was preventable³⁴.

How was public trust affected?

Black Wednesday undermined the credibility of the UK economy and caused a collapse in the public's confidence in the government, specifically the Conservative Party, to manage policy issues. The below graph exhibits the steep fall in confidence in economic handling from 50% in 1992 to 20% in 1994. This sharp fall is highlighted in the graph below.



Source: Green, J & Jennings, W (2017)

This shock signalled a lack of trustworthiness for other issues that the Government handled and in the overall political system in general.

³¹ Green, J and Jennings, W. (2017). 'Will Brexit be another Black Wednesday for the Conservatives? Lessons from the ERM crisis'. Available at: <http://blogs.lse.ac.uk/politicsandpolicy/will-brexite-be-another-erm-crisis/> (3 September 2018).

³² Schelsinger, H. (2017). 'Black Wednesday and the Bundesbank'. OMFIF. Available at: <https://www.omfif.org/analysis/commentary/2017/september/black-wednesday-and-the-bundesbank/> (3 September 2018).

³³ Elliot, L. (2005). 'What Black Wednesday did for us'. The Guardian. Available at: <https://www.theguardian.com/business/2005/feb/14/economicpolicy.comment> (3 September 2018).

³⁴ Ibid.

3) *The Dot-Com Bubble (1995-2000)*

As with the S&L crisis and Global Financial Crisis, the Dot-Com Bubble was preceded by a bull-run which bolstered investors' confidence and encouraged riskier financial decision-making. In some respects, this episode is also an outlier to the other events covered in this report, since those who lost their investments were primarily individuals who placed their own capital into bad investments, as opposed to this having been done on their behalf by the supposedly trustworthy institutions and governments they support.

What happened?

The Dot-Com Bubble refers to a period of excessive speculation that occurred as a result of the rapid growth of the internet and associated businesses during the late 1990s. Personal computer ownership increased dramatically in the US during this decade: just 15% of households owned a computer in 1990 but, by 1997, this figure had increased to 35%³⁵. Online retailing was one of the biggest drivers of this growth, drawing significant investment and gaining a place in American consumer culture. As investment grew, so did stock value. The value of the NASDAQ, home to many of the biggest tech stocks, grew from around 1,000 points in 1995 to more than 5,000 in 2000.

The bubble burst and, in 2000, the NASDAQ's worth shifted suddenly from \$6.71 trillion to \$5.78 trillion in five days, with some companies losing between \$10 and \$30 million a quarter. Unsurprisingly, companies began to fold, and investors raced to be rid of their assets as they declined in value.

Why?

The growth in the use of the internet and personal computers meant that investors were overly keen to invest in 'dot-com' companies. The frenzy meant that people began to forget important metrics, such as the price-to-earnings ratio. When the boom was at its peak, a dot-com company could go public via an IPO and raise large sums of money even if it had never made a profit or produced a product. As Jonah Lehrer explains, "start-ups without business models were suddenly worth billions of dollars."³⁶ At the market's peak in 2000, two big companies, Dell and Cisco, placed huge sell orders on their stocks, which spooked investors. The stock market began to lose value and as investment began to dry up, the dot-com companies lost their funding. It is evident that the value of these dot-com companies was inflated and when this inflation was dramatically revealed these companies tanked, and investors suffered significant losses.

Was it preventable?

Periods of speculation, such as this one, are nothing new. For example, Lehrer refers to one of the first financial bubbles surrounding speculation on tulips in the Netherlands in the late sixteenth century³⁷. This suggests that consumers ought to learn from their mistakes and stop speculating. However, studies show that humans are driven to speculate; suggesting that it is difficult to prevent this kind of behaviour and, therefore, bubbles of this kind in the future³⁸. It should be noted that this event was not the result of malpractices from within the financial services sector, banks or individuals

³⁵ US Department of Labor. (1999). 'Computer Ownership up Sharply in the 1990s.' Available at: <https://www.bls.gov/opub/btn/archive/computer-ownership-up-sharply-in-the-1990s.pdf>. (24 August 2018).

³⁶ Lehrer, J. (2011). 'Can we prevent the next bubble?'. Available at: <https://www.wired.com/2011/06/can-we-prevent-the-next-bubble/>. (24 August 2018).

³⁷ Ibid.

³⁸ Camerer, C., and Teck-Huo, H. (2014) 'Behavioural Game Theory Experiments and Modeling'. California Institute of Technology and University of California, Berkeley. Available at: <http://faculty.haas.berkeley.edu/hoteck/PAPERS/Camerer-Ho-Book.pdf> (24 August 2018).

manipulating members of the public. The dramatic rise in the popularity of and confidence in technology companies was the key instigator of this event. However, this crisis could have been avoided had investors been more cautious. As would later be shown by the bursting of the subprime bubble and the subsequent global financial crisis, a high-risk strategy not based on sound fundamentals is a prescription for eventual disaster.

How was public trust affected?

Financial bubbles are, by definition, unpredictable and regulators cannot prevent their emergence in a free market. But it is not falling share prices that erode the public's confidence. What truly harms trust in the financial services sector is when institutions and individuals deceive investors with false information and malpractices. In the case of the dot-com bubble, both played a role.

When the bubble burst, it was reported that some tech companies had been artificially inflating their earnings. Investment advisers had also been acting dishonestly. According to a New York Times article "they would do things like issue enthusiastic reports about the same stocks they were describing as worthless junk in internal e-mail messages."³⁹

However, the rapid rise of social media giants, such as Facebook and Google, begs the question if any lessons have been learned from the dot-com bubble.

While commentators on all sides expect these companies to dominate markets in years to come, history suggests that it is exactly this kind of confidence that fuels financial bubbles. This shows that even a few years after a major bubble, investors start to adapt a this-time-is-different approach.

The Dot-Com Bubble showed that a significant correction is almost inevitable when asset prices run well ahead of 'fundamentals'.

In order to curtail their negative impact, it is important we identify bubbles when they begin to form.

Over the past seven years, we have developed a software tool to help investors understand the extent to which stock prices are underpinned by economic fundamentals. It suggests a bubble has been forming in equities markets since 2013.

Fortunately, the new understanding of the economics of listed companies embedded in this tool points to a way to collapse the bubble without it bursting.

Marvin Schneider, Partner, The KBA Consulting Group

³⁹ Dooling, R. (2003) 'A Fraud by Any Other Name'. The New York Times. Available at: <https://www.nytimes.com/2003/05/04/opinion/a-fraud-by-any-other-name.html>. (24 August 2018).

4) *The Global Financial Crisis and subsequent 'Great Recession' (2007-2010 and ongoing)*

The Global Financial Crisis is a prime example of financial services over-confidence following a bullish period in the market. In this instance, credit and subprime mortgages were rising exponentially, driven by blind faith in the efficiency of free-markets to evaluate risk and return effectively. The lax controls on the sale of mortgage products, and the warning signals that a crisis was imminent were ignored in favour of prolonging the status quo. Public anger towards traders and the financial services sector in general peaked particularly when so few senior bankers received retributive justice for their role in creating a problem which cost the world trillions of dollars to solve. The crisis is generally perceived as having been preventable since, in hindsight, the culture of risk-taking and both regulatory and governmental complacency on such a global scale was clearly unsustainable in the long term.

What happened?

In 2007, the bursting of the subprime bubble in the US precipitated a global financial crisis, leading to the worst global recession since 1929⁴⁰. In the years preceding the crisis, favourable economic conditions had sustained stable economic growth and relatively low levels of unemployment. Consequently, house prices had risen strongly, encouraging greater borrowing and risk-taking, motivated by the belief that this would continue indefinitely. The sub-prime mortgage market was riddled with opacity; with very few institutional investors truly understanding the toxic nature of the investments they owned. The

first signs of instability came in 2006 when the number of homeowners with questionable credit became clear. As house prices fell, so too did the price of securitised subprime mortgages. Opaque, high-risk mortgage debt saw major financial institutions begin to fail due to a lack of liquidity as default levels soared. This included Lehman Brothers, which filed for bankruptcy on the 15th September 2008 and became symbolic of the transition to shore up crisis. Just a day later, AIG was bailed out by the US Federal Reserve Board, but despite such interventions, the crisis rapidly evolved into a global jobs crisis as the credit crunch strangled the economy and trade flows collapsed.⁴¹ The mortgage crisis mainly affected the US market, but the resulting shortage of funds affected the rest of the world. In all major economies, the recession equated to a sharp fall in gross domestic product (GDP), with the UK seeing the slowest recovery from recession on record.

Why?

US mortgage lenders were selling inappropriate mortgages to customers with insufficient income and poor credit, indicative of lax controls on the sale of mortgage products. These mortgages quickly became unaffordable, as many products were sold with 1-2 years of extremely low interest rates. Thus, consumers saw a dramatic rise in payments after this short period, while the US had to increase interest rates due to inflation in 2007. This led to a significant rise in mortgage defaults, so banks were unable to recoup their loans. A lack of liquidity ultimately meant that banks were loath to lend

⁴⁰ Business Wire (2009), 'Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps are not Taken'. Available at: <https://web.archive.org/web/20100212214538/https://www.reuters.com/article/pressRelease/idUS193520%2B27-Feb-2009%2BBWJ20090227> (23 August 2018).

⁴¹ Verick, S. and Islam, I. (2010). 'The Great Recession of 2008-2009: Causes, Consequences and Policy Responses'. Forschungsinstitut zur Zukunft der Arbeit, no. 4934. Available at: <https://www.econstor.eu/bitstream/10419/36905/1/625861256.pdf>. (23 August 2018).

money, making it difficult to borrow. This resulted in banks such as Northern Rock, who had relied on loans to produce their income, being unable to receive the amount of money that they expected and needed.

Was the crisis preventable?

There are many factors that contributed to the Financial Crisis of 2008 and the blame should not solely be laid at the feet of financial institutions. Fran Tonkiss states that “financial markets failed in their twin tasks of managing and distributing risk and effectively allocating capital for investment”, but also that “governments and other regulatory agents failed in their responsibility to monitor and steer such financial activities.”⁴²

Both the US Senate’s Levin-Coburn Report and the US Financial Crisis Inquiry Commission (FCIC) indicate that the crisis was preventable. The Levin-Coburn Report, the result of a two year investigation into the “origins of the 2008 financial crisis” concludes that it was caused by “high risk, complex financial products; undisclosed conflicts of interest; the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of Wall Street.”⁴³ Similarly, the FCIC argued that the crisis was the result of failures in regulation, corporate governance and risk management, combined with excess borrowing, risky investments and a lack of transparency on the part of financial institutions. The Nobel Prize-winning economist, Joseph Stiglitz, agrees with the FCIC: “America’s financial system failed in its two crucial responsibilities: managing risk and allocating capital.”⁴⁴

When Lehmann collapsed and the Great Financial Crisis slammed an unsuspecting public, I was just finishing my PhD in Philosophy, specializing in moral philosophy. The ensuing news about the greed and corruption of Wall Street banks, main street mortgage lenders, rating agencies, and apparent complicity of regulators literally enraged me. This was not the financial industry I had known for two decades in the 1980s and 90s. Feeling helpless in the face of this huge wave of moral decrepitude, I decided to do something to improve the dire situation. I decided to start a think tank focused on research, education and promotion of ethics in finance. I called this new field of ethics, ‘financial ethics’ and the Seven Pillars Institute continues to work to enhance financial practice and policy by highlighting and analyzing ethical issues in finance.

Dr Kara Tan Bhala, President & Founder, Seven Pillars Institute for Global Finance and Ethics

42 Tonkiss, F. (2009), ‘Trust, Confidence and Economic Crisis’. *Intereconomics*. Available at: <https://www.ceps.eu/system/files/article/2009/09/196-202-Tonkiss.pdf>. (23 August 2018).

43 Levin, C. and Coburn, T. (2011), ‘Wall Street and Financial Crisis: Anatomy of a Financial Collapse’. Available at: https://www.hsgac.senate.gov/imo/media/doc/Financial_Crisis/FinancialCrisisReport.pdf?attempt=2 (23 August 2018).

44 Stiglitz, J. (2008), ‘The Fruit of Hypocrisy’. *The Guardian*. Available at: <https://www.theguardian.com/commentisfree/2008/sep/16/economics.wallstreet>. (23 August 2018).

Moreover, according to Paul Krugman, the crisis may have been preventable, and he notes that economists were blind to “the very possibility of catastrophic failures in a market economy;”⁴⁵ however, such a widespread catastrophe was not predicted at the time and did come as a surprise to many. With hindsight, it is easy to see that warning signs certainly were there. As explained in *The Great Recession of 2008-2009: Causes, Consequences and Policy Responses*, there were:

“Large current deficits in the US, UK and other advanced economies that were being financed by the excess savings of emerging economies and oil exporters (the global current imbalance); loose monetary policy (most notably in the US in the wake of the mild recession of 2001); the search for yield and misperception of risk; and lax financial regulation.”⁴⁶

It may have been hard to predict the extent to which the deteriorating US housing sector would have impacted the global economy, but it is evident that a lack of regulation and insufficient evaluation of risk played a significant role. This suggests that the crisis was preventable, as was the systemic domino effect it caused, later affecting the global economy, public trust in financial institutions and governments worldwide.

How was public trust affected?

This crisis has had a direct impact on public trust. 71% of people surveyed by Which?, as explained in a Guardian

article of 2012, felt that banks had not learnt their lesson⁴⁷. The level of distrust was entrenched, despite significant fines imposed on those banks involved in the Libor scandal and the arrest of some of the culprits. Consumers also expressed low levels of trust when it came to the government and their regulation of the financial sector; only 26% of respondents felt confident that a parliamentary inquiry into banking ethics would have a positive effect.

US citizens, according to Pew Research Center, have been expressing significant levels of mistrust in the federal government in every major poll since July 2007⁴⁸. This constitutes the longest period of diminished trust in the US government for more than half a century, although financial institutions are unlikely to be the sole cause. For example, other issues that could have been contributing factors are the mismanagement of the war in Iraq and the federal government’s slow response to Hurricane Katrina⁴⁹. Further scandals, such as the manipulation of the Libor rate, which came to a head in 2012, have eroded public confidence in financial institutions even further, while some believe that the government bailout of the financial sector in 2008 demonstrated Wall Street’s significant power in government circles.

Stiglitz explains that “dishonesty in the finance sector dragged us here, and Washington looks ill-equipped to guide us out.”⁵⁰ This short statement summarises the reasons for the lack of public trust as demonstrated by surveys, such as the one by Which?

45 Krugman, P. (2009). ‘How Did Economists Get It So Wrong?’. *New York Times Magazine*. Available at: <https://www.nytimes.com/2009/09/06/magazine/06Economic-t.html> (23 August 2018). 46 Op. cit. Verick and Islam.

46 Krugman, P. (2009). ‘How Did Economists Get It So Wrong?’. *New York Times Magazine*. Available at: <https://www.nytimes.com/2009/09/06/magazine/06Economic-t.html> (23 August 2018).

47 Press Association. (2012). ‘Financial crisis, five years on: trust in banking hits new low’. *The Guardian*. Available at: <https://www.theguardian.com/business/2012/aug/09/financial-crisis-anniversary-trust-in-banks>. (23 August 2018).

48 Pew Research Center. (2015). ‘Beyond Distrust: How Americans View Their Government’. Available at: <http://www.people-press.org/2015/11/23/1-trust-in-government-1958-2015/> (23 August 2018).

49 Op. cit. Stiglitz, J.

50 Ibid.

For over 100 years, financial products have been central to nearly every financial scandal and the worst economic crises, including the Great Depression, the recent Banking Crisis and the Great Recession. Sales processes mislead consumers into confusing safety or a high rate of return with freedom. The proper function of financial advice is to deliver consumers into their life of choice, their life plans, not the sale of products. Marketing and political power enable corporations to mislead consumers and shift societal focus from freedom to products.

The resulting low trust levels for financial advisers and financial services undermine public confidence in our economic and political systems and help create a massively inefficient allocation of human resources. Financial products must be vetted, their risks fully identified and analysed, hopefully by advisers who are fiduciaries to their clients, before they can be recommended with advice as we define it. Regulators and politicians should have no ties or political debts to companies or surrogates, no conflicts of interest.

*George D. Kinder, Founder and President,
The Kinder Institute*

What were the long-term consequences of the impact on trust?

Case studies:

1. Northern Rock

The collapse of Northern Rock in 2008 showed that over-confidence in the financial markets is by no means an American phenomenon. Only a few months before Northern Rock's collapse, chairman Matt Ridley, described 2007 as "another excellent year" and said "our strategy of using growth, cost efficiency and credit quality to reward both shareholders and customers continues to run well."⁵¹

There may have been more controls in place when it came to mortgage lending in the UK and Northern Rock had almost no subprime lending, but the Newcastle-based bank still relied on short-term funding⁵². By August 2007, Northern Rock found itself under intolerable financial strain due to high inter-bank lending rates combined with the closure of the mortgage securities market⁵³. As Lehman Brothers would later demonstrate, such a business model was not conducive to a trusting public. Following emergency financial support from the Bank of England and a £27 billion bailout announced on 14th September 2007, Northern Rock customers began to panic and queued to withdraw their savings in the first bank run since 1866⁵⁴. A survey commissioned by financial services marketing agency Team Spirit on trust in the financial services sector in the immediate aftermath of Northern Rock's failure showed that approximately 23% of UK citizens had little to no trust in their financial providers⁵⁵. Evidently,

⁵¹ O'Connell, D. 'The collapse of Northern Rock: Ten years on' BBC. Available at: <https://www.bbc.co.uk/news/business-41229513>. (12 September 2017).

⁵² Song Shin, H. (2009). 'Reflections on Northern Rock: The Bank Run that Heralded the Global Financial Crisis'. *Journal of Economic Perspectives*. vol. 26, no. 3. pp. 49-68. Available at: <https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.23.1.101>. (23 August 2018).

⁵³ Op. cit. The Press Association.

⁵⁴ Op. cit. Song Shin.

⁵⁵ Ennew T. C. (24 June 2007). 'The Financial Services Trust Index'. *Financial Services Research Forum*. Available at: <https://www.nottingham.ac.uk/business/businesscentres/crbfs/documents/researchreports/paper45.pdf> (23 August 2018).

Northern Rock's mismanagement severely damaged public trust in the financial services sector, as a whole.

Unfortunately, Northern Rock was not the only bank to be affected during this period, as the UK government announced plans on the 13th October 2008 to pour billions of pounds into RBS, Lloyds TSB and HBOS, resulting in their effective nationalisation⁵⁶. Inevitably, this led to more bad press for financial institutions, contributing to the gradual erosion of public faith.

2. Royal Bank of Scotland

In autumn 2007, Royal Bank of Scotland (RBS) announced the biggest ever operating profit of a Scottish company: £10.3 billion⁵⁷. Less than two years later, RBS effectively failed and was part-nationalised. It had to rely on Bank of England Emergency Liquidity Assistance (ELA) and the British government spent over £45 billion to recapitalise the group. In the process, RBS became a prime example of how financial services institutions have eroded their credibility over the past decade.

Many people in the UK assumed that their deposits in a UK regulated bank were safe. The GFC brought home to many the fact that their bank deposits were and are at risk. People also realised – to their horror – that their banks were not run by the conservative, cautious people like Captain Mainwaring, but instead they were run by commission-hungry sales staff.

Prof. Andrew Clare, Chair in Asset Management, Cass Business School

RBS underwent a period of rapid growth in the early 2000s. Over the course of seven years, RBS acquired 27 companies and developed from a regional bank to a global giant in the financial services sector. RBS took over NatWest, a bank three times its size, in 2000, but the acquisitions of Royal Insurance, Churchill Insurance and Charter One were also noteworthy⁵⁸.

For a while, it seemed as if there were no limits to RBS's growth. But when RBS, the then fifth largest financial institution of the world, outbid Barclay's to take over ABN AMRO, a Dutch credit institution, the structural weaknesses of RBS became apparent. A consortium consisting of RBS, the Belgian-Dutch bank Fortis and Spain's Banco Santander agreed to pay three times the book value for the Amsterdam-based bank - the largest deal in financial services history.

The deal left RBS vulnerable and it soon emerged that several companies that RBS had acquired, particularly US-based firms, were highly affected by the subprime mortgage crisis. As a result, they were suddenly worth only a fraction of what RBS had paid for them. A few weeks after Lehman Brothers collapsed in September 2008, the British Government saw itself forced to announce an initial £21 billion bailout for RBS to prevent a national crisis.

The direct cause of RBS's failure was a liquidity run, but a more in-depth analysis shows that a range of factors caused it to collapse. The Financial Services Authority's (FSA) 2011 report into the failure of the Royal Bank of Scotland identified the main reasons for RBS's failure⁵⁹. The report, which was only published after a public outcry against

56 BBC News. (2013). 'Timeline: Libor-fixing scandal'. Available at: <https://www.bbc.co.uk/news/business-18671255>. (23 August 2018).

57 Thomas, D. 'Timeline: The rise and fall of RBS' Financial News. Available at: <https://www.fn.london.com/articles/timeline-the-rise-and-fall-of-rbs-20111212> (12 December 2011).

58 Treanor, J. (2015). 'RBS sale: Fred Goodwin, the £45bn bailout and years of losses' Available at: <https://www.theguardian.com/business/2015/aug/03/rbs-sale-fred-goodwin-bailout-years-of-losses> (3 August 2015).

59 Financial Services Authority (2011). 'The failure of the Royal Bank of Scotland. Financial Services Authority Board Report'. Available at: <https://www.fca.org.uk/publication/corporate/fsa-rbs.pdf>

the shutdown of the official investigation into RBS, stated that the bank was overly reliant on risky short-term wholesale funding - a situation that could have been prevented by an adequate approach to the regulation of liquidity by regulatory bodies. The report also points to concerns and uncertainties about RBS's underlying asset quality, which in part arose due to the FSA's failure to complete a fundamental analysis of the company's assets.

These underlying issues were then suddenly revealed by the ABN AMRO acquisition which, as the FSA argues, had taken place with inadequate due diligence. The report concludes that RBS was finally pushed over the edge by an overall systemic crisis which led to substantial losses in credit trading activities. As market confidence eroded at pace and scope, which neither bank nor regulators anticipated, banks in worse relative positions were extremely vulnerable to failure and, in RBS's case, collapsed.

Put simply, the FSA's report found that RBS's failure was a result of management error and lax regulation and its meltdown triggered by the global financial crisis. But what this report did not find were individuals that could be held accountable. As a result, public trust in the financial services sector suffered immensely. The British people had paid more than £45 billion to save a bank from a crisis of its own making, but no one was found legally responsible for the failure.

The public was also shocked by details that emerged about RBS's internal culture following the bailout. For example, RBS's Global Restructuring Group, which was supposed to support struggling businesses was advised to

give customers enough rope to 'hang themselves'.⁶⁰ In 2014, RBS was named UK's least trusted bank' by its own boss and today, ten years after the bailout, RBS continues to be partly state owned and is unlikely to ever fully repay the state for its bailout.⁶¹

Therefore, the collapse of RBS and its aftermath served as a double hit to trust in the financial services sector. Not only did mismanagement by RBS employees lead to significant direct costs to British taxpayers but the fact that not a single person was convicted for it, caused outrage and was met with incomprehension.

Since 2008, several new national and international regulations have been passed to prevent a repeat of 2008's crisis but the Bank of England's annual stress test in 2016, showed that RBS would not be prepared for the next credit crunch due to its high exposure to risky assets.⁶²

3. Libor

If the bailouts of Northern Rock and RBS had destroyed public faith in the financial services sector, the Libor scandal could be described as the 'nail in the coffin' for trust in the banking sector. The scandal made clear that the banking industry has undeniable structural issues.

Libor, the London Interbank Offered Rate, is the benchmark interest rates at which banks may lend each other unsecured funds on the London interbank market. In 2012, an international investigation revealed that several banks including RBS, Deutsche Bank, UBS, Rabobank and Barclays, had been manipulating this rate for profit.

⁶⁰ Hosking, P. (2018). 'RBS gave clients 'enough rope to hang'. *The Times*. Available at: <https://www.thetimes.co.uk/article/rbs-gave-clients-enough-rope-to-hang-xwgmqsgpf> (18 January 2018).

⁶¹ Bold, B. (2014). 'RBS: UK's 'least trusted bank' on mission to become 'most trusted'. *Campaign*. Available at: <https://www.campaignlive.co.uk/article/rbs-uks-least-trusted-bank-mission-become-most-trusted/1282659> (27 February 2014).

⁶² Treanor, J. (2016). 'RBS fails Bank of England stress test'. *The Guardian*. Available at: <https://www.theguardian.com/business/2016/nov/30/rbs-fails-bank-of-england-stress-test> (30 November 2016).

According to a report by the Financial Services Authority (FSA), Barclays derivatives traders had been making requests to fix Libor rates as far back as January 2005⁶³. An article by Douglas Keenan, published in the Financial Times in 2012, suggests that Libor had been manipulated since 1991. The scandal caused such an outcry that the Parliamentary Commission on Banking Standards was set up in response.

The problem appears to have been deeply ingrained in banking culture. This was demonstrated by events in 2009, when Barclays, after the publication of new British Bankers' Association (BBA) guidelines in November, made no effort to alter their practices to comply with these guidelines, which intended to standardise the setting of the Libor rate⁶⁴.

As self-regulation had clearly failed, it was necessary to introduce the Financial Services Act of 2012, bringing Libor under regulatory oversight. The bill also made it a criminal offence to knowingly

however, had been damaged irreversibly.

5) The European Sovereign Debt Crisis (2009- present)

The European Sovereign Debt Crisis, in contrast to the crises that predates it, is primarily a case of over-optimism specifically in respect to the borrowing and debt accumulation of sovereign governments. It is therefore intrinsically political in nature. Whereas it is possible for the people of the respective nations to democratically elect (and reject) their governments, the same cannot be said for the financial services institutions that serve them. While the Greek government underwent an upheaval of leadership following the crisis, the same cannot be said for Goldman Sachs, which evaded accountability despite their role

or deliberately make false statements relating to benchmark-setting⁶⁵. Furthermore, the fact that, beginning in 2014, the setting of the Libor rate began to be overseen by the Intercontinental Exchange, as opposed to the BBA, shows that tighter regulation could have prevented the wholesale manipulation of the rate from becoming a norm in the banking industry and, consequently, a scandal. The manipulation of the rates was only possible because those submitted were estimates and not actual transactions. Today, rates are based on the terms of actual arms-length exchanges. If such a process had been in place from the beginning, the scandal could have been avoided.

In contrast to the collapses of RBS and Northern Rock, the Libor scandal had legal consequences for those involved. Barclays was fined £290 million in 2009, arrests were made and the Chief Executive, Bob Diamond and the Chairman, Marcus Agius, resigned as a result. Public Trust,

of concealing the debts of Greece upon securing its position in the single Euro currency.

What happened?

Next year, the Eurozone will celebrate its 20th anniversary in a monetary union using the Euro as their single currency. In 2011, the outlook for the euro was very different, as it experienced what is considered its deepest crisis since its foundation⁶⁶. This was the European Sovereign Debt crisis, and it began to spiral out of control in August 2007, when the European Central Bank initiated liquidity operations. The 2008 global financial crisis caused a deterioration in government finances and, as a result,

⁶³ Financial Services Authority. (2012). 'Final notice'. Available at: <http://www.fsa.gov.uk/static/pubs/final/barclays-jun12.pdf>. (23 August 2018).

⁶⁴ BBC News. (23 August 2018).

⁶⁵ HM Treasury. (2012). 'Financial Services Bill receives Royal Assent'. Available at: <https://www.gov.uk/government/news/financial-services-bill-receives-royal-assent/>. (23 August 2018).

Eurozone nations borrowed heavily to fund domestic debt and consequently became over reliant on external credit sources⁶⁷. Despite this, it was not until 2009, that the situation reached crisis level and the true magnitude of sovereign debt across the European bloc was fully recognised. The newly elected Greek government announced a revised budget deficit forecast of more than double the estimates of the previous government. Greece had national debts larger than their GDP, and the net debt-to-GDP ratio for the euro area peaked at over 90% in 2012⁶⁸. Fiscal vulnerability in the euro area increased rapidly which resulted in Standard and Poor's mass downgrade of European nations including France and Austria from their long-standing AAA ratings, along with seven other Eurozone members who were downgraded one or two places in 2012⁶⁹.

Why?

The problems the Eurozone encountered in 2009 onwards stemmed from the over-confidence policymakers felt in respect to the monetary union at its establishment. In the *Journal of Economic Integration*, published in 2012, commentators were scathing at the optimism which led to the Euro being "constructed for fair weather, as no life rafts were put on board."⁷⁰ They were referring to the lack of an effective system to prevent the spiralling build-up of sovereign debt and proper crisis resolution mechanisms that would prevent weaker nations from defaulting. This was due to the failure of policymakers to appreciate the different

systems various European nations had established to cope with their individual economic circumstances. When a one-size-fits-all monetary policy was implemented, and the global recession of 2008-9 hit, peripheral nations could not deploy the tools they formerly used to maintain equilibrium, particularly exchange rate devaluation. When the catastrophic effects of such a limitation on these nations was realised, the EU was slow to respond given that action required the consent of all nations in the union.

Was it preventable?

The single currency produced strong credit booms in the periphery members of the union, because, for the first time, many countries in the Eurozone were able to raise funds from international sources in a stable currency of their own, without having to rely on exchange rates. However, this provided a false sense of security. With the establishment of the Eurozone, not only were the stabilisers that individual nations had used to manage their respective currencies taken away, but not enough was done to replace these stabilisers and future-proof the union in a down-turn. Admittedly, the Eurozone did acknowledge the inherent risks associated with a common currency in 1997, with the establishment of the Stability and Growth Pact. This set a budget deficit limit of 3% of GDP and an external debt ceiling of 60% of GDP⁷¹. However, these figures were consistently breached by multiple nations, whose activities were not penalised by the European community. The sovereign debt

66 <http://stec.univ-ovidius.ro/html/anale/ENG/full-text/> (23 August 2018).

67 Sandoval, L., Beltran, E., Ulziikhutag, S., and Zorigt, T. (Spring 2011). 'The European Sovereign Debt Crisis: Responses to the Financial Crisis'. *New Voices in Public Policy*. 5. Available at: <https://journals.gmu.edu/newvoices/article/view/4/4> (11 September 2018).

68 Khan, M. (2017). 'Eurozone debt ratio falls to lowest since 2012'. *The Financial Times*. Available at: <https://www.ft.com/content/b6456e79-a1da-3866-9a47-cf041369675c> (24 August 2018).

69 Kavoussi, B. (2012). 'S&P Downgrades Eurozone Countries As Investors Avoid Eurozone Government Debt'. *The Huffington Post*. Available at: https://www.huffingtonpost.co.uk/entry/sp-downgrade-eurozone_n_1204775?guccounter=1&guce_referrer_us=aHR0cHM6Ly93d3cuZ29vZ2xLLmNvLnVrLw&guce_referrer_cs=zEzlfxpnl08TmWJWSIPFPBA (24 August 2018).

70 Jovanović, M. (2012). 'Is the Eurozone Rescue Strategy Tantamount to the Rearrangement of the Deckchairs on the Titanic?'. *Journal of Economic Integration*. vol. 27, no. 1. pp. 33-79. Available at: <http://www.jstor.org/stable/41473731> (24 August 2018).

71 European Parliament (1998). 'Stability and Growth Pact'. Available at: [http://www.europarl.europa.eu/RegData/etudes/note/join/2014/528745/IPOL-ECOM_NT\(2014\)528745_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/note/join/2014/528745/IPOL-ECOM_NT(2014)528745_EN.pdf) (20 August 2018).

crisis simmered, unchecked, for years before boiling over, and not enough was done initially to prevent the full-scale disaster that was waiting to happen.

How was trust affected?

The belief that it was feasible to maintain a monetary union while also retaining national responsibility for financial regulation and for fiscal policy contributed to the lack of risk management from the birth of the Eurozone⁷². Public anger was directed towards policymakers and governments for being unscrupulous and overconfident. Looking to the success of the monetary union of the US, policymakers were optimistic that economic integration could be sustained in Europe, and that the Euro could viably compete against the Dollar for the status of primary international currency. However, significant differences between the Dollar union and the Euro existed from the outset.

With such a varied range of countries involved in the union, political integration was inconceivable. Since the idea of a United States of Europe was an entirely unpalatable political eventuality for most, if not all, European nations, the European system then lacked what is believed to have made the monetary union in the US successful; it lacked 'wage flexibility, labour mobility, a flexible labour market, semi-automatic fiscal transfers and built-in stabilisers'⁷³. Whereas the US could move unemployed workers across states with relative ease, the Eurozone faced language barriers and cultural challenges which restricted labour

Most Americans estimate that it took more than 100 years before their ancestors began to view themselves as Americans first and New Yorkers, Pennsylvanians, Virginians or South Carolinians second. Depending on when you place the beginning of the European Project, it has certainly been in progress less than 70 years. In addition, there are far more divisions of language, history and culture across the countries of the EU than was true of the original thirteen US states. Clearly politicians have been pushing integration far faster than the peoples of Europe are willing to support. Whether politicians like it or not, history cannot not be rushed.

*David M. Rowe, Ph.D., President,
David M. Rowe Risk Advisory*

mobility and flexibility. Commenting on this systemic issue, academics from the University of Edinburgh and the University of Hong Kong determined, in 2012, that the recent crisis they experienced had 'proven beyond doubt that a common currency area is not viable without building, at the same time, transnational supervisory structures in the field of fiscal monitoring and responsibility and bank supervision'.⁷⁴ Policymakers' 'blind confidence' in the virtues of the financial market seriously damaged the credibility of the union in the years following the crisis⁷⁵. Public perception of the Eurozone's output legitimacy was found to have 'plummeted' with the crisis as a result⁷⁶.

72 Lane, P. (2012). 'The European Sovereign Debt Crisis'. *Journal of Economic Perspectives*, vol. 26, no. 3, pp. 49-68. Available at: <https://pubs.aeaweb.org/doi/pdf/10.1257/jep.26.3.49> (24 August 2018).

73 Op. cit. Jovanović.

74 Avgouleas, E., and Arner, D. (2013). 'The Eurozone Debt Crisis and the European Banking Union: A Cautionary Tale of Failure and Reform'. Available at: http://www.law.ed.ac.uk/includes/remote_people_profile/remote_staff_profile?sq_content_src=%2B-dXJsPUh0dHALM0ElMkYlMkZ3d3cyLmxhdY5lZC5hYy51ayUyRmZpbGVfZG93bmxvYUwQlMkZudWJsaWNhdGlbnmMlM-kUyXzI2MV90aGVldXJvem9uZWRIYnRjcmlzaXNhbmR0aGVldXJvcGVhbmJhbmtplnBkZiZhbGw9MmQ%3D%3D (11 September 2018).

75 <http://stec.univ-ovidius.ro/html/anale/ENG/full-text/> (11 September 2018).

76 Foster, C., and Frieden, F. (2017). 'Europeans have lost faith in their governments and institutions. Why? We did the research.'. *The Washington Post*. Available at: https://www.washingtonpost.com/news/monkey-cage/wp/2017/09/22/europeans-have-lost-faith-in-their-governments-and-institutions-why-we-did-the-research/?noredirect=on&utm_term=.e76f3fba614e (11 September 2018).

Common rhetoric surrounding the crisis centred primarily on the faults of Greece and other peripheral European nations whose consistent habit of spending over their means resulted in unmanageable debt accumulation. This has been reflected in the widespread loss of public confidence in the leading political parties of the day; the crisis triggered significant overhauls in the political environments of Greece, Ireland, Italy, Portugal, Spain, Slovenia, Slovakia and the Netherlands. A rhetorical analysis of leading newspapers in four EU nations (Germany, France, Italy and Spain) published by the London School of Economics demonstrates how these newspapers tended to frame the crisis upon external factors, leaving their respective nations free from blame. For example, Germany's leading paper, *Süddeutsche Zeitung*, identified Greece as 'the chief subject' and stressed the need to return to the stability and fairness associated with Germany's post-war model.⁷⁷

What will be the long-term consequences of the impact on trust?

The ripple effects in public confidence were wide and severe, not least because Euroscepticism reached new heights across Europe in the following years⁷⁸. At the tail-end of the crisis in 2012, Germany was the only major European

nation to still believe that political integration has helped its economy; every other nation in the bloc believed it to have had a negative impact. In 2012, Bruce Stokes, the director of the Pew Global Economic Attitudes Project, said: "Europe is experiencing a full-blown crisis of public confidence: in the benefits of European economic integration, in membership in the EU and in the euro."⁷⁹ Going forward, all eight of the countries who received financial assistance have now exited their programmes, and as of 2017, only three-member states were subject to the corrective policies of the Stability and Growth Pact, down from the 24 countries at the peak of the crisis.⁸⁰ Initially, Euroscepticism was likened to a 'virus' spreading throughout the continent, but over time this seems to have mellowed⁸¹.

Although not directly impacted by the debt crisis of 2007-12 due to its exclusion from the euro, the UK has been the first and only EU country to pull out of the union. Significantly, 21% of those who voted 'leave' in the UK's EU referendum did so primarily because of 'the economy', and in a survey of nearly 3,000 people conducted by polling company Kantar, over 20% of those who voted leave, cited 'I don't want the UK sending any more money to the EU' as their primary reasoning⁸². These will no doubt have been influenced by the memory of the economic strain

⁷⁷ Müller, H., Porcaro, G., and von Nordheim, G. (2018). 'Don't put the blame on me: How different countries blamed different actors for the Eurozone crisis'. *The London School of Economics and Political Science*. Available at: <http://blogs.lse.ac.uk/europpblog/2018/03/01/dont-put-the-blame-on-me-how-different-countries-blamed-different-actors-for-the-eurozone-crisis/#Author> (11 September 2018).

⁷⁸ Schmidt, V. (2015). 'The Eurozone's Crisis of Democratic Legitimacy: Can the EU Rebuild Public Trust and Support for European Economic Integration?'. *European Economy Discussion Papers*, 15. Available at: https://ec.europa.eu/info/sites/info/files/dp015_en.pdf (11 September 2018).

⁷⁹ Waterfield, B. (2012). 'Increasing 'crisis of confidence' in the EU'. *The Telegraph*. Available at: <https://www.telegraph.co.uk/finance/financialcrisis/9298641/Increasing-crisis-of-confidence-in-the-EU.html> (11 September 2018).

⁸⁰ The European Commission. (2017). '10 years since the start of the crisis: back to recovery thanks to decisive EU action'. Available at: https://ec.europa.eu/unitedkingdom/news/10-years-start-crisis-back-recovery-thanks-decisive-eu-action-0_en (11 September, 2011).

⁸¹ Torreblanca, J and Leonard, M. (2013). 'The Continent-wide rise of Euroscepticism'. *European Council on Foreign Relations*. Available at: https://www.ecfr.eu/page/-/ECFR79_EUROSCPTICISM_BRIEF_AU.pdf (3 September 2018).

⁸² Carl, N. (2018). 'CSI Brexit 4: People's Stated Reasons for Voting Leave or Remain'. *Centre for Social Investigation*. <http://ukandeu.ac.uk/wup-content/uploads/2018/07/CSI-Brexit-4-People%20%80%99s-Stated-Reasons-for-Voting-Leave.pdf> (3 September 2018).

the Eurozone experienced following the crisis. The EU continues, therefore, to be considered an economic drain on public finance, years on from the crisis.

Case Study: Greece and Goldman Sachs

The culture of borrowing that dominated Greek fiscal policy left it with levels of sovereign debt far exceeding the 60% of GDP limits set by the European Union, thus restricting its admission to the euro. To rectify this situation, Greece called upon the work of Goldman Sachs, in an atypical currency swap that would ostensibly remove \$1bn from the nation's balance sheets⁸³. Although not nearly enough to bring Greece's debt to an EU-approved level, this deal, coupled with various attempts at fiscal adjustment and exchange rate stabilisation, was enough of a move in the right direction to allow its admission to the euro. Once in the euro, Greece's economy boomed due to its renewed credibility; the government was able to borrow more cheaply. The Lisbon Council referred to this period as: 'a dramatic example of unsustainable, boom-based growth acceleration pursued under weakening systemic growth forces'⁸⁴.

The unsustainability of this activity became evident following the global fall in interest rates triggered by the 9/11 terror attacks. Greece's deal with Goldman Sachs, which was already costly due to long-term payment obligations, became even more expensive. In this deal and many others like it, Greece forfeited their

rights to future government income such as airport fees and lottery proceeds, effectively chocking the income of future governments⁸⁵. Goldman Sachs profited from Greece's dire economic condition, and on more than one occasion the argument has been made that Greek policymakers did not have the expertise or understanding to judge the risks and costs of the deal they were entering into in 2001⁸⁶. Goldman 'doctored the books of an entire nation' and since they profited from that nation's subsequent demise, this firm has been accused of financial deception and fraudulence⁸⁷.

Ultimately, the Greek public are the losers in this game of bluff, having to take the brunt of the austerity measures and cuts to public services and funding, which may have been avoided had Greece's financial data been an accurate reflection of reality in the early 2000s. The sweeping austerity measures of 2009-10 seriously angered Greeks, who took to the streets in civil unrest⁸⁸. Public confidence in financial services, and in government, is dependent upon the transparency and integrity of the figures they produce; both of which were lacking from the outset of Greece's initiation into the Euro. Because of this incident, Goldman has been subject to inquiries into its dealings with Greece, although no fines or changes in regulation have been made. It is true to say, however, that neither Greece, nor Goldman Sachs, could have predicted the global interest rate fall following the 9/11 attacks. The reaction might have been very different, had interest rates peaked and Goldman Sachs been the one to suffer losses.

83 Huneke, S. (2011). *The Accumulation of Greek Debt*. Seven Pillars Institute. Available at: <https://sevenpillarsinstitute.org/case-studies/1492-2/> (3 September 2018).

84 Balcerowicz, L, Rzonca, A, Kalina, L & Laszek, A. (2014). 'Economic Growth in the European Union'. The Lisbon Council. Available at: <https://lisboncouncil.net/publication/publication/100-economic-growth-in-the-european-union.html> (3 September 2018).

85 Story, L & Thomas Jr, L & Schwartz, N. (2010). 'Wall St. Helped to Mask Debt Fuelling Europe's Crisis'. *The New York Times*. Available at: http://www.teamsters952.org/Wall_St_Helped_Greece_to_Mask_Debt_Fueling_Europe_s_Crisis_-_NYTimes.com.pdf (3 September 2018).

86 Armitage, J. (2015). 'Greek debt crisis: Goldman Sachs could be sued for helping hide debts when it joined euro'. *The Independent*. Available at: <https://www.independent.co.uk/news/world/europe/greek-debt-crisis-goldman-sachs-could-be-sued-for-helping-country-hide-debts-when-it-joined-euro-10381926.html> (3 September 2018).

87 Hass, M. (2013). 'Goldman Sachs: The Greek Situation'. UCCS. Available at: <https://www.uccs.edu/business/sites/business/files/inline-files/Goldman%20Sachs.pdf> (3 September 2018).

88 Allen, K. (2015). 'Greek debt crisis: the 20 key moments'. *The Guardian*. Available at: <https://www.theguardian.com/business/2015/jun/25/greek-crisis-20-key-moments-eurozone> (3 September 2018).

Rogue Individuals

Finally, it's important that we give some consideration to the 'rogue actors' involved in some of the highest profile financial scandals. The actions of these individuals can be thought of as 'unpreventable' but they have played a massive part in eroding trust in financial services at the expense of the best operators. These individuals have become the human public face of financial wrongdoing and confirmed some of the Hollywood stereotypes.

Bernie Madoff

Bernie Madoff ran the largest Ponzi scheme in US history and in 2008 he admitted to stealing \$50 billion from hundreds of victims. Madoff abused the trust of his clients, who included members of the Jewish community, charities, benefactors and celebrities including Steven Spielberg. From the 1990s through to the late 2000s, Madoff deposited the money of his clients into his personal bank account rather than investing it to generate returns. Thus, when his clients wanted to liquidate their investments for cash, he dipped into the bank account to fund this⁸⁹. While thousands of lives were ruined and even four suicides linked to the scandal, Madoff's betrayal enabled him to fund his lavish lifestyle with four homes, six boats and four cars⁹⁰. Major news coverage reported the tragic repercussions of Madoff's scheme, such as the suicides of Rene-Thierry Magon de la Villehuchet who invested \$1.4 billion in Madoff's Ponzi scheme and Charles Murphy who lost \$50 million

of the \$7.5 billion his company invested with Madoff⁹¹.

Public trust in the financial services was damaged, especially among those who had an affinity to the Madoff victims. According to a Cornell Study published in the Review of Financial Studies, trust was dramatically lost in the areas where victims were concentrated, and this affected their investment behaviour⁹². This was exacerbated by the increased coverage in the local media and heightened awareness of the fraud through social connections to the victims.⁹³

As a rogue trader, it is argued that Bernie Madoff's actions could not have been prevented; however, he got away with his crimes for numerous years. US regulators found evidence of misconduct dating back to the 1970s but the Securities and Exchange Commission (SEC) failed to discover the fraud.⁹⁴ Despite the SEC having conducted two investigations and three examinations into the Madoffs' finances, they only discovered the crime when Madoff's sons turned him in, in 2008.⁹⁵

Kweku Adoboli

Kweku Adoboli was sentenced to seven years in prison for losing £1.4 billion in trades for Swiss bank UBS. Adoboli was told by the judge, Mr Justice Keith, that he will 'forever be known as the man responsible for the largest trading loss in British history'.⁹⁶ Adoboli had been booking fictitious trades to hide the exposure to UBS that had been

89 Huneke, S. (2011). *The Accumulation of Greek Debt. Seven Pillars Institute*. Available at: <https://sevenpillarsinstitute.org/case-studies/1492-2/> (3 September 2018).

90 Clark, A. (2009). 'How did Bernard Madoff's victims fall for his \$65bn scam?'. *The Guardian*. Available at: <https://www.theguardian.com/business/2009/apr/02/bernard-madoff-fraud-victims-sec> (3 September 2018).

91 Gogoi, P and McCoy, K. (2008). 'Madoff investor who lost \$1.4B apparently committed suicide'. *ABC News*. Available at: <https://abcnews.go.com/Business/story?id=6521133&page=1> (3 September 2018).

92 Gogoi, P and McCoy, K. (2008). 'Madoff investor who lost \$1.4B apparently committed suicide'. *ABC News*. Available at: <https://abcnews.go.com/Business/story?id=6521133&page=1> (3 September 2018).

93 Op. cit. Schwartz.

94 Gurun, U. (2016). 'Trust Busting: The Effect of Fraud on Investor Behaviour'. *Harvard Law School Forum*. Available at: <https://corpgov.law.harvard.edu/2016/02/18/trust-busting-the-effect-of-fraud-on-investor-behavior/> (3 September 2018).

95 *The Telegraph*. (2017) 'Bernard Madoff: How did he get away with it for so long?'. *The Telegraph*. Available: <https://www.telegraph.co.uk/business/0/bernard-madoff-did-get-away-long/> (3 September 2018).

96 *BBC News*. (2018). 'Ex-UBS trader who lost £1.4bn faces deportation to Ghana'. *BBC News*. Available at: <https://www.bbc.co.uk/news/business-45400814> (4 September 2018).

accumulated by the 'real' trades which were \$5 billion on the S&P 500 and \$3.75 billion in German futures⁹⁷. In the same way that a gambler might behave in a casino, Adoboli enlarged his bet after each loss. On three separate occasions, including his bet that the Greek vote on austerity would cause a fall in the market, when it in fact rose, Adoboli was wrong about the direction of the market. He made extreme losses in the process. Evidence released by the police after Adoboli's conviction of two counts of fraud, detail a phone call with his senior, William Steward, in which Adoboli asks Steward to explain what he understood an asset to be. The fact that Adoboli did not see the problem with UBS assets being on both sides of the same trade, exposing them to insurmountable losses, should have been the signal to regulators and risk managers that something must have been done to prevent the losses accumulating. By this point, however, it was too late.

Common rhetoric surrounding Adoboli's conviction made him a figurehead for everything the public distrusted about the City. When testifying in his own trial, Adoboli argued that many other staff used similar methods and that managers encouraged them to bend the rules to make profits. The fact that his trades accumulated such extreme losses, and that he was not called out until after he himself confessed to the extent of his malpractice, does not instil confidence in the strength of regulation on traders such as Adoboli. When asked

by a BBC reporter whether the crimes he committed could happen again, Adoboli's responded 'absolutely'.⁹⁸ It is difficult to ascertain, therefore, just how 'rogue' Adoboli's trading style was, and whether a repeat is likely anytime soon.

Nick Leeson

Nick Leeson was the rogue trader responsible for the collapse of Barings; the City's oldest merchant bank, a respected financial organisation and banker to the British royal family. After Leeson gambled away £872 million in Barings' name, the entire institution collapsed in 1995 and the World's first merchant bank fell⁹⁹. Leeson earned the trust and admiration of his bosses from unauthorized speculative trades, which earned 10% of the bank's profits equating to £10 million in 1993; however, Leeson was deceiving the bank by appearing to earn these phenomenal profits but actually incurring catastrophic losses¹⁰⁰. These impressive profits instilled confidence in management who lacked knowledge in subtle trading techniques and financial markets.¹⁰¹ In 1994, despite having accumulated trading losses of £208 million, Leeson was officially massively in profit because he was using the 'error account' Account 88888 which was set up in 1992 by an accounts technician¹⁰². Unsurprisingly, Leeson was driven by profit and he stated the ethos of Barings in his autobiography, 'Rogue Trader' 'We were all driven to make profits, profits, and more profits ... I was the rising star.'¹⁰³

97 Adoboli manager's 'disbelief over email'. *Financial Times*. Available at: <https://www.ft.com/content/be92418e-026c-11e2-8cf8-00144feabdc0> (4 September 2018).

98 Ahmed, K. (2016). 'UBS rogue trader: It could happen again', *BBC News*. Available at: <https://www.bbc.co.uk/news/business-36937109> (4 September 2018).

99 Rodrigues, J. (2015). 'Barings collapse at 20: How rogue trader Nick Leeson broke the bank', *The Guardian*. <https://www.theguardian.com/business/from-the-archive-blog/2015/feb/24/nick-leeson-barings-bank-1995-20-archive> (4 September 2018).

100 Ibid.

101 Monthe, P. (2007) 'How Nick Leeson caused the collapse of Barings Bank', *Next Finance* <https://www.next-finance.net/How-Nick-Leeson-caused-the> (4 September 2018).

102 The Journal. (2015). 'Timeline: How Nick Leeson brought down Barings Bank at the age of just 28', *The Journal*. Available: <http://www.thejournal.ie/nick-leeson-barings-1957799-Feb2015/> (14 September 2018).

103 Drummond, H. (2002) 'Living in a fool's paradise: the collapse of Barings' Bank', *Management Decision*, vol. 40, issue: 3, pp.232-238. Available at: <https://doi.org/10.1108/00251740210420183> (4 September 2018).

The fall of Barings Bank created an unprecedented crisis within the city and Nick Leeson's action had a world-wide impact, even for those who were not in the financial community. The public lost confidence and trust in the financial services sector as it was revealed that "golden boys" who were younger than 30 had the power to cause the demise of a prestigious financial institution¹⁰⁴.

Despite being a "lone wolf", Leeson's actions should have been detected by statutory auditors and control interns, indicating that the account regulation procedures within the institution were inefficient. Not only did Barings benefit from special privileges from the Bank of England but the Bank of England's investigation into the collapse acknowledged that, "whilst the various danger signs might not have meant much in isolation, taken together they should have alerted Barings to danger. Barings might have been saved, if a senior level executive had simply stepped forward and said, "I don't understand this"¹⁰⁵. As this crisis was deemed to be preventable, it has caused a significant frustration and a consequent erosion in public trust of the financial services.

Nick was sentenced to six years in prison on charges of fraud and forgery but due to illness, he was released from prison early for good behaviour. Despite being responsible for the collapse of England's oldest merchant bank, Nick Leeson has become an iconic name and a sort of celebrity; he has released an autobiography, become a key note speaker and in 2018 entered UK

reality show, *Celebrity Big Brother*. This suggests that Nick Leeson may not have been appropriately punished, for his actions, but somewhat celebrated instead.

Toshihide Iguchi

Despite not being as famous as Nick Leeson, Toshihide Iguchi is considered one of the 'pioneers' of rogue trading after he hid \$1.1 billion worth of trading losses from Daiwa's New York branch between 1983 and 1995¹⁰⁶. Iguchi lost this money through speculating in the bond market and then he sold securities belonging to the bank and its customers to cover up his losses. According to Iguchi, he concealed the costs of the unauthorized trading to protect his reputation and job¹⁰⁷. Consequently, Iguchi was sentenced to four years in prison and subject to \$2 million in fines to deter others from committing similar crimes.¹⁰⁸

This scandal identified deeper problems than solely Iguchi's actions as senior managers at Daiwa covered up the losses when Iguchi confessed in July 1995. The facts were concealed to attempt to have the problem handled in a traditionally opaque, Japanese manner. It was reported that the bank's top managers had communicated extensively with Iguchi between July and September, before reporting the losses; and they advised Iguchi on how to handle and even hide the losses from regulators¹⁰⁹. This highlighted the lack of transparency between banks and the financial services community and triggered a further decline in public trust.

¹⁰⁴ Op. cit. Monthe.

¹⁰⁵ Op. cit. Drummond.

¹⁰⁶ Holliday, K. (2014) 'I'm not a criminal: Daiwa rogue trader who lost \$1 billion'. CNBC. Available at: <https://www.cnbc.com/2014/04/29/im-not-a-criminal-daiwa-rogue-trader-who-lost-1-billion.html> (5 September 2018).

¹⁰⁷ Bankgate. (2016), 'Toshihide Iguchi, the man behind the loss of \$1.1 billion at Daiwa Bank'. Bank Gate. Available at: <https://bankgate.info/toshihide-iguchi-man-behind-loss-1-1-billion-daiwa-bank/> (5 September 2018).

¹⁰⁸ McMorris, F & RapportStaff. (1996), 'Former Daiwa Bank Trader Gets Stiff Sentence, Fines'. *The Wall Street Journal*. Available at: <https://www.wsj.com/articles/SB850770337826244500> (5 September 2018).

¹⁰⁹ Truell, P. (1995), 'A Japanese Bank Is Indicted In U.S and Also Barred'. *The New York Times*, Available at: <https://www.nytimes.com/1995/11/03/business/a-japanese-bank-is-indicted-in-us-and-also-barred.html> (5 September 2018).

Consequently, the entire Japanese financial system came under question as well as the US financial regulatory agencies who failed to identify the problems at the New York branch. As the Daiwa bank incident was exposed soon after Nick Leeson's scandal at Barings Bank, the combined scams raised serious doubts about the risk management policies followed by the financial services sector. The failure to detect Iguchi's crimes suggested that it was not an isolated incident and that the Japanese and New York financial systems were covering up other issues. Thus, this created public doubt in the financial systems' ability to handle these types of issues and this ineffectiveness was clearly highlighted in one of Iguchi's letters where he states; "I can clearly say on the basis of the experience I gained from the Fed inspection the year before last, that there is zero possibility that this case would be found out in the United States "if a cover up were implemented".¹¹⁰

To an extent Iguchi's actions were unpreventable as he acted irresponsibly on his own accord. However, it is strongly argued that US regulators should have identified his wrongdoings and change in behaviour. Iguchi even claimed that the Daiwa Bank continued to exploit some of his phony transactions after he confessed to the executives.¹¹¹

Jerome Kerviel

Jerome Kerviel was a junior level derivatives trader at Société Générale who, by way of risky one-sided bets, fake hedges and false documents, lost the bank £3.7 billion. Kerviel had learnt how to manipulate the bank's risk monitoring software to present unauthorised trades (building €50 billion exposure to European futures markets) as lower-risk arbitrage

trades. Upon Kerviel's criminal trial, Société Générale claimed that this was how the individual trader hid trillions of US dollars-worth of trades from his superiors and the bank at large. However, in 2016, a French court awarded Kerviel \$511,000 for unfair dismissal, claiming it was impossible that the trader was working in isolation: the bank must have played a role in facilitating and encouraging his risk-taking. Société Générale has been accused of 'almost wilful blindness or Nelsonian knowledge' in its treatment of Kerviel, who is pursuing a retrial on his conviction of forgery considering the verdict of unfair dismissal.¹¹²

If Société Générale's claims of ignorance are sustained, this is severely damaging for the credibility of the bank, and the wider financial services sector. That a trader of relatively junior position could generate such extreme losses points to clear shortcomings in regulation, stewardship, governance and risk-management competence. Equally, if the ruling is overturned and the Bank is shown to have played a facilitatory role in the orchestration of these fraudulent trades, then credibility is also at stake. Since the title 'rogue trader' seems to almost always be applied in retrospect, it is noteworthy that, in the time that Kerviel's trading strategy was earning the bank money, seventeen inspections were made by the banks internal risk controls. None of these highlight the deviancies from company policy.

110 Blustein, P (1995), 'From Trader's Losses to Daiwa's Scandal'. *The Washington Post*. Available at: https://www.washingtonpost.com/archive/politics/1995/11/04/from-traders-losses-to-daiwas-scandal/ef3f6792-353b-43ca-ab2c-9c13396a1810/?noredirect=on&utm_term=.b6b11158a2bd (5 September 2018).

111 Wudunn, S (1997), 'Daiwa Bond Trader Puts His Spin on Scandal'. *The New York Times*. Available at: <https://www.nytimes.com/1997/01/13/business/daiwa-bond-trader-puts-his-spin-on-scandal.html> (5 September 2018).

112 Gilligan, G (2011) 'Jérôme Kerviel the 'Rogue Trader' of Société Générale: Bad Luck, Bad Apple, Bad Tree or Bad Orchard?'. *Company Lawyer*, vol. 32, no. 12, pp. 355-362. Available at: <https://ssrn.com/abstract=2014487> (5 September 2018).

Cryptocurrencies: A New Source of Mistrust?

One of the most important innovations in fintech, cryptocurrencies and their blockchains is reforming the way money is transferred between businesses. The development of such technology in 2009 has encouraged banks to innovate trading desks and forced governments to react with regulatory measures over the decentralised transfer system. Although cryptocurrencies are increasing efficiency for financial services firms, there remain potentially crippling risks.

What is cryptocurrency?

Cryptocurrency is a digital currency that uses cryptography (converting data into unbreakable codes) to conduct transactions.¹¹³ It also utilises this process to 'mine' new coins of a certain cryptocurrency. Importantly, cryptocurrency transactions are not operated through a centralised banking system such as that used for electronic banking, thus meaning that government and central banks cannot control the flow of digital currency.¹¹⁴ Development of this technology was first attempted in the 1990s, yet it was not until 2009 that the first currency – bitcoin – was invented by the anonymous creator/s Satoshi Nakamoto. Since then, a host of currencies have been created, including Ethereum, Ripple and Litecoin – although none as large as bitcoin¹¹⁵.

Anyone can own cryptocurrencies through two methods: 'mining them', which requires thousands of calculations per second and a vast electricity supply; or by buying them through exchanges¹¹⁶. Moreover, digital currencies can be used for a range of purposes, from consumer to professional level: for purchasing goods, investing in, 'mining', or for business payments.¹¹⁷

Since they burst onto the scene in 2009, cryptocurrencies have seen a fast growth in interest and value; in August of 2018, Goldman Sachs announced plans to become the first large Wall Street Bank to open bitcoin trading.¹¹⁸ Nonetheless, it remains a controversial financial area in about which members of the public know relatively little. There is an ongoing inquiry being conducted by the House of Commons Treasury Select Committee analysing the risks and opportunities raised by cryptocurrencies, and committee chair Nicky Morgan MP has called for more regulation in this 'Wild West' industry.¹¹⁹ Polling agency Lend&DU found that, in the USA, only 32% of Americans knew about Ethereum, whilst considerably fewer (18%) considered investing in it.¹²⁰ Similarly, a joint poll by Wells Fargo and Gallup revealed that only 2% of U.S. investors had a stake in bitcoin, whilst 75% of investors viewed it as

¹¹³ Cointelegraph. 'What is Cryptocurrency. Guide for Beginners'. Available at <https://cointelegraph.com/bitcoin-for-beginners/what-are-cryptocurrencies#history>. (18 September 2018); Milutinovic, M. (2018). 'Cryptocurrency'. *Економика*, vol. 64, no. 1, p. 106.

¹¹⁴ Ibid. Milutinovic.

¹¹⁵ Op. cit. Cointelegraph; Hearn, A. (2018). 'Bitcoin and cryptocurrencies – what digital money really means for our future'. *The Guardian*. Available at <https://www.theguardian.com/technology/2018/jan/29/cryptocurrencies-bitcoin-block-chain-what-they-really-mean-for-our-future>. (18 September 2018).

¹¹⁶ Ibid. Hearn.

¹¹⁷ Op. cit. Cointelegraph.

¹¹⁸ Cuthbertson, A. (2018). 'Goldman Sachs Bitcoin Fund Rumour Boosts Cryptocurrency and Mixed Price Predictions'. *The Independent*. Available at <https://www.independent.co.uk/life-style/gadgets-and-tech/news/goldman-sachs-bitcoin-fund-rumour-cryptocurrency-price-predictions-a8480291.html> (18 September 2018).

¹¹⁹ House of Commons Treasury Select Committee. (2018). 'Digital Currencies inquiry'. Available at <https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2017/digital-currencies-17-19/> (19 September 2018); H. Cole. (2018). 'A FIST FULL OF BITCOIN: The 'wild west' of crypto-currencies such as Bitcoin 'must be regulated' to protect Brits at risk from hacking, MPs warn'. *The Sun*. Available at <https://www.thesun.co.uk/news/7292325/bitcoin-regulated-hacking-fears/> (10 September 2018).

¹²⁰ Gitlen, J. (2017). 'Ethereum, Ripple, and Initial Coin Offering (ICO) Survey Data & Report'. Lendedu. Available at <https://lendedu.com/blog/ethereum-ripple-ico-survey-data-report/> (18 September 2018).

The growth of the cryptocurrency market, led by bitcoin, flies in the face of how the asset management and advisory communities have tried to badge their service offerings since the financial crisis: sound investing based on diversification, risk and volatility management and, in decumulation, cashflow management as well. Yet the disintermediated model and high potential returns have appealed to a segment of (often younger) consumers who are wary of large institutions, both political and financial. Aside from the unhelpful 'get rich quick' allure of crypto, it goes against the move towards ESG and responsible investing. It takes an astonishing amount of energy to mine a bitcoin in the first place. Perhaps we should make cryptocurrency converts more aware of their carbon footprint.

Annalise Toberman, Head of Insight, Research in Finance

As 90% of public don't understand the details of blockchain & cryptocurrencies, it is an area of hype that can be exploited. Regulation is the only foreseeable way to ensure safe development of this technology and if it is correctly developed further, could lead to a device for increased trust and transparency in the future.

David Hannam, Co-founder, SharesInside

a 'very risky' opportunity – something which must be considered in deciding whether financial services organisations should look to expand their use of cryptocurrencies.¹²¹

Blockchains & Financial Services

Cryptocurrencies can be fully decentralised or operated through a blockchain system created by 'miners'.¹²² In exchange for mining new coins, miners are entitled to earn cryptocurrencies themselves.¹²³ Essentially, blockchains form the connections between transactions of certain bitcoins; a bond between previous owners of the coins whom all need to give permission for a particular transaction to occur. It is the miner who oversees this. Blockchains can be public – with unrestricted flows of currency – or private, which have limited accessibility.¹²⁴ Most importantly, while the abilities and scope for blockchains are unknown, research thus far indicates that they have the potential to hugely influence how financial transactions are conducted – particularly in financial services.¹²⁵ The financial services sector has invested \$22 billion, since 2015¹²⁶. Financial services leaders have successfully identified the advantages of private blockchains to financial transactions and it is currently utilised in: payments, post-trade settlements, security, trade finance and regulation.¹²⁷ Indeed, industry leaders are only becoming more committed to blockchains: 55% sought to use them in production by this year (and a further 22% by 2020), with the potential to employ blockchain transactions for royalty calculations and managing access to information.¹²⁸

121 Emem, M. (2018). 'Only 2% of U.S. Investors Own Bitcoin, Most View it as 'Very Risky': Wells Fargo Poll'. CKN. Available at <https://www.ccn.com/only-2-of-u-s-investors-own-bitcoin-most-view-it-as-very-risky-wells-fargo-poll/> (18 September 2018).

122 Op. cit. Milutinovic, p. 112.

123 Op. cit. Hearn.

124 Ducas, E., and Wilner, A. (2017). 'The security and financial implications of blockchain technologies: Regulating emerging technologies in Canada'. *International Journal*. vol. 72, no. 4, p 545.

125 Diordjiev, V. (2018). 'Blockchain Technology and Its Impact on Financial and Shipping Services'. *Economics, Ecology, Socium*. vol. 2, no. 1, pp. 51, 53

126 Arner, D., Barberis, J., and Buckley, R. (2016). 'Evolution of fintech'. *Georgetown Journal of International Law*. 47, pp. 1274-1275, in Ducas and Wilner, p. 541.

127 Ibid. Ducas and Wilner, pp. 548-9.

128 Op. cit. Diordjiev, p. 56.

Advantages to Cryptocurrency in Financial Services

Due to the decentralised operating system of cryptocurrencies, financial services firms would not need to use banks to conduct transactions, thus increasing efficiency in the industry.¹²⁹ This would give firms more control over their finances, and aid transparency by distancing themselves from the negative public reputation held by the banking industry. Private blockchains also provide advanced security due to the limited number of people involved in transactions, all of whom need to provide permissions.

As well as this, even though they are decentralised, cryptocurrencies can still be regulated. For instance, broker Bitcoin Suisse is a member of the Swiss Financial Services Standards Association (FSSA) and is thus committed to acting against money-laundering.¹³⁰ Such practice is essential in a mixed economy whereby money moves between crypto and regular currencies. It also ensures governments can still have some control in this area and confront issues they would not necessarily be able to solve in pure cryptocurrency transactions.¹³¹ For the financial services industry, this means they can demonstrate to both governments and the public how they act responsibly.

Disadvantages to Cryptocurrency in Financial Services

Yet, despite clear benefits to blockchain transactions, there are greater issues that such technology can bring to the financial

services industry. This primarily relates to the market uncertainty blockchains entail and criminal reputation held by cryptocurrencies. At a basic level, it is the unknown potential of blockchains that cause concerns.¹³² For instance, there is a maximum number of 21 million bitcoins available, and such a small market creates volatility and limits transfers to small amounts (to retain market stability).¹³³ Likewise, such scarce assets will increase the value of bitcoins as more are sold and could lead to hoarding by powerful financial services firms, if they vastly increase their use of the predominant cryptocurrency¹³⁴. More worryingly, some analysts believe that the wealth cryptocurrencies can bring investors has driven speculation, which could cause the market to crash and in turn threaten both large-scale investors (including financial services providers) and individual buyers alike.¹³⁵

Cryptocurrencies already have a negative reputation as the preferred currency of cyber-criminals. Individuals on the dark web take advantage of the anonymity provided in cryptocurrency transactions; this enabled the 'Silk Road' website to operate and sell illegal drugs.¹³⁶ Moreover, in May 2017, the 'WannaCry' global computer hackers demanded bitcoin ransom money in return for data they stole from 200,000 victims¹³⁷. Financial services firms should be careful to use such technology when it evidently has the potential to cause damage on a global scale. When paired with the lack of support from U.S. investors, this only makes cryptocurrency riskier to use.

¹²⁹ *Ibid.* Diordiiev, p. 53.

¹³⁰ *Ibid.* Diordiiev, p. 62.

¹³¹ Franklin, J. (2017). 'Swiss shut down 'fake' E-Coin in latest cryptocurrency crackdown'. Reuters. Available at <https://www.reuters.com/article/us-swisscryptocurrency/swiss-shut-down-fake-e-coin-in-latest-cryptocurrency-crackdownidUSKCn1BU0ZT>, in Milutinovic, p. 119; Ducas and Wilner, p. 561.

¹³² *Op. cit.* Diordiiev, p. 62.

¹³³ *Ibid.* Diordiiev, p. 54.

¹³⁴ *Op. cit.* Hearn.

¹³⁵ *Ibid.* Hearn.

¹³⁶ *Op. cit.* Milutinovic, p. 110; P. Vigna, and M. Casey, *The Age of Cryptocurrency: How Bitcoin and the Blockchain are Challenging Global Economic Order* (New York, 2015), p. 84., in Ducas and Wilner, p. 555.

¹³⁷ *Op. cit.* Milutinovic, p. 115; Cameron, D. (2017). 'Today's Massive Ransomware Attack was Mostly Preventable; Here's How to Avoid It. Gizmodo. Available at <https://www.gizmodo.com.au/2017/05/todays-massive-ransomware-attack-was-mostly-preventable-heres-how-to-avoid-it/> (18 September 2018).

Conclusion

This report has provided a comprehensive review of some of the major events that have impacted the UK, European and US financial services sectors. As shown by the examination of the crisis cases, they have all negatively affected the public's trust in financial regulators and governments, leading to disillusionment and scepticism. The after-the-fact notion that becomes plainly apparent is that most crises were 'preventable' or 'possibly preventable'. From the savings and loans crisis of the 80s and 90s through to the current Global Financial Crisis, it has been argued that these 'preventable crises' have played a significant role in eroding the already threadbare trust the public have held in financial institutions whose main job should be safeguarding customers and clients' money. While there are many other crises that could be examined, the case studies presented especially highlight the disparity in trust between customer and provider. These cases also demonstrate how technology has played its role reinforcing this lack of trust. Using literature from Robert C. Merton, Lynn, G. Zucker, Diane Coyle, Luigi Guiso, Angus Armstrong and others, this report has shown that 'my word is my bond' has been convincingly forgotten through the examined decades by many financial professionals and their institutions. This is reflected in the results of polling data and surveys by the public.

However, it is unfair to place the full blame on financial institutions because rogue traders will always look for loopholes and ways to game the system. While Hollywood romanticises their exploits, these people have financially harmed the public in their respective epochs for their own greed-driven, self-interested gain. Films depicting the playboy, cavalier attitude of these individuals detract from the seriousness of their actions and only inspires and encourages further mimicry, manipulation and corruption; all the while deepening the distrust people have in poorly regulated financial systems.

As technology has advanced into a new frontier of cryptocurrencies and blockchains, financial institutions, services and regulators are struggling to keep pace with these changes. The unregulated availability of Bitcoin, Ethereum, Ripple, Litecoin and countless others in production has presented a new challenge that many banks and other financial service firms will see as a source of new profitable opportunities. However, these innovations also present new obstacles to convincing customers and clients that this new technology will not lead to another financial crisis. The stigma of illegal activities such as 'dark web' transactions and money laundering have been the subject of most of the coverage for this new-age financial service. Taking these products into the mainstream will prove to be an uphill struggle for financial services as they come with negative connotations, to an already wary and distrusting of public. While there has not been a crisis involving this new technology to date, the warning signs are apparent due to the unregulated and decentralised nature of cryptocurrencies.

As the 4th industrial revolution steams ahead, new emerging technologies and business models that favour 'correct procedure' will continue to emerge and develop, eliminating the intermediaries who have their own agenda. This, in time, could have a positive impact on trust as people understand these revenue models can change and therefore the intentions of individuals and companies. Technology can be a force for good when used appropriately.

Hindsight has provided a basis for learning from mistakes of past crises; and it has allowed regulators and institutions to close loop-holes and formulate reforms to tighten controls. Continuing to adjust oversight and regulation based on lessons from the past will be of paramount importance as well as a basic requirement for overcoming entrenched scepticism and rebuilding trust in the financial system. However only time will tell if the relevant authorities will respond proactively, embracing the inevitable changes that new technology brings and getting ahead of the curve before another crisis rears its head and affects millions of people.

Next Steps

Progress begins with pragmatism

It is perfectly natural that the financial services industry and the thousands of people working in it have something of an aversion to the idea of looking at the catalogue of malpractice, malfeasance, miss-selling and misconduct that peppers its past. For the same reason that an individual is unlikely to dwell on his or her previous failings – it isn't a pleasant thing to do. It can be embarrassing, awkward, even painful. It can sap our confidence and paralyse us with fear of making mistakes.

However, 'looking in to the abyss' is exactly what needs to happen if we are to truly learn from the lessons of the past. By doing so we can prevent our collective past becoming our collective future. The financial services sector needs to understand and acknowledge that its past is littered with conduct failure, as evidenced by the accounts given in the analysis provided here, plus the hundreds of other incidents of a similar nature that could have been included.

Progress begins with pragmatism. If we are to make real progress, we need to have a very realistic understanding of the truth of the past; and accept it. For some, this will be virtually impossible; it will be hard to come to terms with the idea that the financial services sector has routinely misbehaved.

For others, this will be an easy conclusion to come to. In fact, it is very likely that many are already of the opinion that the financial services sector does have an ignoble past; and is

likely to have an ignoble future, unless something changes.

It is to that group that this paper is particularly aimed; those who are receptive to the idea that it would be a healthy exercise to constructively consider the failings of the past with the specific objective of finding ways to improve the future. We would argue that people with a 'progress begins with pragmatism' mindset are best placed to help positively shape the future. This is because they are unshackled by the inability to accept what needs to be accepted, and as such, can envision what now needs to happen - to move from truly understanding the past to enable the blueprinting of a brighter future.

The future is ours to build; and we can build it without guilt

It will be the people that occupy the present that will build the future, not those who have been responsible for the past. Whilst it is obvious that there have been many errors of judgement by individuals that have previously been in controlled market functions, regulators, trade bodies, professional associations and government departments, it is vital that we recognise that the individuals and organisations that 'had their hands on the wheel' in the past who might, to one degree or another, be partially responsible for what has happened, are not the same people as those in the driving seat today.

This creates a wonderful opportunity for the people that are now in charge to constructively critique what happened

in the past without the burden of any personal or organisational guilt or culpability around what previously occurred. The people in charge today are free to constructively criticise what has happened without fear of blame or “guilt by association” and we believe this to be important. The purpose of this document has never been about attributing blame; it has been to cultivate an honest understanding of the past with a view to finding a sense of collective purpose about the possibilities for a better future.

Critical success factors in optimising the future

At this point it is worth providing a simple and straightforward problem statement. Let’s imagine the problem to be this question: “How can we accelerate the rebuilding of trust and confidence in financial services?” Within this question there are certain assumptions that we hope can be accepted at face value, namely:

1. There is distrust towards financial services
2. It is worth attempting to rebuild that trust
3. There are already various worthwhile attempts being made to restore trust and confidence in the system

If we step back from the detail, and consider what might make the most sense from a generic standpoint, we believe we get to these initial ideas about how trust and confidence can be rebuilt:

- Inclusivity is key; because it is the entire sector that needs to change so all aspects of it should be involved in determining what needs to change and how that change should happen. It follows that market participants, regulators, relevant government departments, think-tanks, campaign groups, trade bodies and professional associations should all be invited to be part of the solution;
- The approach taken should be collaborative, co-operative and collegiate; because it makes sense for all involved with the solution to feel comfortable working together in a constrictive and non-partisan way. We are all on the same side so it should feel that way;
- Remedies must be future-gazing; we need to look forward. Whilst we know we can learn from the past and we know the failings of the past will guide how we move forward, the “time to mourn” is over. It is all about the future now and we must look into the future with a sense of possibility, positivity and promise;
- Government has an important part to play in initiating a collective solution because the government is uniquely positioned to be the spark that lights the fire. However, it should not be government that does the “heavy lifting;” it is the sector itself that that needs to drive the change that is needed;
- The focus should definitely include the pensions and investments sector; because according to the Office of National Statistics (ONS) the UK is experiencing the lowest savings ratio since records began way back in 1963 and it is known that many other countries have similar problems; and pension policymakers and regulators around the world are particularly concerned with what can be done to help avoid mass pensioner poverty in the future. Rebuilding trust is part of that solution so the “pension crisis” and “savings gap” is the most obvious burning platform to be resolved;
- Any approach must be consensus-based; because only a solution that has a broad base of support is likely to succeed. Pensions Automatic Enrolment has been a great success in the UK; and one of the reasons for that has been the broad base of support it has had from all political parties and all relevant parts of the

sector. Pensions Auto Enrolment is an excellent solution to the pensions crisis; perhaps we can capitalise on the broad-base-of-support approach to solve the trust deficit crisis;

- A steady pace to reform will be crucial; because whilst everybody would like the trust deficit crisis to be solved quickly it would be wholly unrealistic to expect that to be possible. The problem is too big and too complex for a quick fix. This is going to be a marathon, not a sprint;
- The effort will need to be sufficiently resourced; however, we do not need to think about resourcing in the very first instance; it will be wiser to first get a feel for what the solution looks like first of all so we can start to better understand how the solution can be implemented and therefore improve our understanding of the quantum of resource that may be required;
- A blended solution will be crucial; because the challenge is complex, multi-faceted and has many root causes. We will need to consider a range of pathways – cultural, regulatory, technological, political, reputational; as well as “hearts and minds,” protocols, codes, oaths, standards, values-based leadership, media management, positive communication, disclosure, accountabilities and so on. The more pathways we can imagine the more opportunities we have to make a positive difference;
- For the UK, we must be cognisant of Brexit in our approach; because Brexit has impacted the UK’s reputation on the world stage. Furthermore, the reputation of our financial services sector is integral to our nation’s overall credibility, respectability, and reliability. If the UK’s reputation were a game of snakes and ladders we have just slid to the bottom of a long snake; compared to where we were at the top of a ladder after the 2012 Olympics. No doubt government will

be mindful of the need to rebuild our country’s reputation post-Brexit and this project could be a small but important part of that;

- The measures we take should be free of hierarchy and status. No project has ever set out to systematically rebuild trust and confidence in the financial services sector, so it would be a mistake to be prejudicial in terms of which individuals and organisations can contribute what; and how senior or otherwise they may be. We want every like-minded and progressively-minded individual and organisation to opt-in to be part of the solution; and every individual and organisation should be able to opt-in at the same level. It is going to take a team effort;
- We do not assume that the Transparency Task Force will lead the project; because whilst we are playing a part in getting the idea off the ground, there are many reasons why others may be better placed to pick up from here. We will be proud to have played our part in getting the idea up and running but our loyalty is to the idea of the project succeeding not to the idea that we lead it. Whoever and whatever is best placed to lead the project, should lead it and we (and all other parties) should be open-minded on how the project is organised and led moving forward;

What is the proposed first step?

We believe there is merit in special meetings being held where all interested stakeholders will have the opportunity to discuss the trust deficit problem and explore ideas that may help to solve it. We are therefore going to be running a series of special meetings around the world dedicated to the question “How can we accelerate the rebuilding of trust and confidence in financial services?”.

Because we are so well established in the UK, the special meeting will be the first ‘Trust and Confidence in Financial Services Summit’ in the World; (akin to

the first Transparency Strategy Summit in the World that we led in October 2016, held at the House of Commons and Co-Chaired by Tom Tugendhat MBE MP).

At the UK Summit, attendees will include senior representatives from:

- The Financial Regulators i.e. the Financial Conduct Authority, The Pensions Regulator, The Financial Reporting Council, The Prudential Regulatory Authority;
- Relevant Government Departments;
- Members of the House of Lords;
- Members of the House of Commons;
- Members of relevant All Party Parliamentary Groups;
- Financial Services Trade Bodies;
- Financial Services Professional Associations;
- Relevant Campaign Groups;
- Relevant NGO's;
- Think Tanks;
- Governance and Risk Experts;

In addition there will be relevant academics and authors; and progressive market participants from all parts of the financial services and related sectors including banks, building societies, insurance companies, pension firms, pension schemes, asset managers, investment consultants, custodians, FX firms and so on; plus related professional services firms i.e. legal, audit, accounting; plus specialist organisations that may be able to make a valuable contribution to the discussion from a technology, culture, human capital, incentive design, communications, PR, reputation management and behavioural finance perspective; and more.

For commercial organisations, this will be a pay-to-attend event to help cover the costs of running the project as a whole but a donation model will be used so no individual need pay anything if they do not want to – it is very important that cost does not become a barrier to participation because we want the best people involved regardless of the size of their budget.

Government officials, regulators and so on will not be expected to pay to attend.

The Summit will have 4 elements:

- i.** An overview of this “How can we accelerate the rebuilding of trust and confidence in financial services?” White Paper;
- ii.** Speeches from senior representatives of key stakeholders including regulators, trade bodies, professional associations, progressive market participants, thought leaders and so on;
- iii.** “Discuss and Report Back” sessions on “How can we accelerate the rebuilding of trust and confidence in financial services?” It is in this part of the programme that we will be able to tap into the collective creativity of the group;
- iv.** The Next Steps section, i.e.
 - A “straw man” overview of how the Project could be run over the next 3 to 5 years;
 - Decisions on who does/doesn't want to be included in the project moving forward;
 - The types of role that individuals/ organisations can have; including becoming part of the Project's Steering Group (strategy) and the Project's Management Team (tactical, implementation); and
 - Confirmation of agreed actions and time-scales; date for the next meeting.

The experience of successfully leading the Transparency Strategy Summit in October 2016 at the House of Commons fills us with confidence that our second Summit will also be a success.

We anticipate that the Summit will galvanise support for an inclusive, consensus-based approach to tackling the trust deficit whereby all the key stakeholders including regulators, can play an important part in. We expect the project to go well but it could be great; it could become a landmark initiative that will make a significant improvement to the reputation of UK PLC's financial services sector moving forward; the size of the prize is XXL.

In practical terms we are planning for the Summit to yield:

- Many great ideas on how we can accelerate the rebuilding of trust and confidence in financial services
- The outline of a multiple work-stream project plan on how those ideas can be developed, refined, finessed and implemented
- Many individuals willing and able to roll their sleeves up and help drive the project forward
- Direct input from all the relevant regulators and government departments. We believe that from their point of view this is a "what's not to like?" initiative that positively aligns with their statutory remits and core purpose

Outside the UK we will be running smaller versions of the UK Summit. We will be repeating the process at least yearly in each City we engage with over a five year period; making the "How can we accelerate the rebuilding of trust and confidence in financial services?" question central to a major 5-year project.

We produced this paper with the intention to:

- Show that there is a trust deficit in financial services
- Demonstrate that the trust deficit has adverse consequences for the finance sector and the public at large
- Express that there is merit in "putting the past behind us" and looking into the future for solutions; not the past for people to blame
- Show the wisdom in building a broad base of support for a sector-wide solution
- Explain how running special meetings around the world is the ideal way to galvanise support and kick-start the quest for solutions that will be needed

For the UK in particular, the Paper will illustrate that there is a tremendously positive up-side for "Brand Great Britain" and UK Plc in repairing the reputation of our financial services sector; especially timely given the reputational consequences of Brexit

The action we now ask you to take

If having read this paper you believe:

- There is a trust deficit
- You like the idea of accelerating the rebuilding of trust and confidence in financial services
- There is merit in all key stakeholders working collaboratively
- You would like to be part of the solution
- You or a suitable representative would like to explore the idea of being included in what we are doing

...then please let us know ASAP and we will provide further details about how you can get involved including through participation at the various special meetings being arranged around the world.

Thank you.

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