6 Freedom in Finance

The Importance of Epistemic Virtues and Interlucent Communication

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Introduction

The global financial crisis (GFC) that started in 2007 has made us aware of the vulnerabilities of sellers and buyers of mortgages; for whereas economists have over the years uncovered many larger causal factors of the crisis, there is little doubt that most contemporaneous commentators thought the crisis had started with the 'subprime mortgage meltdown'. Sub-prime mortgages, the story went, were borrowed by people who couldn’t really afford them from lenders who didn’t care because they knew that they could easily get rid of the risks by selling the mortgages on to structured finance firms that would 'repack' them into the notorious mortgage-backed securities—a supply chain of misinformation, moral hazard, and myopia.

There is little doubt that something else would have started the recession if the sub-prime mortgage bubble had not burst, but mortgage regulation is nonetheless central in many policy responses to the crisis. In the United States, the Dodd-Frank Act aimed, amongst other things, at providing consumer protection in mortgage markets by setting compensation standards for loan originators, minimum standards for mortgages, and minimal underwriting standards, and it capped fees for borrowers of high-cost mortgages. EU Mortgage Credit Directive 2014/17/EU introduced information requirements. These helped borrowers make better mortgage decisions and aimed to protect borrowers from over-indebtedness through a set of conditions on their mortgages’ loan-to-income and loan-to-value ratios. Such measures were motivated by observations concerning the informational challenges that certain consumers face. Elderly and less educated consumers use most financial services significantly less than well-educated and younger consumers and have less trust in consumer protection in mortgage markets (Clifton, 2017).

There is certainly merit in the idea of introducing regulation that ensures the industry creates ‘products that consumers actually want—and actually understand’, as former U.S. president Barack Obama (White House, 2009) once phrased it. But that only takes us so far. There are two ways in which you can make sure that a given consumer understands a product: you can decrease the complexity of the product until the desired understanding is reached; or you can increase the understanding of consumers until they grasp the complexity of the product. Most regulators seem to have taken the first route. Indeed, this is often a very sensible route, but not always, because it may stifle innovation that we badly need.

We first swiftly marshal evidence for two preliminary claims: firstly, that consumers have an interest in fostering what we call known freedom (consumers will be said to have known freedom about mortgages whenever they have sufficiently detailed and justified information about relevant mortgage options); and secondly, that consumers have an interest in being able to buy complex products. (Vulnerable consumers in particular may need complex products to deal with life’s adversities.) These claims are meant to establish that complexity must be increased in certain cases. We then consider a case that has received significant attention in the finance literature: the Continuous Workout Mortgage. Finally, we address the issue of how the desired increase in understanding of a complex product might be brought about, considering the regulation of information, epistemic virtues, and interlucent communication.

Known Freedom

Why would consumers assign value to freedom? We are fairly neutral here with respect to the precise definition of freedom: all we assume is that typically your freedom grows if your choice set grows, and your freedom shrinks if your choice set shrinks. We are here loosely inspired by Carter’s (1999) and Kramer’s (2003) work on (pure) negative freedom. One argument is that freedom boosts desire satisfaction. If desire satisfaction is valuable, and if in addition to that it is true that if your freedom increases, your desire satisfaction increases, it follows that freedom is valuable. This is a fairly standard observation based on the assumption that the likelihood with which your desires are satisfied increases with the number of actions available to you. A more deontological argument could be put in terms of responsibility: if you assign value to personal responsibility, and if, in addition, you hold onto the view that your personal responsibility increases if your freedom increases, then freedom is again of value to you. The idea is that if you make a choice, you not only decide in favour of some action but also against the other available actions, and thus, the argument goes, you bear responsibility for choosing one thing and for excluding the other things (Hurka, 1987).

These are not just two arbitrary arguments for the value of freedom. As Brown (2009) has argued persuasively, it is these two arguments (taken together as implying that there is value to assuming personal responsibility for satisfying your own desires) that informed the Reagan and Thatcher administrations to move the responsibilities for, amongst other
things, healthcare, housing, and financial planning from the state to the individual. So these arguments were essential to provide ideological backing for deregulation (which increases freedom of business and, as a result, may increase freedom of choice for consumers) that is often alleged to have caused so much trouble.

One might doubt whether these arguments are still very appealing after a financial crisis. We believe they are; but only if we realise that we need to insert an additional premise that seems to have been ignored in many cases of deregulation—namely, that genuinely to use your freedom to assume personal responsibility for your desire satisfaction, you need to know what your freedom amounts to. You need what we call known freedom.

To exemplify the concept of known freedom, we will first give a more precise picture of a person’s choice situation. Firstly, there is a set of available actions from which you can choose: your choice set. Secondly, each of these available actions has numerous consequences arising with objective probabilities. A person discussing mortgages with an advisor, for instance, may face a choice between various mortgages involving different down payments, interest rates, maturities, and so forth. These options naturally have different characteristics. They have different possible consequences, and even if two options have identical possible consequences, the probability with which they arise may not be the same. We will say that you possess known freedom in a choice situation if you know, firstly, which actions are available and which ones are not; secondly, what the possible consequences of these actions are; and thirdly, what the probabilities are with which these consequences arise. To be sure, full known freedom is practically impossible to attain. But much value can be gained from approximating the ideal.

Our claims now follow easily: if we assume that the larger your known freedom, the greater is your desire satisfaction (or personal responsibility, respectively), then known freedom has value for you; for if freedom increases desire satisfaction and responsibility, known freedom increases these things to an even larger (or at least not smaller) extent because none of the actions available to you are curtailed if you exhibit known freedom.

You may have ample freedom, but as long as you lack information about the particular actions you can select, you won’t use these actions to satisfy your desires or to assume personal responsibility for those that you are unaware of and don’t select. Furthermore, even if you have ample freedom, if you are not aware of the actions available to you, your capacity to be responsible for choosing or omitting a particular course of action is impaired.

When policy-makers or the financial industry maintain that innovative, complex financial products and services help people to satisfy their desires, the implicit assumption is that these people are sufficiently well informed about these products and services to be able to make a responsible choice. If this assumption does not hold, consumers do not have known freedom.

Complex Innovation

Although many commentators have accused financial innovation as being one of the major contributing factors to the crisis, Nobel-prize winning economist Robert Shiller has been an outspoken advocate of innovation. In *Finance and the Good Society*, Shiller (2012) outlines how innovation in financial capitalism may enable consumers to secure and safeguard a wide array of long-term interests that, he believes, are morally relevant. Shiller shows that contrary to what it is popular to think today, financial instruments are not there just to please Wall Street; rather, well-designed products mitigate risks that have adverse effects on the satisfaction of essential needs and interests of consumers (e.g., access to food and clothing, adequate housing and education, etc.). In capitalist societies, the degree to which individuals can secure such long-term needs and interests depends to a significant degree on budget constraints determined by income, assets, access to credit, and so on. Consumers find a host of threats on their way to achieving these goals, including things such as health problems, crime, natural catastrophes, wars, and macroeconomic shocks. Such events may severely contract consumers’ budgets and thereby decrease their chances of securing their long-term interests. These risks are, in Dworkin’s well-known terminology, cases of “brute” luck: They have negative effects on your budget constraints, but you don’t take on these risks in a ‘deliberate and calculated’ manner (Dworkin, 1981, p. 293).

As Dworkin argues, insurance effectively transforms brute luck into option luck, by which he means a risk that is calculable and can be assumed deliberately. Although insurance has been with us since the Italian Renaissance, there is still a wide range of brute luck events not addressed by off-the-peg insurance policies. One reason why insurance may be hard to come by has to do with moral hazard. Moral hazard is the risk that policyholders behave less carefully than they would without insurance (e.g., with insurance against bike theft, you might be less likely to use an additional bike lock). Shiller proposes that more sophisticated insurance contracts could be designed whose coverage and efficiency go beyond standardly offered policies.

Here is a stylised example (Shiller, 2012). Because crops depend heavily on weather conditions, it would help farmers if they could buy insurance against excessive rainfall, droughts, and so on. If the policy covers crop failure itself, moral hazard is likely to be a problem as farmers may shirk their responsibilities or engage in downright fraud. Meteorological information technology has advanced to such a degree, however, that the actual insurance contracts can refer to third-party data about local weather conditions rather than to crop failure data deriving from the policy-holders themselves. Shiller observes, however, that because such policies are more complex than traditional crop insurance, uptake amongst farmers in developing countries is poor. A policy that refers to statistical
models provided by some meteorological organisation may just be very
difficult for them to understand. At the same time, however, they would
clearly benefit from such insurance.

Better Mortgages?

Crop insurance may not be the most straightforward concern for most
people. But mortgages probably are. We will now consider the example of
the CWM, as proposed by Robert Shiller (Shiller et al., 2017), to illustrate
how a complex product consisting of a fairly standard mortgage contract
and an innovative, index-based insurance product benefits consumers.

Consider first a fixed-rate mortgage (FRM). FRMs are debt contracts
for the purchase of real estate with two components: the principal, that
is, the amount of money borrowed from the lender that has to be fully
repaid; and the interest the borrower has to pay. Typically, each month
the borrower pays some interest and repays some part of the loan until
the loan has been fully repaid after, say, 30 years (maturity). FRMs are fully
amortised, which means in this case that if borrowers make the scheduled
monthly payments, they will have repaid the entire loan after 30 years.
With a fixed interest rate, monthly payments are constant over time, but
the portion of interest decreases, while the portion of repayment increases.
The consequence of this is that equity in the house grows at a lower rate
in the first years of the loan than in the last years. For instance, if you
borrow £100,000 at a rate of 5% with a maturity of 30 years, your interest
in the first month is £417 and repayment is £120, whereas in the last
month your interest is £2 and your repayment is £535. The interest rate
is fixed, so the monthly payments are constant at £537. After 15 years,
you haven’t even repaid a third of the total loan (£32,116, to be precise).

FRMs have two advantages. Constant payments decrease the risk that
a borrower’s income will be insufficient to cover the monthly payment at
some point in time. This contrasts with adjustable-rate mortgages that,
even though they may fully amortise, may lead to ups and downs in the
monthly payments. And this contrasts, too, with interest-only mortgages
that do not amortise and which require the borrower to pay off the total
principal at maturity.

Although a fully amortised FRM is a little more complex mathematically
than an interest-only mortgage, it has emerged as the popular stan-
dard mortgage contract after the Great Depression of the 1930s. But brute
luck may kick in. Take an extreme case first: for whatever exogenous
reason, the house becomes worthless after 15 years. With an FRM you
still have to keep on repaying £100,000—£32,116 = £67,884 for a house
that is worthless on the market. Unsurprisingly, such cases of ‘negative
equity’ often lead to repossession of the house by the lender. U.S.
households exposed to negative equity have historically been twice as likely
to default (negative equity is often considered a necessary condition for
default) or involved in serious mortgage-related delinquencies (Haugh-
wout & Okah, 2009).

CWMs were created to counteract the effects of negative equity; they
do this by insuring borrowers against decreases in house prices. The
repayment schedule of a CWM differs from that of an FRM: it adjusts to
regional house prices because it is linked to a regional house price index
such as the Shiller-Case Index (Case & Shiller, 1989), such that monthly
payments decrease if the index drops. At the origination of a CWM, a
maximum annual repayment is specified, which is determined by the
value of the regional house price index at the time of origination. If at
some point in time the index exceeds this initial value, the borrower has
to repay the maximum. But if the index is lower than the initial value,
the repayment is going to be lower as well. So if a house loses market
value (as measured by the index), the borrowers’ payments decrease and
in the extreme case described they would have to repay nothing, not
even interest.

A result of this is that lenders cannot know what they will earn. If house
prices decline and CWM repayments are reduced due to this, it is the lend-
ers that have to absorb these losses. So one should expect them to want
to be compensated. The compensation they request is a risk premium that
CWM borrowers pay. This risk premium is the difference between the
initial maximum repayment negotiated at the origination of the CWM
contract and the (slightly lower) repayment for an equivalent FRM. In
good times, when the house price index is high, CWM payments will be
slightly higher than FRM payments; but in bad times, CWM payments
will be substantially lower than FRM payments.

Unfortunately, despite their potential to safeguard consumers from neg-
ative equity, CWMs have remained rather unpopular amongst mortgage
borrowers. A particularly plausible reason is that whereas consumers are
not prohibited from access to CWMs, they refrain from choosing these
loans because of a failure to grasp the contract sufficiently well. We make
several quick observations in this connection. First, risk-adverse consum-
ers have no strong incentive to experiment with non-standard mortgages
outside times of crisis or times in which crisis are relatively recent. As
we hinted earlier, FRMs emerged as the popular standard in the United
States only after the experiences of the Great Depression when it became
clear that short-term ‘balloon’ loans became virtually impossible to refi-
nance due to limited bank lending, which caused a wave of foreclosures
(Campbell et al., 2011, p. 96). So without a trigger event, markets for
CWMs are likely to remain illiquid. Secondly, there is evidence that due
to cognitive biases, consumers often focus primarily on the short-term
costs of mortgage contracts, even if they might be vastly more expensive
in the long run (Garthgood & Weber, 2017, Badarizna et al., 2018). The
result in the case of CWMs is that consumers will probably shy away from
choosing CWMs because their implicit insurance makes these contracts
more costly in the short term. Thirdly, mortgage originators and innovators have little incentive to contract products such as CWMs if consumers focus on salient, short-term price dimensions of mortgages. Originators find it vastly more profitable to offer superficially attractive products to consumers than offering complex, but potentially better, long-term products (Campbell et al., 2011).

Regulating Information

We have tried to provide some evidence for two claims: Known freedom is instrumental to increasing consumer desire satisfaction and responsibility, and to deal with some of life’s adversities, innovative, complex financial products will be necessary. At the same time, known freedom is not always achieved in practice, and the post-crisis attitude towards financial innovation is not very positive to say the least. We here consider two of the policies that regulators consider: providing information to consumers and enhancing their information gathering and processing skills (Clifton et al., 2017).

The degree to which these policies increase known freedom of course depends on the characteristics of the consumers. The first type of policy is appropriate to address information asymmetries inhibiting rational consumers’ capabilities to make an optimum choice given their needs. But whether a given financial product suits these needs may be difficult to ascertain if information asymmetries cloud the consumer’s judgement. For instance, if you contemplate buying a CWM, you must form a judgement concerning the correlation between the price development of the house you own and the development of a given house price index that captures the average house price development in a certain region. If your house is atypical, a CWM may not be the most attractive choice. But whether your house is atypical may be rather difficult for you to find out. The lender, on the contrary, may have private information about price movements of similar houses that they financed before, or it may be much less costly for the lender to obtain the information from other sources.

We believe that this suggests that we may have to face a trade-off between increased innovation, on the one hand, and, on the other hand, increased informational regulation; if we allow for a greater degree of innovation to stimulate the design of products and services that people really need, then it may be reasonable to make sure that sellers face more stringent rules concerning information disclosure as disclosing information to prospective, rational buyers increases their known freedom. Such a trade-off in favor of disclosing information to buyers is, we believe, justified as long as it makes a genuine contribution to the liberal ideal of known freedom.

Information provision only goes so far, though. Consumers won’t all benefit from accessible information to the same degree. We are here particularly interested in the negative influence of cognitive biases on financial decision-making; that is, we are concerned with those consumers who economists tend to call ‘irrational’. Such consumers are likely users of simple heuristics that make them focus on easily discernible features of a mortgage contract instead of its specific risk characteristics (Thaler, 1985). In such cases, merely providing information is unlikely to enhance known freedom; it may even decrease it.

We focus on two cognitive biases that have attracted some attention in the literature on mortgage contracting: myopia and optimism (Bar-Gill, 2009). The term myopia means to capture the propensity of consumers to place excessive weight on present costs while ignoring future costs. Optimism refers to the propensity to underestimate the likelihood of certain adverse events. Consumers who are biased in their decision-making due to myopia are much more likely to accept contracts with deferred cost features, which often turn out to be more expensive than contracts that do not exhibit these features. The combination of myopia and optimism is particularly dangerous to borrowers, as it leads them to prefer mortgage contracts with deferred cost features, that is, contracts including low initial interest rates (‘teaser’ rates) that are compensated by escalating interest rate payments a few years after the origination of the loan. Consumers with these biases don’t see the future sufficiently clearly, and to the extent they see the future, it is painted in overly rosy colours. They may, for instance, falsely expect their incomes to increase proportionally with the interest rate on their mortgage or fail to perceive the likelihood of losing their jobs.

These and other biases undermine known freedom: in general terms, consumers suffering from cognitive biases fail to assign accurate probabilities to the consequences of the actions in their choice set, and they may even fail to see that certain actions are available and/or erroneously believe that certain actions are available to them. These biases are well-known. Yet before the crisis broke out, regulators by and large assumed consumers to be rational and to be capable of making informed choices; consumer protection regulation in mortgage markets (and elsewhere) was therefore primarily focused on regulatory interventions of the first type. Even today, regulators globally seem to be aiming first and foremost at information provision. Mortgage Credit Directive 2014/17/EU, which we mentioned earlier, contains rules on the provision of information concerning the amount and duration of a loan, the type of interest rate, the conditions for pre-payment, and exchange rate risks associated with the loan as well as the total costs of the loan, including fees, in terms of annual percentage rates. This has led to the use of disclosure forms known as European Standardised Information Sheets (ESIS), which have a very similar purpose to Truth in Lending Disclosure Statements and the Good Faith Estimate of Closing Costs Form (GFE) in the United States.
from becoming the victims of problematic heuristics, that is, to limit the impact of cognitive biases that stand in the way of weighing options appropriately. Financial literacy education (FLE) initiatives are the key example here. FLE focuses on teaching consumers a range of core concepts including personal finance, information about national legal frameworks, budgeting, and so on. Although such programmes are to be applauded, critics point out that their success depends significantly on participants' motivation (Mandell & Schmid Klein, 2009) and that they do not significantly decrease the impact of cognitive biases on decision-making (Willis, 2008). Thus, it is doubtful whether FLE in principle enhances consumers' known freedom efficiently.

Epistemic Virtues

Let us take stock. We started arguing that consumers stand to benefit from being informed about the characteristics of the products offered by the financial industry and moreover, that complex financial products may be needed to insulate them against life adversities. This naturally leads to a tension: Will consumers ever be informed enough about complex products? Will they attain the ideal of known freedom? We moved on to look critically at two ways in which regulators attempt to boost informedness amongst consumers, namely, through detailed information disclosure requirements and financial literacy education, and we concluded that there are reasons to be sceptical about effectiveness.

We are not going to propose a cure-all here; gaining, processing, evaluating, sorting, storing and discarding information can be extremely hard work for which people may lack motivation or competence. What we do want to do is to suggest a move away from regulatory solutions (at the level of collective, public policy) by considering an ethical approach (at the level of individual, private action) to information based on epistemic virtues. A potential worry about such a move is of course that it will lead to the minimalist position that it is entirely and solely the responsibility of individual consumers to make sure that they possess the requisite knowledge. However, as we will show in the final section, an industry committed to the desire satisfaction and/or personal responsibility argument for freedom must contribute to consumer knowledge.

A more philosophical worry might be: Does it make sense to consider belief formation from an ethical point of view? A key paper defending exactly that claim is Clifford's (1877) 'The Ethics of Belief'. His celebrated case of the epistemic vices of a ship owner is worth recounting here. The ship owner considers sending one of his ships to sea. Seeing that it is in poor condition, perhaps not even seaworthy, he considers having it refurbished. However, to do so will cost him a lot of money, which he does not want to spend. As a result of his desire not to spend the required funds, he gradually rejects his negative beliefs about the ship's condition, eventually...
deceiving himself into believing that the ship will come home this time too, based on an unjustifiable induction from the fact that it had made many successful trips in the past. It does not return, though, and many passengers die at sea. Clifford then blames the ship owner, noting that 'he had no right to believe [in the soundness of the ship] on such evidence as was before him' (Clifford, 1877, pp. 289–290).

Of course the belief was false, and the ship owner had no good reason to hold it. Yet what can it mean to deny him a right to believe a certain proposition and to charge him with moral censure about holding it? Epistemologists and ethicists have recently started developing a full-blooded ethics of belief along Kantian, consequentialist and virtue-theoretical lines. Of these, the concrete insights from virtue epistemology are especially useful in the present context. One of the main tasks of a virtue ethics of belief is to examine what the specifically epistemic virtues are and how such virtues relate to practical, non-epistemic virtues. Epistemic virtues are genuinely Aristotelian virtues in that they are acquired dispositions to strive for the mean between two extremes, and they are constitutive of the good life. (They do not, though, coincide with what Aristotle calls the 'intellectual' virtues such as wisdom and prudence.)

A helpful way to categorise epistemic virtues is the following (Montmarquet, 1993). Firstly, there are the virtues of intellectual impartiality. These include dispositions such as open-mindedness, readiness to confront one's ideas with those of others, and an active awareness of one's epistemic shortcomings and fallibility. Next are the virtues of intellectual sobriety. Intellectually sober-minded individuals are disposed to steer the middle course between the reckless, overly enthusiastic adoption of beliefs, on the one hand, and the inert disinterestedness that can lead to a reticence to espouse beliefs, on the other. Intellectually sober consumers, for instance, take advertisements with a grain of salt; they are sceptical but not so sceptical as to never adopt a belief. The terminology may suggest that intellectual sobriety is simply the non-epistemic virtue of temperance exercised in an epistemic domain, but that impression would be wrong. Epistemic virtues are acquired in different ways from non-epistemic virtues, and non-epistemically temperate persons are not of necessity intellectually sober minded. This is also true of the next kind of epistemic virtue, intellectual courage. Intellectually courageous individuals are eager to subject their beliefs to thorough scrutiny and persist in their inquiry—even if they meet resistance from others—until it has reached completion. Intellectually courageous individuals keep trying to answer the questions they ask, even when this boldly reveals their ignorance. But again, a person who acts courageously on the battlefield is not necessarily intellectually courageous.

Clearly, epistemic virtues do not come cheap: In addition to the afore-surveyed biases (myopia and optimism), there are a host of other biases that negatively affect them; and stress, sleep deprivation, and alcohol have similarly discapacitating effects. But an emerging body of empirical research suggests that acquiring and maintaining epistemic virtues is feasible and that using them is beneficial. Most of this research still concerns medical decision-making (Pritchard, 2005). However, we believe that encouraging findings are coming forward from behavioural finance supporting concrete recommendations to make individual investors aware of their epistemic limitations (Forbes, 2009; Montier, 2007).

Interlucent Communication

That is all very fine of course: intellectually sober-minded consumers will not immediately conclude that the mortgage the adviser claims has the lowest rate is the best choice for them; intellectually courageous consumers will keep asking questions about the specific differences amongst the options on the table; intellectually impartial consumers will actively seek to find counterarguments against particular options. Yet, if finance practitioners give evasive, incomplete, deceptive or plainly false answers, even the most epistemically virtuous consumers will hardly be able to acquire sufficient knowledge about their choice options.

And even if sellers speak without intention to deceive and buyers exercise their epistemic virtues, problems may arise as it is not always clear that communication will succeed. Here is a stylised example. In most countries, one type of mortgage you can buy is a mortgage that does not amortise. (So the full principal has to be paid at or after the loan reaches maturity instead of a bit every month.) Such mortgages are called 'interest-only mortgages' in English. We draw our example from a Dutch context, though, where they are called 'aflossingsvrije hypotheek'. Although the English term emphasises the fact that one only pays interest on the loan, the Dutch term suggests that the most important feature is that the mortgage doesn't need to be repaid (the literal translation is 'repayment-free mortgage', as in Dutch parlance 'aflossing' [repayment of principal] and 'rente' [interest] are distinguished). Personal communication with compliance officers from Dutch mortgage providers (and many consumer complaints on online fora, TV programmes, etc.) attest to the fact that a sizeable number of people didn't realise that a repayment-free mortgage does in fact require you to repay.

Did providers mislead consumers? We don't necessarily think so. We are sold 'skin rejuvenation treatment' but don't think this actually decreases the age of our skin, and we buy stain removers despite the fact that we are aware that the ads overstate their effectiveness. We use euphemisms and hyperbole all the time. Game theorists might describe situations in which, despite understatement and overstatement, speaker and hearer possess common knowledge about the meaning of the words and thereby succeed in communicating effectively (Chwe, 2001). Common knowledge captures a particular kind of epistemic situation in which
This might raise the issue of who is responsible for such failures. Establishing common knowledge is not the responsibility of the finance industry only. Consumers exercising the virtue of interlucency will easily spot possible failures if they concern technical terms. Take a mortgage provider that, questioned about fees, says that if the par rate on sub-prime loans is 9 per cent, they earn one point in YSP (yield spread premium) if the mortgage sells at 9.5 per cent. Firstly, rather than using standard, everyday words in non-standard ways, the mortgage provider is using technical terminology in the standard way used in the profession. It is certainly possible that they realise that the explanation is not going to help this particular customer very much. Yet given that par rates and YSPs are things mortgage providers deal with rather frequently, they may well believe that consumers understand these terms sufficiently well and hence may not suspect a lack of common knowledge about the meaning of terminology. (Doctors may just as well come to believe that all of their patients understand certain technical medical terms.) Customers, by contrast, will immediately spot the lack of common knowledge because they realise they don’t understand what ‘par rate’ and ‘YSP’ mean. Moreover, customers also know that the provider knows that they, the customers, are best placed to spot such failures. So here it is the interlucent consumer rather than the service provider who has to take action to generate common knowledge.

Conclusion

Freedom has value due to its contributions to the satisfaction of desire and the enabling of increased responsibility. Yet freedom concerning choices of which consumers are unaware doesn’t increase the satisfaction of their desires or the extent of their responsibility: What they need is knowledge about what choices are available. Finance is one of the main sources of information about the availability of a range of choices such as insurance policies, retirement plans, mortgages, and so on. Its practitioners ought to be truthful and abstain from lying and deception; and consumers ought to exercise the epistemic virtues of impartiality, sobriety and courage. But consumers’ knowledge of financial products will not increase if salespeople and consumers do not establish the common knowledge necessary for successful communication.

One might wonder about the extent to which our argument succeeds in making the case for certain moral obligations on the part of financial service providers. In particular, what normative grounding does the virtue of interlucency have? In typical interactions amongst salespeople and their customers, the virtue of interlucency as developed in this chapter is instrumentally necessary if a customer is to understand what a salesperson tells him or her about his or her options. Without interlucency there can hardly be common knowledge about the relevant terms, and without such common knowledge, the customer will find it difficult to acquire any knowledge about financial products. Although this demonstrates the
importance of the virtue of inter lucency for consumers, service providers may remain unmoved as long as they do not see it as their task to contribute to their customers' known freedom.

The starting point of this chapter is a liberal conception that seeks to find a justification for freedom of enterprise in terms of the two ideals of consumer desire satisfaction and personal responsibility. One way to address an industry unmoved by our earlier argument is to note that this liberal view is actually fairly popular within finance itself: Many finance workers justify their activities at least partly in terms of increasing the general satisfaction of consumers' desires. As a result, if increasing consumer satisfaction is indeed what they think justifies their work, it follows from what we have said here that just designing more products won't do. The industry has to ensure that known freedom grows too. Further, given that known freedom cannot be attained in the absence of common knowledge, inter lucency is an immediate second ideal.

This line of reasoning is entirely general in that it applies to a wide variety of industries. Yet it will not be very convincing if you don't share its normative starting point. In that case a second (admittedly less general) answer can be given. As we noted at the beginning of this chapter, desire satisfaction and personal responsibility are ideals that many people in Western countries subscribe to and are frequently used to motivate legislation. Reagan-Thatcher style liberalisation is a case in point. Without 1980s deregulation, sub-prime mortgage lending would have been (largely) illegal, and the market for private retirement plans would have been much smaller than it is nowadays. Legislators justified these changes precisely on the grounds that liberalisation would lead to increased consumer satisfaction and responsibility. Often it did not, though (and the argument about known freedom may show why not, at least in cases where deregulation wasn't accompanied by increased knowledge). If the motivation for changing the law is that we wish to increase consumer satisfaction and responsibility, then we should change it in such a way as to lead to an increase in consumers' known freedom. The state can only marginally contribute the relevant knowledge itself: Financial education may become part of a mandatory school curriculum, but its effects are not very promising; moreover, information about the precise characteristics of financial products will come mainly from those that design and sell these products. So if the finance industry isn't motivated to contribute to the ideal of known freedom through information provision and inter lucent communication, there is reason for the state to require them to do so.

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References
7 Aristotelian Lessons After the Global Financial Crisis
Banking, Responsibility, Culture and Professional Bodies
Christopher Megone

Introduction
This piece is not going to offer an analysis of the factors contributing to the global financial crisis (GFC). Its primary focus is the relationship between individual responsibility for good and bad behaviour and organisational culture. However, the reason for this focus is that it is widely supposed that one thing that did occur in the lead-up to the GFC, and contributed to it, was the development within major banking organisations of ‘toxic’ cultures. Such ‘toxic’ organisational cultures had the effect of encouraging or permitting ethically bad behaviour and discouraging individuals from speaking up, or raising concerns, about that bad behaviour. In other words the organisation’s culture militated against the organisation’s staff developing as ethically mature, virtuous individuals. This in turn led to unethical decision-making, which was one factor contributing to the crisis.

Such a rather general story has implications for the analysis of the responsibility of staff within an organisation for such bad behaviour. It suggests complex links between the culture of an organisation and the behaviour of individual staff and consequent repercussions for our judgement of those individuals. It will be argued in what follows that these links involve both ways in which the culture of an organisation can affect an individual’s ethical development and also ways in which individuals in an organisation, and the nature of their ethical development, can affect organisational culture. Thus the responsibility of individual staff for bad behaviour within an organisation turns out to be a complex matter.

However, if individual responsibility and organisational culture are intertwined, and if toxic culture was a contributory factor to the GFC, then in drawing lessons it may be beneficial to reflect on the factors, both internal and external, that can affect the development of organisational culture. What can be beneficial and what harmful? What factors contribute to the existence of ‘toxic’ cultures?

The aim of this chapter is to set out an Aristotelian framework regarding the development of ethically mature, virtuous individuals, which