Fairness in Financial Markets, Reconceiving Market Norms

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Meantime we shall express our darker purpose
(1.1.36) King Lear

Abstract

"Fairness" can be defined as the capacity to take the perspective of another and to adjust our conduct to take account of others' perspectives in order to achieve more equitable outcomes. Yet the notion of fairness in financial markets is limited primarily to creating equal opportunity to participate in the market, including mechanisms to "level the playing field" such as disclosure and anti-fraud remedies. While the express goals of regulation of financial markets do not seek to remedy existing allocations of wealth, the rules and practices that have arisen have had serious direct and indirect distributive consequences, made visible by the 2008-10 global financial crisis and the continuing financial crises in Europe. The paper examines the structural aspects of financial markets and the limits of current regulatory efforts globally to address these problems, arguing for a new normative framework that would embed notions of fairness in both institutional practices and in services that directly implicate ordinary citizens in their banking, investment and pension activities.

One might puzzle what King Lear has to do with fairness in financial markets. You will recall Shakespeare's plot: elderly King Lear decides to divide his realm in ancient Britain among his three daughters, Cordelia, Regan, and Goneril.[1] Yet once wealth and land accrue to Regan and Goneril, greed surfaces and Lear is shocked by the fact that the loss of property is a loss of voice, influence or economic security. While the analogy is not direct, it evokes an observation that the regulatory reform now in progress in global financial markets involves the powerful voice of those who hold wealth, the exclusion of those who do not, unfairness of outcomes that is directly related to who holds power and property, and the need for both procedural and substantive fairness going forward.

The underlying causes of the global financial crisis were complex, and included the interplay of structured financial products; regulatory gaps; inadequate liquidity and capital adequacy standards; extreme leveraging that accounted for much of the increase in banks' returns on equity; misalignment of economic incentives and regulatory objectives; over-reliance on inadequate internal monitoring and controls; insufficient expertise and resources within the regulatory design, monitoring and oversight structure; failure to appreciate the interrelated relationships in different aspects of the market and the consequent opportunities created for self-dealing; and a failure to understand the complexity of systemic risk.[2] Just as the causes were multifaceted but interrelated, so too is the needed regulatory reform, given that there are multiple types of financial markets, multiple stakeholders implicated in their complex structures and multiple entities operating on a supra-national basis such that single jurisdiction regulation is insufficient.

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[1] W. Shakespeare, *King Lear.* Lear plans the division of property based on who professes to love him the most, certain that his favorite daughter, Cordelia, will win the challenge. While the two other daughters flatter with excessive declarations, Cordelia refuses to engage and is disowned completely.

[2] For an analysis of the causes of, and structural factors relating to, the financial crisis, Janis Sarra, "Embedding Fairness as a Fundamental Norm in Financial Markets", in J. Sarra, ed., *An Exploration of Fairness, Interdisciplinary Inquiries in Law, Science and the Humanities* (Toronto, Carswell: 2013); Basel Committee on Banking Supervision/ Financial Stability Board, *Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Requirements*, Interim Report (2009), Bank for International Settlements http://www.bis.org; Financial Stability Forum, "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience" (7 April 2008), online: Financial Stability Board http://www.financialstabilityboard.org; M. Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness" (1985) 91 American Journal of Sociology 481, who discusses the embeddedness of market players in a network of social relations, continuing economic relationships that can become overlaid with trust and may limit opportunism; but that networks and resulting trust can create opportunities for opportunism and abuse across of range of types of interrelationships.

This paper builds on earlier research and explores how fairness can and must be embedded in financial markets, offering some initial principles and norms that can provide the basis for a broader public policy discussion.[3]

At its heart, fairness is the capacity to take the perspective of another and to adjust our conduct and decisions to take account of others' perspectives, in order to achieve more equitable outcomes.[4] Yet the notion of fairness in financial markets is limited primarily to creating equal opportunity to participate in markets, including disclosure requirements and anti-fraud remedies. While the express goals of regulation of financial markets do not seek to remedy existing allocations of wealth, the rules, practices and norms that have arisen have had serious direct and indirect distributive consequences, made visible by the 2008-10 global banking crisis and the continuing financial crises in Europe and elsewhere.

Notions of fairness are socially constructed, including general acceptance in most jurisdictions that financial markets should aim for procedural fairness but are not a tool for substantive fairness or a fairer distribution of wealth. Yet despite this social construction, people across the globe had a deep visceral reaction to the unfairness associated with the harms caused by the financial crisis: millions of homes lost through foreclosures, millions of individuals had their savings accounts or retirement investments wiped out, massive unemployment, lost pensions and continuing profound economic insecurity.[5] The costs to taxpayers and national governments were also profound.[6] The economic costs of the financial crisis in terms of increases in public debt and loss of gross domestic product was considerably larger than all previous crises occurring in advanced and emerging economies combined.

At least some of what occurs around perceptions of fairness is physiological, located in parts of the brain that offer an intuitive sense of what is fair or unfair. Cognitive neuroscience, while still developing as an explanation for fairness in human interactions, suggests that individual understandings of fairness likely result from a complex interaction of chemicals in the brain, creating some instinctive reactions to fairness or unfairness, a "hard-wired" understanding.[7] That baseline is then altered by social influences, particularly from early childhood.[8] The hard-wiring suggests that, physically, we are not completely self-regarding and that our brains react to fair or equitable treatment, with perceptions of fairness recorded in brain activity. Adults have been found willing to share wealth with strangers and have a tendency to react negatively to inequitable or unfair situations.[9] Other studies suggest that individuals are willing to incur costs to punish antisocial behaviour such as unfairness or failing to pull one's weight in cooperative endeavours.[10] Understanding the physiological and social aspects of fairness may assist in trying to conceptualize fairness beyond individual financial self-interest.

This paper commences with the notion that fairness is a fundamental norm that should be embedded in

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[3] Sarra, *ibid.*
[4] *Ibid.* at 193.
[5] The US Treasury has reported that the crisis cost US households $19.2 trillion in wealth and 8.8 million jobs. US Department of Treasury, "The Financial Crisis Response In Charts" (2012) at 1, online: US Treasury http://www.treasury.gov/resource-center/data-chart-center/Documents/20120413_FinancialCrisisResponse.pdf. See also Jennifer Taub, *Other Peoples Houses* (Princeton University Press, 2013).
[6] For example, European Union (EU) member states committed to aid banks in a value of 30% of the EU GDP and paid out amounts equivalent to 13% of EU GDP; Herman V Rompuy, "Reshaping Europe's Economy— The Role of the Financial Sector" (2011) at 3, online: European union http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/119231.pdf.
[7] Patricia Churchland, *Braintrust, What Neuroscience Tells Us about Morality* (Princeton, N.J.: Princeton University Press, 2011). It is thought that the amygdala, ventral striatum, and ventro-medial PFC areas participate in a reward circuit that is activated by offers of fairness or fair actions; G. Tabibnia, A.B. Satpute & M.D. Lieberman, "The Sunny Side of Fairness: Preference for Fairness Activates Reward Circuitry (and Disregarding Unfairness Activates Self-Control Circuitry)" (2008) 19 Psychological Science 339. See also Lawrence Ward, "The Dance of Fairness", in J. Sarra, ed., *An Exploration of Fairness, Interdisciplinary Inquiries in Law, Science and the Humanities* (Toronto, Carswell: 2013).
[8] Shelley Hymel & Lina Darwich, "Developmental Psychology Perspectives on Fairness", in J. Sarra, ed., *An Exploration of Fairness, Interdisciplinary Inquiries in Law, Science and the Humanities* (Toronto, Carswell: 2013).
[9] E. Tricomi *et al.*, "Neural Evidence for Inequality-Averse Social Preferences" (2010) 463 Nature 1089.
[10] B. Herrmann, C. Thöni & S. Gächter, "Antisocial Punishment Across Societies" (2008) 10 Science at 1362, observing that even where direct and indirect reciprocity provide no incentives to behave cooperatively as a violation of fairness norms.

public policy making that affects the financial security of individuals. It examines the limits of current regulatory efforts globally to address the problems made painfully transparent by the continuing global financial crisis, arguing for a new normative framework that would embed notions of fairness both in institutional practices and in services that directly implicate ordinary citizens in their banking, investment and pension activities. It utilizes a framework of six core ideas for reform: fairness in capital adequacy and liquidity standards, prudential obligations as a fairness norm, requiring fairness in financial advice, fairness in financial products, fairness in the cost of consumer credit, and fairness in the process for change to financial markets.[11] The embedding of fairness norms would make regulation of markets more responsive to the complexities of financial markets and more responsive to their economic and social role in a global society. Given length limitations, the paper is necessarily a discussion at a higher conceptual level, aimed at generating deeper discussion of a different normative approach to financial markets.

1. *Fairness in Capital Adequacy and Liquidity Standards*

One cause of the global banking crisis was that banks and other financial institutions that developed and sold the vast majority of products in the financial market were not sufficiently capitalized. The capital investments that banks used to backstop their promises to deposit-holders were overvalued, and when their prices dropped, the capital was insufficient to fulfill those promises.[12] Banks securitized their debt, essentially bundling hundreds of thousands of mortgages and loans into collateralized debt obligations (CDO) and selling these rights to ordinary people, often sold as low- or medium-risk investments when, in fact, they were high risk.[13] This selling of debt in tranches meant that the originating lender immediately shed its risk and then proceeded to lend again in the market because others had taken the risks of bad loans, rapidly increasing the amount of debt outstanding. Because default risk was shifted off their books by the sale of CDO, banks stopped monitoring the quality of credit applications or the ability to repay loans. Securitization, originally aimed at managing risks in banks' loan portfolios, resulted in a situation whereby once fees on the originating loan were extracted by the bank; the risk was passed along to various tranches of debt, which in turn resulted in less front-end assessment of credit worthiness. There was lack of any effective system-wide oversight, which allowed for the regulatory arbitrage that developed in the shadow banking sector, further contributing to the crisis.[14] These developments occurred as outcomes of a loosening of regulatory oversight both under Basel II and under the regulatory frameworks of influential countries such as the United States and the United Kingdom.[15]

Governance standards and norms for all banks and financial institutions should be aimed at long-term financial sustainability of the institution and its customers, rather than geared to short-term profits. While national governments across the globe are committed to the notion of financial stability, there has been insufficient analysis of the incentive effects that arise from policy measures that continue to try to accommodate short-term wealth maximization goals within an aspirational framework of long-term financial sustainability. There have been some initial important policy reforms since the height of the banking crisis. The Basel Committee on Banking Supervision's (BCBS) measures to strengthen regulatory standards for internationally active banks now require banks to carry more capital and liquidity, designed to improve the safety and robustness of the global financial system. Basel III provides for a macro-prudential overlay to better deal with systemic risk, with a significant increase in the required

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[11] For a discussion of the reason for and development of these core concepts, see Sarra, *supra* note 3.
[12] Janis Sarra, "Prudential, Pragmatic and Prescient, Reform of Bank Resolution Schemes" (2012) 21: 1 International Insolvency Review 17 [Sarra, "Prudential"].
[13] Andrew Haldane, Executive Director of Financial Stability for the Bank of England said, in April 2009, "An investor in a CDO squared would need to read in excess of 1 billion pages to understand fully the ingredients."
[14] Mario Draghi, "Next steps on the road to financial stability", *Financial Times* (16 September 2010), online: Financial Times <http://www.ft.com>.
[15] Basel II was aimed at strengthening resilience of the banking sector, but left much of the implementation to bank self governance; http://www.bis.org/publ/bcbsca.htm.

level and quality of capital.[16] Basel III also seeks to reduce systemic risk by reducing procyclicality, *i.e.*, the financial system's tendency to amplify ups and downs of the real economy, taking account of the interlinkages and common exposures among financial institutions deemed systemically important. Banks will be required to hold a capital conservation buffer to withstand future periods of stress.[17] While they will be allowed to draw on the buffer during periods of financial distress, they will face restrictions on paying dividends and discretionary bonuses during these periods.[18] Basel III seeks internationally harmonized liquidity standards.[19] Higher capital and liquidity requirements should result in lower-risk banks and should reduce the probability and severity of future bank failures, create smoother economic cycles that allow economic growth, and lower the incidence of spread of financial failure to the global financial system.[20]

The new levels of capital adequacy were hotly contested by a number of jurisdictions during global deliberations to determine acceptable risk-reducing levels, resulting in reduction of the amounts originally proposed; and there may be some unwillingness to implement even these standards, creating fairness concerns for other countries. Canada had higher capital adequacy standards pre-crisis, suggesting that the amount set by Basel III may not be sufficient to protect against a further serious banking crisis.[21] The recent measures, aimed at the safety and soundness of the banking sector, reflect a consensus among the most powerful developed countries in respect of these measures. Yet one of the real challenges for international sources of law, such as Basel III, is to ensure that they are implemented. They require action by national governments around the world, and hence are dependent on countries' willingness to implement the measures. In some instances, there is no capacity to meet the capital adequacy requirements, particularly in some emerging Eastern European and southern nations. The World Bank's financing arm was undertaking contingency planning for failure of these nations to meet the new standards, even as the ink was drying on Basel III.[22] One can see an example already in the recent Argentinian debt default. Mander has observed that investors are dodging capital controls by buying equities in local currency that are then sold abroad as dollars; and while the Argentine central bank is attempting to stem further crisis, the secondary markets are flourishing, encouraging short-term gains for a few, but undermining attempts at capital stability.[23] In the United States, post-reforms, banks are even bigger and more concentrated than previously, still fully engaged in the same speculative activities, including using large amounts of short-term borrowing to fund purchases of speculative securities.[24]

To date, there has been insufficient discussion as to whether the more "nuanced" factors to assess capital adequacy have merely made opaque the assessments and decisions about risk. Andrew Haldane, Executive Director for Financial Stability, Bank of England, has observed that the number of risk buckets that financial institutions are to consider increased from seven under Basel I to over 200,000 under Basel II, requiring larger banks to undertake 200 million calculations to determine the regulatory capital ratio, making it a technical process that makes it difficult for regulators and market participants to assess accuracy of the reported capital ratios.[25] Moreover, while Basel III amended regulatory capital

[16] Basel Committee on Banking Supervision, "Group of Governors and Heads of Supervision Announces Higher Global Minimum Capital Standards" press release (12 September 2010), Bank for International Settlements, <http://www.bis.org/press/p100912.pdf>.
[17] *Ibid.*
[18] Bank for International Settlements, *supra* note 3; Basel, *International Framework*, *supra* note 3; this countercyclical buffer would build up during periods of rapid aggregate credit growth and released in the downturn of the cycle, reducing the possibility of an adverse cycle of losses and tightening of credit.
[19] The Liquidity Coverage Ratio is aimed at ensuring short-term liquidity in times of severe stress and the Net Stable Funding Ratio is aimed at promoting medium and long-term funding by establishing a minimum acceptable amount of stable liquidity; BCBS, "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring" (December 2010), at 25-26; online: <BIS https://www.bis.org/publ/bcbs188.htm>.
[20] Mark Carney, (then) Governor Bank of Canada, speech, at 5-6.
[21] Sarra, *supra* note 3.
[22] Sarra, "Prudential", *supra* note 13. There is also a need for jurisdictions to be committed to evaluating and adjusting these standards.
[23] Benedict Mander, "Argentine Banks forced to sell dollars in push to steady peso", Financial Times, September 5, 2014.
[24] Jennifer Taub, "Reforming the Banks for Good", *Dissent,* summer, 2014 at 34.
[25] Andrew G Haldane, "Capital Discipline" (2011) at 4, at 2-3, online: Bank of England www.bankofengland.co.uk/publications/speeches. See

requirements, it may have failed to fully recognize the importance of risk-weighted assets in assessing the robustness of capital ratios,[26] and insufficiently accounted for the degree and type of leveraging. Other countries are examining tools that arguably are better; for example, Sweden's Financial Supervisory Authority has recently introduced a 15 percent risk weight floor for mortgages, as well as requiring capital adequacy standards well above the amounts required by Basel III.[27] The Basel Committee is examining whether leverage ratios, the ratio of equity to total assets, would be a more transparent and better indicator of financial health or financial distress that risk-based capital requirements.[28] A recent OECD study found that of 94 international banks between 2004 and 2011, the tier 1 risk-based capital ratio was not a statistically significant indicator of bank default, whereas the leverage ratio was found to be statistically significant.[29]

The Basel Committee has now recognized that the build up of leverage was a factor in the crisis and it has introduced a leverage ratio aimed at constraining leverage in the banking sector, aimed at mitigating the risk of the destabilizing deleveraging processes; and introducing "safeguards against model risk and measurement error by supplementing the risk-based measure with a simple, transparent, independent measure of risk."[30] Yet here too, there has not been the political will to ensure a high enough ratio, banks can be leveraged up to 33 times, hence not tempering the amount of leveraging sufficiently. There are now studies to suggest that the leverage ratio must be higher than the 3 percent figure of Basel III, particularly for systemically important banks that tend to be more opaque and aggressive in their risk modelling.[31] There are also time-lag issues, Basel III introduced the leverage ratio in 2011, its full implementation cannot be expected until 2018, with banks still lobbying for amendments to reduce requirements.[32] Given imperatives by bank investors for short-term returns, the incentives for banks to minimize the capital buffers they provide are huge, and the complexity and self-governing aspects of the current requirements are thus problematic. While regulators globally found that regulators' reliance on the complex models for measuring risk were one of the causes of the crisis, the current reforms continue this heavy reliance.

The bailouts of banks in the United States and many other countries *privatized the gains*, in that resources used in the bailout accrued to the banks, their officers and their equity holders; at the same

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also Andrew Haldane, "The Dog and the Frisbee" (2012) at 8-9, online:
Bank of England <http://www.bankofengland.co.uk/publications/Pages/speeches/2012/596.aspx>.

[26] Vanessa Le Leslé & Sofiya Avramova, "Revisiting Risk-Weighted Assets: Why Do RWAs Differ Across Countries and What Can Be Done About It?" (2012) at 20, IMF, https://www.imf.org/external/pubs/ft/wp/2012/wp1290.pdf.

[27] Niklas Magnusson, "Sweden Watchdog Raises Banks' Mortgage Risk-Weight Floor to 15%", May 21, 2013. Sweden is also tightening capital requirements in requiring its four biggest banks need to hold at least 10 percent core Tier 1 capital of their risk-weighted assets this year, and 12 percent by 2015, compared with Basel III's 7 percent requirement by 2019 and a 9 percent minimum standard for some European banks; http://www.bloomberg.com/news/2013-05-21/sweden-watchdog-raises-mortgage-risk-weight-floor-to-15-percent.html. See also Fitch Rating, "Swedish Mortgage Risk Weight Rise Manageable for Banks" (29 November 2012), Fitch Wire https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Swedish-Mortgage-Risk?pr_id=775684.

[28] BCBS, "Revised Basel III Leverage Ratio Framework and Disclosure Requirements - Consultative Document" (June 2013) at 2, online: BIS https://www.bis.org/publ/bcbs251.pdf.

[29] Adrian Blundell-Wignall & Caroline Roulet, "Business Models of Banks, Leverage and the Distance-to-default" (2013) 2 *Financial Market Trends*, at 9-10, online: OECD http://www.oecd.org/finance/BanksBusinessModels.pdf. The study included systemically important financial institutions that failed during the crisis.

[30] BCBS, "Basel III: A global Regulatory Framework for more Resilient Banks and Banking Systems" (December 2010) at 4, online: <BIS https://www.bis.org/publ/bcbs189_dec2010.htm>. The Basel leverage ratio introduces a number of new meaures. First, the proposed minimum ratio is 3 percent (tier 1 capital) of total exposure. The exposure measure for leverage is typically assets, but the Basel III leverage ratio adds off-balance-sheet exposures and percentage of derivatives notional. In addition, it disallows the use of physical or financial collateral to reduce the on-balance-sheet exposures, at 61-64.

[31] Sheila Bair, former chair of the FDIC, proposes a leverage ratio of 8 percent; Sheila Bair, *Bull by the Horns: Fighting to Save Main Street from Wall Street and Wall Street from Itself* (New York: Free Press, 2012) at 325-326. Blundell-Wignall and Atkinson suggest that the Basel III leverage ratio adds little security to the system and a much higher leverage ratio is required; Adrian Blundell-Wignall & Paul E Atkinson "Deleveraging, Traditional versus Capital Markets Banking and the Urgent Need to Separate and Recapitalise G-SIFI Banks" (2012) 1 Financial Market Trends, online: OECD http://www.oecd.org/finance/financial-markets/Deleveraging,%20Traditional%20versus%20Capital%20Markets%20Banking.pdf; http://ssrn.com/abstract=2344831.

[32] BCBS, "Amendments to Basel III's Leverage Ratio Issued by the Basel Committee" (2014) online: BIS http://www.bis.org/press/p140112a.htm. Significantly, the leverage ratio carries a Pillar 2 designation during the seven-year initial transition period.

time, the bailouts *socialized the losses* by placing the burden of costs of bank bailouts on taxpayers rather than the banking sector and its decision-makers.[33] Individual nation states and their economic unions, such as the European Union (EU), are ultimately the safety net for bank failures, yet that safety net can create incentives for banks to behave purely self-interestedly, rather than being other-regarding of the interests of deposit holders and others. Taxpayers have been paying the costs of the most recent crisis and will continue to do so in the future. The reason is that nation states, to varying degrees, care for their citizens, and feel socially compelled to bear the costs of economic harms whether through propping up the banking or financial system or bearing the accelerating costs of social welfare, health care and other remedial services that arise through the health effects of loss of economic security. Given that obvious correlation, regulatory oversight of capital adequacy and other measures need to be undertaken understanding the direct and complex relationship between financial markets and the quality of life of individuals.

Andrew Haldane has observed that financial systems, like eco-systems, involve elements highly connected to one another in complex patterns of interdependencies; and hence, there should be greater use of network diagnostics, system-wide stress testing and the development of resilience of the network, not just of the individual institutions that comprise it, a very different approach than currently being undertaken.[34]

There are distributive consequences of these new standards, in terms of who will bear the costs of retooling the safety and soundness of the banking system. Stronger capital requirements will impose costs on local economies, since banks will pass on to their customers the higher costs of carrying more capital.[35] Hence, one fairness measure would be to spread the costs of the new capital adequacy requirements over different types of stakeholders, rather than consumers or taxpayers paying the costs.[36] Going forward, fairness should embody Rawls' notion of fairness as apportioning the benefits to the least advantaged members of society, rather than the most privileged.[37] In this respect, the category prudential obligation should be expanded, as discussed in the next part.

2. *Prudential Obligations as a Fairness Norm*

The second key aspect is to embed prudential obligations as a fairness norm within financial institutions. Corporate governance of banks and other financial institutions differs from the governance of corporations in manufacturing or other direct economic activity because of the prudential nature of bank regulation and the different nature of stakeholders with investments at risk.[38] Deposit-holders have their life savings in banks, and thus, historically, it was believed that directors and officers of banks should have prudential obligations towards those deposit-holders, a considerably higher obligation than faced by

[33] Sarra, *supra* note 3 at 218.
[34] A. Haldane, 'Rethinking the Financial Network', speech to Financial Student Association, Amsterdam 2009, http://www.bankofengland.co.uk/publications/Documents/speeches/2009/speech386.pdf.
[35] Carney, *supra* note 21 at 2. The Bank of Canada has observed that, if given enough time to meet the new capital requirements by regulators and markets, banks can generate capital internally over time through the retention of earnings; yet, they will likely pass on the costs of the higher standards to their customers by demanding higher interest spreads, increasing non-interest fee income or reducing operating expenses.
[36] *Ibid* at 18.
[37] John Rawls, Justice *as Fairness (*Cambridge, Mass.: Harvard University Press, 1985); John Rawls, *A Theory of Justice* (Cambridge Mass.: Harvard University Press, 1971, revised 1999).
[38] Janis Sarra & Gordon Dunning, "Assuring the Future: Reform of the Insolvency Framework for Insurance Companies and other Financial Institutions under the Canadian *Winding-up and Restructuring Act"* in J. Sarra, ed., *Annual Review of Insolvency Law, 2010* (Toronto: Carswell, 2011) at 40; Basel Committee on Banking Supervision, "Enhancing Corporate Governance for Banking Organisations", online: Bank for International Settlements <http://www.bis.org/publ/bcbs122.htm>; Banca d'Italia, "Supervisory Provisions Concerning Banks' Organization and Corporate Governance" (Decree of 4 March 2008), online: Banca d'Italia <http://www. bancaditalia.it>; International Finance Corporation, "Strengthening Risk Governance in Banks: Lessons from the Design and Implementation of the Forum's Financial Markets Recovery Project", online: <http://www.ifc.org/ifcext/corporategovernance. nsf/Content/CGTools_FinancialInstitutions>; L. Laeven & R. Levine, "Bank Governance, Regulation, and Risk Taking" (2008), online: Social Science Research Network <http://ssrn.com/abstract=1142967>; Pablo de Andres Alonso & Eleuterio Vallelado Gonzalez, "Corporate Governance in Banking: The Role of the Board of Directors" (2008) 32 Journal of Banking & Finance at 2570.

directors of business. However, in the years prior to the financial crisis, an entire sector arose, colloquially referred to as the shadow banking sector, in which many financial firms avoided prudential obligations by casting themselves outside the regulatory framework of prudential regulation.

The notion of human responsibility or accountability has been remarkably absent in the current public policy debate, save the rare instances where fraud was made evident by the freezing of markets. Entire economies continue to be negatively affected, yet the discourse has largely been one of *everyone erred and thus no one is responsible*, and thus the better strategy is to develop systems to mitigate risk going forward, rather than trying to understand which aspects of human agency contributed significantly to the crisis. In many cases, there have been express releases from personal and professional liability as part of the package to remedy the worst effects.[39] The moral hazards can be addressed in part by ensuring that the regulatory framework going forward imposes the costs of any future failures on financial institutions or intermediaries themselves.

All financial institutions should be required to manage prudentially. In terms of prudential obligations, directors and officers of financial institutions should act in the best interests of the institution in the long term. Prudential obligations should include protection of depositors and insurance policyholders, thus embedding fairer or more equitable protections. It should take account of parties with a direct economic interest, such as deposit insurance funds, creditors, and investors. Taking account of diverse interests may serve as a mechanism to increase the quality of bank long-term risk management strategies.[40] Bank corporate governance should also be aimed at both the institution's financial stability and the stability of the financial system. Governance must be responsive to conflicting interests of stakeholders, either by creating direct representation of broad interests on the corporate board or through regulator imperative. There should also be statutory authority to hold directors and senior management accountable for failure to meet their prudential obligations, with accessible and meaningful remedies for individuals harmed by managers' disregarding of their obligations. There is also need to reduce conflicts of interest within the complex structure of global financial institutions and their interactions, such as professionals advising on investments while managing investment funds.[41]

Prudential obligations would then encourage financial institutions to implement remuneration schemes for directors, officers and employees that counteract incentives for short-term returns to potential detriment of depositors' and other stakeholders' best interests. In this respect, fairness would suggest remuneration that recognizes the skills and effort being contributed, but discourages excessive risk-taking and self-regarding behaviour. Creating incentives for directors, officers and their professionals to be more prudent would assist in dealing with the limits on regulatory oversight and the problem of global entities, where financial institutions can create harms and then shift their registered head offices and assets to other jurisdictions to avoid being held responsible for their harmful activities. Increased prudential obligations on directors and officers would protect against some of this shirking and still allow for financial activity necessary for liquidity function.

In terms of lending, fairness might suggest adoption of different kinds of standards for different transactions. While it is difficult to conceive of a fiduciary obligation by lenders to businesses, it may be that for products that we as a society believe are important, such as loans for housing and health care, that there is an obligation on the lender advising the individual of the choices of loan, to act in the best interests of that individual. It would prevent problems identified by Cheryl Wade, wherein African-Americans capable of paying for regular mortgages were steered to sub-prime mortgages, and people incapable of paying those rates were still given mortgages that the lender knew would ultimately lead to

[39] Sarra, "Prudential", *supra* note 13.
[40] *Ibid.*
[41] Sarra, *supra*, note 3 at 219.

default, foreclosure, and loss of their homes.[42] In the United States alone, there have been 5 million home foreclosures since the start of the financial crisis.[43]

Many banks collapsed during the financial crisis, and millions of individuals globally lost all their savings, estimated in the trillions of dollars. In many countries, there was no deposit insurance or deposit insurance coverage was restricted to the smallest depositors and thus was not of assistance for many depositors when banks began to fail. Moreover, deposit insurance in the EU and other parts of the world was not pre-funded, as it was believed that not all banks would fail at the same time, so there was no money set aside in trust for insurance claims for lost deposits. Canada has pre-funded deposit insurance protection through the Canada Deposit Insurance Corporation, but not all banks are members and the amount of savings that is protected is capped.[44] Arguably, pre-funded deposit insurance funds should be created in most nation states and all deposit-taking banks, insurance companies, and financial conglomerates should be required to contribute to national deposit insurance programs. The amount of savings protected by deposit insurance should be increased, even in countries where the funds currently exist. Such measures would assist in reducing the currently unfair allocation of loss that occurs on bank failure.[45]

3. Requiring Fairness in Financial Advice

The majority of people in developed nations are implicated in global financial markets, whether they choose to be or not. The banks where their savings are deposited are engaged in financial market activity: their banks are promoting a variety of investment products for their deposits with highly varying degrees of financial risk; their pension funds are heavily invested in multiple types of products; and even their life insurance company is heavily implicated in such markets. Yet, as noted above, there continue to be insufficient protections of capital and inappropriate incentives for the management of these financial institutions. Even where retail consumers' investments are solely in mutual funds or similar pooled investment strategies, they are highly dependent on the investment choices of the fund managers, who themselves have conflicts of interest.[46] Moreover, with the shift from defined benefit pension plans to defined contribution pension plans or no pension plans at all, individuals are being asked to manage their own future economic security, and yet, not given the skills, information or choices of products to do so.[47] Determining risk capacity and the safety and security of individual investment choices is very difficult for ordinary investors and they rely on or trust the financial advice they are given. Yet the standard of professional advice is lacking in serious ways and there continue to be tremendous conflicts of interest. Essentially, products are being sold to retail investors who do not have the capacity to lose money. Financial and securities markets have been structured on the premise that investors have excess capital to invest and that they have the capacity to suffer the potential losses. That premise has not fundamentally changed in many of the reforms currently being implemented.

There continues to be a standard of financial advice in many jurisdictions that creates vulnerability and unfairness for retail investors. One of the most common misconceptions of retail investors is that their financial adviser is acting in their best interests. Yet, financial advisers in Canada and elsewhere are required only to *know their client*, and this suitability rule is quite different from a fiduciary obligation to act in their clients' best interests.[48] The *know your client* standard has given rise to conflicts of interest

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[42] Cheryl Wade, "Fairness, Narrative, Empathy and the US Racial Wealth Gap", in J. Sarra, ed., *supra*, note 3 at 49-70.
[43] Taub, *supra*, note 6.
[44] The current cap in Canada is CDN $100,000, Canadian Deposit Insurance Corporate, http://www.cdic.ca/home/Pages/default.aspx.
[45] Sarra, *supra*, note 3.
[46] Ronald B . Davis, *Democratizing Pension Funds, Corporate Governance and Accountability* (Vancouver: UBC Press, 2008).
[47] There is a large literature on both financial literacy and also the psychological reasons that individuals often opt not to make prudent choices regarding savings for the future. See for example, Jerry Buckland, "Money Management on a Shoestring: A Critical Literature Review of Financial Literacy & Low-income People", Research Report Completed for the Canadian Task Force on Financial Literacy (2 February 2011), online: Financial Exclusion & Poverty in Canada <http://financial-exclusion.uwinnipeg.ca/>.
[48] Sarra, *supra*, note 3 at 229.

in how advisers promote particular investments.

While other countries are moving to a higher standard of acting in their clients' best interests, most jurisdictions lag; creating unfairness for retail investors. The reforms to financial advice post-crisis have been aimed at increasing the quality of information that retail investors receive from dealers: relationship disclosure, including the process used to review suitability of the investors; "disclosure of conflicts of interest in a fair, equitable, and transparent manner", and due diligence to ensure that an order from a customer is suitable for him or her based on the customer's financial situation, investment knowledge, investment objectives, and risk tolerance.[49] The suitability requirement, however, does not apply if the dealer accepts an order from the customer and no recommendation is provided.[50] Hence the dealer may offer a series of products but does not need to consider suitability of the investment if the dealer does not expressly give advice or make a recommendation.

The suitability standard is fraught with difficulties. It establishes only the very baseline of other-regarding behaviour. It individualizes the standard, in that suitability is determined on minimal criteria and thus retail investors are left vulnerable. It does not sufficiently protect retail investors in the way that an obligation to act in the client's best interest does. Where the adviser is recommending products that might earn it a higher fee than other products that would be in the investor's best interests, the conflict disclosure rules are uncertain. Financial advisers should have a fiduciary obligation to act in their clients' best interests. Lawyer, teachers and doctors all currently have fiduciary obligations; it seems that the adviser that holds the power to jeopardize the retail investor's financial security in its hands should have similar obligations.

The Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets (Task Force) has recommended a renewed policy and regulatory focus on financial consumer protection, given risks to individuals in various segments of financial services, increased complexity of financial products, and rapid technological change; it recommends that "all financial consumers should be treated *equitably, honestly and fairly* at all stages of their relationship with financial service providers."[51] If such a norm is adopted, the content of that fairness and equity will be critically important. The Task Force suggests that treating consumers fairly should be an integral part of the good governance and corporate culture of all financial services providers and authorized agents, recommending that special attention be dedicated to the needs of vulnerable groups.[52] Most importantly, it recommends that "financial services providers and authorized agents should have as an objective, to work in the best interest of their customers and be responsible for upholding financial consumer protection".[53] This recommendation, if implemented, would considerably enhance fairness for retail investors.

In the United Kingdom, financial advisers and firms offering investment services are now required to act

[49] The Investment Industry Regulatory Organization of Canada (IIROC), "Proposals to Implement the Core Principles of the Client Relationship Model" Rules Notice (7 January 2011) at 12, IIROC <http://iiroc.ca>. IIROC is the national self- regulatory organization that has oversight of all investment dealers and trading activity on debt and equity marketplaces in Canada. The dealer member must provide a fulsome, clear, and meaningful explanation of its suitability obligation and to inform the client on whether suitability disclosure will be performed in response to market fluctuations. *Ibid* Rule XX05 (c); Rule XX03; Rule 3100.1 (p); Rule 3100.1 (r).

[50] *Ibid.* For example, there is a national instrument promulgated by Canadian securities administrators that imposes the *know your client* standard and disclosure requirements for conflicts of interest. It specifies that prior to making a recommendation or accepting an order from a client, the dealer should take reasonable steps that the sale or purchase of the security is suitable for the client, the suitability rule only applicable if the client is a retail investor and the dealer acts as its adviser. *National Instrument 31-103 Registration Requirements and Exemptions;* the dealer is to take reasonable steps to know the client's needs and objectives, financial circumstances, and risk tolerance.

[51] Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets (CMF), *G20 High-Level Principles on Financial Consumer Protection* (2011), online: Organization for Economic Cooperation and Development (OECD), principle 3 <http:// www.oecd.org/regreform/liberalisationandcompetitioninterventioninregulated sectors/48892010.pdf>

[52] Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets, *ibid.* at 5. There should be disclosure of material information, and the "provision of advice should be as objective as possible and should in general be based on the consumer's profile considering the complexity of the product, the risks associated with it, as well as the customer's financial objectives, knowledge, capabilities, and experience."

[53] *Ibid.* principle 6.

honestly, fairly, and professionally in accordance with the best interests of their client; the adviser must obtain the necessary information regarding the client's knowledge and experience in the investment field, financial situation, and investment objectives so that it can recommend or conduct a transaction suitable for the client and in the client's best interests.[54] In the United States, there have been highly uneven obligations imposed on professionals giving financial advice and selling products to retail investors. Investment advisers have been regulated as "trusted advisors", while broker-dealers were regulated as "salespeople".[55] Broker-dealers are required by the Securities and Exchange Commission (SEC) to deal fairly with customers, held only to a suitability standard.[56] Where a broker-dealer processes a customer order but has not recommended it, its duty is even narrower, only to disclose material information, not other information regarding the security or its own self-interest in the security.[57] When recommending a security, the broker is required to give honest and complete information, including economic self-interest that could have influenced its recommendation.[58] Investment advisers' conduct in the US is governed under the *Investment Advisors Act*,[59] which the US Supreme Court has interpreted as establishing a fiduciary duty on investment advisers.[60] The fiduciary duty applies to the entire relationship of the adviser with its clients and prospective clients and imposes an "affirmative duty of outmost good faith and full and fair disclosure of all material facts" as well as an affirmative obligation "to employ reasonable care to avoid misleading" their clients.[61] Fundamental to the US fiduciary standard are duties of loyalty and care, requiring an adviser to act in the best interest of the client and not to subordinate the client's interest to its own.[62]

These key differences between investment advisers and broker-dealers in the United States are not well understood by retail investors who often believe that both groups are required to act in their best interests. Contributing to the misconception are also different titles that professionals use to describe themselves, including financial consultants, investment advisers, financial planners, and asset managers. In some instances, the title masks the true nature of the advice relationship to avoid the fiduciary obligation. These problems were highlighted in the recent US financial reform initiatives. The *Dodd Frank Wall Street Reform and Consumer Protection Act 2010* requires the SEC to study the regulatory standards governing all advisers, dealers, and brokers with a view to developing a uniform fiduciary standard of acting in clients' best interests when providing personalized investment advice about securities to retail customers.[63]

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[54] FSA Conduct of Business Sourcebook (COBS), Rule 2.1.1(1). Rule 2.1.3, online: FSA <http://fsahandbook.info/FSA/html/handbook/COBS>; the client's best interest rule requires a firm to avoid excluding or restricting any liability that it has towards a retail client unless it is "honest, fair and professional for it to do so"; Rule 9.2.1.

[55] Commission (SEC) and self-regulatory organizations (SROs), usually the Financial Industry Regulatory Authority (FINRA); *Securities Exchange Act of 1934*, § 3(a)(5), 15U.S.C. § 78c(a)(5) (2006). They could also be regulated by State Regulators, and their representatives must be registered with FINRA or other self-regulatory organizations; K.A. Fausti, "A Fiduciary Duty for All" (2010) 12 Duq. Bus. L.J. 183 at 185-86. Investment adviser is generally defined as a person who is engaged in the business of providing advice to others regarding the securities; *Investment Advisers Act of 1940*, § 202(a)(11), 15 U.S.C. § 80b-2(a)(11). At both US federal and state levels: Under the *Securities Exchange Act of 1934*, broker-dealers are generally defined as persons engaged in the business of buying and selling securities; *Securities Exchange Act of 1934*, § 3(a)(4), 15 U.S.C. § 78c(a)(4) (2006).

[56] FINRA Manual, Rule 2010, online: FINRA <http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=5504> NASD Rule 2310. The SEC also enforces the suitability obligation under federal securities laws; see *e.g.*, *In the Matter of the Application of Raghavan Sathianathan*, Exchange Act Release No. 54722 (Nov. 8, 2006).

[57] *Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 536 (2d Cir. 1999); *Carras v. Burns,* 516 F.2d 251, 257 (4th Cir. 1975), broker-dealer not required to volunteer advice where "acting only as a broker".

[58] NSAD rules, IM-2440-1. Mark-Up Policy.

[59] *Investment Advisers Act of 1940,* § 206(1) & (2).

[60] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *Transamerica Mortgage Advisors, Inc.,* 444 U.S. 11, 17 (1979).

[61] *Capital Gains,* 375 U.S. at 191-192.

[62] Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) at 119. The duty of care requires an adviser to "make a reasonable investigation to ensure that it is not basing its recommendations on materially inaccurate or incomplete information." The fiduciary duty of disclosure applies to conflicts of interest that arise during the advisers' relationship with its client, wherein the adviser must disclose all material information regarding the conflict of interest, so that the client can make an informed decision whether to enter or continue its relationship with the adviser. US Securities and Exchange Commission (SEC), "Study on Investment Advisers and Broker-Dealers study" (January 2011) at 23, online: SEC <http://www.sec.gov/news/ studies/2011/913studyfinal.pdf>.

[63] *The Dodd-Frank Wall Street Reform and Consumer Protection Act,* Pub. L. No.111–203, § 619, 24 Stat. 1376 (2010); § 913(g).

Another serious problem is that there are woefully inadequate resources in the US to monitor and enforce professional standards of financial advice. The chair of the SEC was turned down for budget dollars to hire enforcement staff.[64] There are currently 11,500 registered investment advisors in the US with client assets of $55 trillion; both the numbers of advisors and assets having doubled since 2004; yet 40% have never been visited or examined by regulators, given the profound lack of monitoring resources.[65] Hence this largely unmonitored industry has the ability to jeopardize the economic security of many people. The best standards in the world are meaningless without a culture of compliance and the regulatory framework to monitor and enforce.

Just as laws have been used to temper consumer products contracts where the consumer has no ability to amend the terms of the contract, one fairness standard could be that there is statutory language that protects retail investors against terms that try to insulate financial advisers or the producers from any liability. Moreover, the remuneration structure for employees of financial services providers and authorized agents should be designed to encourage responsible business conduct, fair treatment of consumers, and avoidance of conflicts of interest.[66] Some jurisdictions have moved to prohibit bonuses or other commissions for selling of particular products. Arguably, the current fee structure was responsible in a number of instances for financial advisers encouraging individuals to invest in higher risk products that previously were available only to sophisticated investors or institutional investors. Many investors did not understand the risks of borrowing to invest or investing in products where they might be called on to meet liquidity requirements, necessitating further output of their capital. The best interest standard would remedy many of these problems, assuming it is accompanied by the information and resources to sanction misconduct.

In addition to legal rules that could require professionals to consider the best interests of their clients in their advice, there is an issue of financial literacy that creates unfairness in financial markets. The *G20 High-Level Principles* recommend that the "provision of broad based financial education and information to deepen consumer financial knowledge and capability should be promoted, especially for vulnerable groups", urging countries to implement OECD international guidelines on financial education.[67] It is a start. Yet some studies indicate that most financial education programs are only minimally effective or uncertain as to their effectiveness in enhancing financial literacy and individuals' capacity to make decisions about money, particularly about investment.[68] As Dimity Kingsford-Smith has pointed out, ordinary retail investors have a wide variety of capabilities, and behavioural research shows that individuals often make irrational decisions against their own interests; they do not understand disclosure well; they often consent because they trust their adviser; and financial education is not very effective in changing irrational investor behaviour.[69]

When counterparties in the market are individuals on the one hand and financial institutions on the other, the likelihood of perspective-taking on the part of the latter is unlikely, unless legal rules require it. Moreover, fairness terms and conditions are unlikely where the bargaining power is profoundly unequal.

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[64] Rick Fleming, Head of the Office of the Investor Advocate, cited in C. Flood, "US advisors may pay to be regulated", Financial Times, September 1, 2014.
[65] *Ibid.*
[66] The remuneration structure should be disclosed to customers when potential conflicts of interest cannot be avoided, but the better standard is to eliminate the conflicts of interest.
[67] OECD International Network on Financial Education, *G20 High Level Principles on Financial Consumer Protection* (2011), online: OECD <http://www.oecd.org/regreform/liberalisationandcompetitioninterventioninregulatedsectors/48892010.pdf>.
[68] David de Meza, Bernd Irlenbusch & Diane Reyniers, *Financial Capability: A Behavioural Economics Perspective*, the U.K. Financial Services Authority, Consumer Research Report 69 (2008), online: FSA OECD, Directorate for Financial and Enterprise Affairs, online: OECD <http://www. oecd.org/daf/>; Government of Canada, Policy Research Initiative, *Why Financial Capability Matters: Synthesis Report on Canadians and Their Money* (June 2005), online: Financial Consumer Agency of Canada <http://www.fcac-acfc.gc.ca>.http://www.fsa.gov.uk/pubs/consumer- research/crpr69.pdf.
[69] D. Kingsford Smith, "Financial Services Regulation and the Investor as Consumer" in Howells *et al., The Handbook of Research on International Consumer Law & Policy* (U.K.: Edward Elgar, 2010) 431; Dimity Kingsford Smith, "Can There be a *Fair* Share? Fairness, Regulation, and Financial Markets", in J. Sarra, ed., *supra* note 3.

The *G20 High-Level Principles* also recommend that "jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, independent, fair, accountable, timely, and efficient. Such mechanisms should not impose unreasonable cost, delays, or burdens on consumers."[70] While procedural fairness is one aspect of financial markets, it is meaningless if individuals do not have the resources to pursue complaints. There is the added problem of the international nature of financial institutions and accessibility to mechanisms for redress in jurisdictions far removed from the individual, as well as the ever-present threat that the institution will move elsewhere if regulatory oversight is too intrusive.

Redesign of the system to create fiduciary obligations by financial advisers to their clients would reduce self-dealing and increase other-regarding behaviour. But alone, it is not sufficient to change markets, as some of the conflicts of interest still remain in the types of products marketed, the credit ratings relied on, and in the system of compensation for the financial advisers.

4. Fairness in Financial Products

Within markets, actors' beliefs and preferences are fundamentally shaped by the cognitive and normative social structures in which they are situated, resulting in diverse outcomes of behaviour.[71] Regulatory structures of financial markets are aimed at facilitating transactions, allowing new products on the market, enforcing counterparty contracts through judicial and quasi-judicial systems, and promulgating rules by which market participants can conduct their activities.[72] These benefits of regulation allow financial institutions to bring products to market; however, they have not been accompanied by a framework that also imposes a high degree of responsibility. It does not recognize how very differently situated different investors are, and hence the need for a radically different approach that recognizes the diversity of stakeholders and the factors driving behaviour in the market.

The UK's Financial Services Authority (FSA) Turner Review observed that a number of core premises influenced previous regulatory approaches at the global and national levels, many of which can be challenged as a result of the outcomes of the financial crisis.[73] It found that regulation was premised on the notion that market prices were good indicators of rationally evaluated economic value; that the development of new and liquid securitized credit markets alleged improved allocative efficiency and financial stability; that the risk characteristics of financial markets could be inferred from mathematical analysis of risk; that market discipline would be effective as a tool in constraining harmful risk taking; and that financial innovation was alleged always beneficial since market competition would weed out any innovations that did not deliver added value.[74] The Turner Review concluded that many of these premises were ill-founded as illustrated in the aftermath of the financial meltdown.[75] The heterogeneity of markets means that such premises may be valid only for a segment of market participants, and that the risk/return equation is not appropriate for investors who seek to have some economic security of their hard earned savings for their aging years. Security in this context means not only of their investment choices, but equally, financial stability of the financial institutions in which they have placed their trust. Regulation of markets needs to be more directly responsive to the huge range of types of market participants and their needs and/or aspirations.[76] In this respect, fairness or a more socially contextual approach to market

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[70] OECD, *supra* note 69; the principle states that "In accordance with the above, financial services providers and authorized agents should have in place mechanisms for complaint handling and redress. Recourse to an independent redress process should be available to address complaints that are not efficiently resolved via the financial services providers and authorized agents' internal dispute resolution mechanisms. At a minimum, aggregate information with respect to complaints and their resolutions should be made public".

[71] W.W. Powell and P.J. DiMaggio (eds), *The New Institutionalism in Organizational Analysis,* Chicago: Chicago University Press, 1991).

[72] PRI, FCAC and SEDI, *Why Financial Capability Matters*: *Synthesis Report on Canadians and their Money* (Ottawa, 2005); ASIC, *Hook, Line and Sinker: Who Takes the Bait in Cold Calling Scams?* (2002), available at www.asic.gov.au.

[73] FSA, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (London: FSA, 2009).

[74] *Ibid.* at para. 1.4.

[75] *Ibid.*

[76] For a contextual discussion, see N. Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist*

regulation would temper or reduce the highly speculative aspects of the markets by placing limits on the ability of these activities to create individual and systemic harm.

To date, not much has changed in respect of regulatory oversight that more accurately understands market drivers. Currently, financiers that develop new derivatives and other structured financial products have no obligation to ensure the level of risk of the products is accurately assessed or that level is accurately disclosed to purchasers. The risks associated with various financial products should be transparent, and product requirements streamed according to some fairness norms. Financial products are now marketed to massive numbers of people; hence it is an opportune time to think about how a fairness norm could inform regulatory choices. Adoption of a fairness standard for structured financial products would mean considerably enhanced disclosure requirements that are more akin to consumer product warning labels; warnings in respect of the risk of losses associated with products should be detailed and prominently displayed in connection with the product. Warnings, such as, "Do not purchase if you cannot afford to lose the entire amount you have invested" or "The product is highly risky and we do not have the information to know the extent of losses you may suffer", would not halt trading (as we know from ads warning about the hazards of smoking), but would cause the unsophisticated retail investor to pause and hopefully consider investing elsewhere. Currently, the valentine language of the financial products— vanillas, exotics, senior super-tranche, principal protected notes—masks the complexity and riskiness of products, promising better returns and underplaying the risks. For example, in Canada, more than 2,000 retirees invested much of their life savings in third-party asset-backed commercial paper (ABCP) on assurances that it was a safe investment; and absent a government bailout, their life savings would have been lost.[77] The ABCP market developed as a mechanism to avoid capital adequacy rules, an example of the interlinkages of all these markets and the need for integrated oversight.[78]

One fairness measure would be to confine credit default swaps (CDS) and similar products to their risk management functions, not allowing them to proliferate on a speculative basis where they are unconnected to the underlying reference assets.[79] A significant problem was that financial institutions and financiers purchased CDS, in which the purchaser would be paid if the company on which the CDS was written failed.[80] CDS were originally created as risk management products, allowing lenders to manage portfolio uncertainties; however, the CDS market rapidly expanded in the period prior to the crisis, and the original objective was overtaken by a speculative market for buying and selling CDS and other derivatives in multiples of the value of the underlying reference assets or entities, resulting in a significant trading market.[81] Those CDS were then hedged in further credit derivatives in multiples of the value of the originating reference entities. Hedge funds were a major driver of change in the market because of their short-term return imperative; as margins squeezed at the upper end of the credit curve, to maintain returns, they shifted to more speculative investment grades and unrated exposures.[82] Initial lenders to business had few incentives to negotiate appropriate loan covenants or to monitor their loans because they were fully hedged through CDS. Where they were over-hedged, purchasing CDS in multiples of the value of the underlying loan, there were new incentives to help cause a loan default because the payout was greater if the business failed. Less sophisticated market participants, such as trade suppliers and retail investors, were unaware of these altered incentives, and they continued to rely on the signalling that occurs when a financial institution lends to a business. The exemption of CDS from most regulatory oversight, ostensibly because the participants were sophisticated market players, failed to recognize the linkage between the

Societies, (Princeton University Press, 2001)
[77] J. Sarra, "Restructuring of the Asset-Backed Commercial Paper Market in Canada" in J. Sarra, ed., *Annual Review of Insolvency Law, 2008* (Toronto: Thomson Reuters, 2009).
[78] Financial Stability Board, *Shadow Banking, Scoping the Issues* (FSB, 2011); Financial Stability Board, *Strengthening Oversight and Regulation of Shadow Banking: An Integrated Overview of Policy Recommendations –Consultative Document* (FSB, 2012).
[79] Sarra, *supra*, note 3.
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*

market for these products and the economic consequences of the incentives created.[83]

Fairness is directly implicated in the structure of the CDS market. Unlike home insurance, where one can only insure to the value of the home to prevent incentives for misconduct, such as burning the house down for the insurance payout, there is no requirement that a CDS purchaser actually invest in the company and no limits on the size of the payout from the CDS, creating incentives to precipitate failure of that business. Moreover, derivatives traders received large bonuses based on derivative deals, which created further incentives for them to market the products, pursuing short-term profits to the detriment of long-term sustainability of their firm and the financial system. Distressed debt funds and other private market players pressed for higher risk financial products aimed at short-term profits to a select few. Financial institutions failed to acknowledge the systemic risks associated with their activities and the direct harm to local economies from risks they generated.[84] In this respect, there was a profound unfairness, a lack of other-regarding conduct such that many businesses and investors suffered materials losses.

Regulators globally could prohibit multiple value CDS, making swaps similar to insurance, requiring an insurable interest. In order to be able to insure, a party must have to be able to suffer a loss that can be accounted for; and it cannot issue multiple insurance contracts on the same economic interest. By prohibiting the ability to purchase CDS and equity swaps in multiples of the value of underlying assets, it would reduce the moral hazard of causing failures to reap rewards from default. It would bring back the important monitoring function of debt, offering incentives to investors to assess and monitor credit worthiness, creating greater fairness in the market.[85]

Access to meaningful remedies for harms caused by derivatives product misrepresentation and market misconduct could shift incentives away from practices that take account of short-term returns and neglect to take account of broader numbers of stakeholders. One possible way to compensate for potential negative externalities is to set a price for participation in the market. One could tax derivatives on a *per* transaction basis. An amount on each transaction could be placed in a central trust fund in the domestic jurisdiction in which the derivative is being purchased. That fund would be available to consumers and counter-parties that had been unfairly harmed by misrepresentation, failure to disclose particular features of the product, or other misconduct by market participants.[86] Not unlike deposit insurance funds or pension guarantee funds, the funds would be available, to some specified cap, to cushion losses. The compensation funds could then be empowered to impose risked-based levies on the counter-parties causing the losses, in order to partially or fully recover payments. Such a strategy would spread the cost of misconduct across parties most actively buying and selling CDS and other derivatives, would allow cost recovery against specific counter-parties in some cases, and would diminish the risk of unfair losses to end purchasers.

In terms of securitization and the off-loading of risk onto investors, many banking supervisory authorities have now acknowledged that uncontrolled securitization can create specific and systemic risks to financial and capital markets. A working norm could be to require entities and parties that are securitizing debt to retain some economic interest in the initial transaction. A requirement that a portion of the exposure be left on the originating lender's balance sheet, or that a seasoning period be required before the debt can be sold, could address some of the immediate agency issues associated with the speculative market. However, *skin in the game* must be set at a sufficiently high level that the amount does not merely become the entrance price for continuing the same kinds of conduct. While the US has moved to impose a 5 per cent holding, such a low amount seems little more than a licence to shed risk. A more robust public policy process could assist in determining what the appropriate level of retained interest

83 *Ibid.*
84 *Ibid.*
85 *Ibid.*
86 *Ibid.*

should be, to generate a culture of greater fairness to end purchasers and greater attention to systemic risk.[87]

A more difficult question is whether regulators should prohibit the sale of some types of products to retail investors. While such an idea is counter to the notion of everyone having equal ability to participate fully, it would have prevented some of the severe harms caused to retail investors. At minimum, such an approach is deserving of a public policy discussion that could be informed by the fairness norm.

At a minimum, institutions that design financial products should have an obligation to design at least some products for the types of investors now implicated in markets, meeting the need for low risk, secure products. The Financial Services Authority (FSA) in the UK is considering such an intervention, and the European Union is considering new methods of product governance as well. The FSA has noted that its regulatory approach has been based on the assumption that effective consumer protection would be achieved if sales processes were fair and product feature disclosure was transparent, but that such an approach was not effective in preventing waves of severe customer harm.[88] The FSA has found numerous weakness in the manner in which retail financial services are marketed; consumers lack relevant information to make appropriate purchases; consumers are obstructed from making accurate judgments about price and quality of products; consumers do not realize there is a problem with a product they have bought until it is too late; and the problems are exacerbated when distribution incentives are not aligned with those of consumers.[89] Hence, the FSA is adopting a new regulatory approach that involves earlier intervention, engaging with firms to ensure that new products serve the needs of the customers to whom they are marketed.

The FSA suggests that, while it is important to balance consumer protection with the risks of restricting consumer choice and product innovation, it is prepared to take action to stop a product being sold where the resulting benefits to the majority of consumers from not being inappropriately sold a product outweigh the costs to the minority who might benefit.[90] It anticipates that consumers will be more certain that they are able to purchase financial products designed in their interests and that will work in the way they expect them to; in turn, firms should benefit from growing confidence in the market; and it may allow early identification of product features that have the potential to cause significant detriment to consumers.[91]

Disclosure would continue to play a role in fairness in financial products, but its requirements would be considerably enhanced. There must be sufficient disclosure of material information to allow market participants to make informed choices about derivatives investment.[92] For example, in respect of CDS, protection buyers could be required to disclose, at the time of purchase, any material adverse risk in the reference entity that they are aware of or ought reasonably to be aware of, in order that protection sellers can appropriately price the contract.[93] Protection sellers could be required to disclose any material adverse risk to their financial health at the time of the sale and/or renewal of a derivative contract, and could have an ongoing disclosure requirement regarding material adverse change to their ability to settle the derivative at the point of a credit event occurring. The fairness implicit here is in standards and

[87] *Ibid.*
[88] Financial Services Authority (FSA), *Product Intervention*, DP 11 (January 2011), at 7; FSA <http://www.fsa.gov.uk/pubs/discussion/dp11_01.pdf>.
[89] *Ibid* at 28.
[90] *Ibid* at 17.
[91] *Ibid* at 19, 25.
[92] Sarra, "Restructuring", *supra* note 3.
[93] *Ibid.* Materiality in this respect could be based on a standard of whether the facts in respect of the adverse risk reasonably would be expected to have a significant effect on the protection seller's valuation or pricing of the derivative.

norms that must be other-regarding, in that disclosure is aimed at providing the counter-party with all material information to make informed decisions.[94]

Retail investors purchasing derivatives should have enforceable remedies for the failure of these entities and individuals to disclose material adverse risks at the point of sale of the derivatives.[95] The outcome sought is to ensure that a standard of greater transparency is applicable to new products as they develop, allowing for market innovation while trying to ensure that there is sufficient information in the market to assess and price risk, and ensure that those making the products available are providing a type of indemnification in respect of the product in terms of assurances that the material adverse risks are known by the counter-parties at the time of sale.[96]

Credit rating agencies and other entities that recommend investment in derivatives should meet a due diligence standard in examining and disclosing material adverse risk in the products being sold in the market. The structured financial products on the market have not been responsive to the change in the profile of investor, they are poorly rated, and there is no accountability for such ratings. Credit rating agencies are compensated by the firms that issue the products, and absent a significant structural change, such as governments or consumers directly funding ratings, neither of which is likely to occur, there needs to be some other means of creating accountability. One option is to impose a *fairness standard* on credit rating agencies and their agents. Not as high as a fiduciary standard, it could nonetheless hold them personally liable to any purchaser for ratings that are not fair and reasonable in the circumstances, including requiring a fulsome assessment of the risks associated with the product. A requirement to be other-regarding would be enforceable in that it would force credit rating agencies to consider the end-users that may have a remedy from them for harms caused by their rating practices. Credit rating agencies should be required to disclose all fees associated with a rating, as well as consulting and other fees received from the financial institution or other entity selling the derivatives. There should be effective remedies for purchasers and other market participants from failure of those individuals and entities recommending or rating financial products to meet due diligence and fairness obligations.[97] It would create appropriate incentives to undertake diligent assessment of products, reduce conflicts of interest, and increase the likelihood of fairness in financial products.

5. Fairness in the Cost of Consumer Credit

The availability of consumer credit is important because it allows consumers to bridge economically difficult periods, cover unexpected health-related or other costs, and obtain financing to allow for the purchase of homes or other significant consumer goods.[98] There are a host of consumer credit practices that need to be addressed if fairness is to become a fundamental norm, issues that particularly face immigrants, youth, and the elderly in a number of countries. In the US, one in five people do not have access to basic banking services.[99] In most countries, there are few limits on what credit card companies can charge in interest, and rates continue to be extremely high, creating a revolving door of high interest debt. Sub-prime credit cards proliferate in some jurisdictions, with interest rates at 30 per cent or higher.[100] Individuals are using home equity lines of credit as a way to repay high credit card debt, not

[94] *Ibid.*
[95] *Ibid.*
[96] *Ibid.*
[97] *Ibid.*
[98] *Ibid.*
[99] Jerry Buckland, "Money Management on a Shoestring: A Critical Literature Review of Financial Literacy & Low-income People", Research Report Completed for the Canadian Task Force on Financial Literacy (2 February 2011), online: Financial Exclusion & Poverty in Canada <http://financial-exclusion.uwinnipeg.ca/>.
[100] Janis Sarra, "At What Cost? Access to Consumer Credit in a Post-Financial Crisis Canada" (2011) in *Annual Review of Insolvency Law, 2011* (Toronto: Carswell, 2012), online: Social Science Research Network <http://papers.ssrn.com/

realizing that they are mortgaging their long-term economic security. Payday loans have proliferated globally, pulling individuals with a regular paycheque onto a treadmill of re-borrowing from which it is difficult to exit. Current legislation in Canada on payday loans allows up to 460 per cent interest per year, far more than the interest rate prohibited under the *Criminal Code*, trapping the borrower in a spiral of mounting debt. Rates in the UK are even higher. Hence, the legislation governing consumer credit has direct and unfair consequences because it fails to protect the most financially vulnerable from lender predators. Payday loans should be capped at considerably lower annual interest rates, and sub-prime credit cards should be controlled or prohibited. Access to basic banking services and consumer protection should be universally available.

Jerry Buckland suggests that financial services need to be more accessible for low-income people as there is an important cause-and-effect issue in the relationship between access to financial services and individual well-being; and the design of literacy policy needs to take account of these linkages.[101] Buckland suggests that there are generally two types of consumer loans that offer affordable credit for vulnerable consumers. First, there are social consumer micro-loan programs that have economic and social objectives, with little or low interest rates and longer repayment periods of one to three years. The second, a consumer micro-loan, is offered by a financial institution on terms that are close to those found in other mainstream bank lines of credit, including interest rates between 11 and 36 per cent APR, most loans ranging from $100 to $1,000. Buckland observes that, in some cases, these loans mimic the payday loan two-week period, and in others, they have longer repayment terms of 3 to 12 months. They are offered in a manner that allows the lender to cover its costs in the short or longer term, yet offer credit on much less expensive terms than payday loans.[102] Buckland's work offers a comprehensive set of strategies that deserve immediate public policy attention if we are to create a fairer system of accessible and affordable credit.

An aging population globally and fundamental changes to public policy regarding retirement income has led to a situation in which many middle-income people will not have sufficient retirement income. Even for individuals with a defined benefit pension plan, requirements to fully fund the plans have not proved adequate, and thousands of individuals have lost their pension savings when their employer went bankrupt. The US has a pension guarantee fund, but it is massively underfunded.[103] Company self-funded pension plans, which do not set up separate pension trusts to protect the money, such as occurred with the multinational, Nortel, create incentives for companies to tap into pension funds when they slide into financial distress, stripping retirees and future retirees in 130 countries of their pension benefits and savings. In countries where pensions are industry funded or funded by the state, there is considerable pressure to dismantle these programs; and in the case of national superannuation funds, such as in Australia, when the individual reaches retirement age, they suddenly have to manage their own portfolios, making them highly vulnerable to fraud or to poor financial advice. A fairness norm would require pension laws to be reformed to ensure companies adequately fund their pension promises and to require all employers to place pension funds in separate trusts that they cannot access. Those pension trusts should be required to manage the trust prudently. All jurisdictions should have a pension guarantee fund, and state social security and financial safety nets should be enhanced.

6. Fairness in the Process for Change to Financial Markets

Arguably, optimal fairness norms can best be established through empowering citizens to voice their views and have their interests meaningfully accounted for; thus, the above suggestions for how fairness

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sol3/papers.cfm?abstract_id=1934457>.

[101] Buckland, *supra* note 99.

[102] *Ibid.*

[103] The Pension Benefits Guarantee Corporation.

can be embedded are only a starting point for the discussion. While there is broad consensus now that financial markets have a strong impact on the real economy, the solutions are being fashioned by financial market experts with remarkably little input from those persons in the real economy affected by long-term framework decisions. While the Basel Committee's Charter says that it will seek "input from all relevant stakeholders on policy proposals",[104] its recent consultation process with respect to Basel III illustrates how narrow the input is; more than 85% of submissions came from industry players, who largely objected to proposals aimed at strengthening the resilience of the banking sector.[105] Moreover, the supra-national bodies developing global financial governance have historically been undemocratic and of limited effectiveness, due in part to the exclusion of the emerging markets and developing economies, notwithstanding calls from those jurisdictions for representation and participation.[106] While the Basel process has now included some of the most significant states such as Brazil, China, India, and Mexico, the focus of the process continues to address US and European financial structures, without addressing financial market issues of the global south.[107]

There are considerable barriers to a broader public policy engagement. The materials generated are often inaccessible to ordinary consumers and investors. For example, in the US, the *Dodd-Frank Act* is 848 pages and there are 400 additional rules that must be developed, with 8,843 pages of material to date.[108] The ordinary citizen does not have the information, time or resources to digest this information and have meaningful input. [109]

The narrow parameters of the discussion may mean that the problems underlying the global financial crash have not been addressed. Aside from the normative choices that need to be made, there are important considerations regarding the nature of the regulatory process itself and the ability of ordinary people to have their voices included in the range of interests being considered as financial market regulation moves forward. Greater transparency is needed regarding how decisions are being made and how they will affect our financial security in the future, and governments have a role in creating opportunities for engagement. Here, Amartya Sen's call to capacity building as necessary to a fair and just society resonates. Sen suggested that central to fairness is a demand to take "note of the interests and concerns of others" and to avoid being ruled by our respective vested interests, but that critically important is development of individual capability to redress unfairness in one's own positioning and in a broader public policy context.[110] Sen observed that a just society strives to equalize the capabilities between citizens, so they can advocate according to their own values.

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[104] BCBS *Charter*, s 17.

[105] BCBS, "Comments Received on the Consultative Documents "Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring" (2009) online: BIS http://www.bis.org/publ/bcbs165/cacomments.htm; see for example Goldman Sachs, "Comment Submitted to the BCBS on "Strengthening the Resilience of the Banking Sector_ Consultative Document"" (2010) at 1-2, online: BIS http://www.bis.org/publ/bcbs165/goldmansachscap.pdf; Bank of America, "Comment Submitted to the BCBS on "Strengthening the Resilience of the Banking Sector_ Consultative Document"" (2010) at 3-4, online: BIS http://www.bis.org/publ/bcbs165/boac.pdf.

[106] Commonwealth Secretariat, "Perspectives on the Governance of Global Financial Regulation" (September 2009) online: Columbia University http://academiccommons.columbia.edu/catalog/ac:153941.

[107] Bank of England, "Financial Stability Report" (October 2008) online: http://www.bankofengland.co.uk/publications/Pages/fsr/2008/fsr24.aspx; Wim Naude, "The Financial Crisis of 2008 and the Developing Countries" (2008) online: World Institute for Development Economics http://www.econstor.eu/handle/10419/84665.

[108] Andrew Haldane, "The Dog and the Frisbee", *supra*, note 27.

[109] *Ibid.*

[110] Amartya Sen, *The Idea of Justice* (Cambridge, Mass.: Belknap Press of Harvard University Press, 2009); Amartya Sen, (1980) "Equality of What?" in S. McMurrin, ed., *The Tanner Lectures on Human Values* (Salt Lake City, Utah: University of Utah Press, 1998) 195.

Arguably, that capacity building could have an impact on public policy decisions concerning financial markets. However, vested self-interest, which Sen counsels us to avoid, is precisely what is driving the current policy reforms. Only the most sophisticated investors and investment professionals are at the public policy discussion table, and hence government regulators do not hear from the broad numbers of individuals harmed by market collapses, who do not have the capacity to participate and who are fatigued by the losses to their economic security.

More fulsome use could be made of our democratic structures. We can engage with public policy-makers to press for reorientation of priorities that are fairer or more equitable for ordinary people in their relationships with financial services and financial markets.[111] Engagement must move beyond periodic voting for elected representatives and, instead, engage deliberations at the national and international levels. To date, that level of engagement has not occurred, in part because the language of financial markets excludes many citizens from engagement. They feel intimidated by the complexity of the system. Yet, we see from the engagement of people in the occupy movements and in the social media that norms, laws, and policies can be influenced. In the utilities context, independent proxy advocates have helped identify processes for civil engagement and have worked to mitigate industry capture;[112] and similar strategies could be conceptualized to help develop and provide expertise in the regulatory design process for financial markets.

Neil Gunningham suggests that non-legal institutions can be as powerful or more powerful than legal rules in shaping behaviour, in that a number of influences affect the motivations of individuals to abuse their positons in markets, including peer pressure, fears of being ostracized, the influence or leverage of large institutional clients, and the opaqueness or transparency of market dealings.[113] John Braithwaite advocates broad principles for regulatory dialogue to give voice to multiple stakeholders, engaging those stakeholders who resist by construing their resistance as an opportunity to improve regulatory design; praise for those stakeholders who show improvement, signalling ultimate formidable sanctions, but used only as a last resort; reflecting the need to be contextual and dialogic.[114] Braithwaite has observed that regulation must necessarily account for the fact that non-state regulation has grown rapidly, that finance capital holds sway over states, its influence exercised through capital movements, but also through lobbying global institutions that have more direct control over a specific sphere of state activity, creating severe accountability problems.[115] In a context of moderate wealth and power disparity, which the current global situation is not, Braithwaite's model has some appeal. Sanctions can provide the regulatory *big stick* operating in the background to bring and keep parties at the regulatory design table. However, Braithwaite's model is built on the relational aspects of business relationships, in that stakeholders have repeat interactions, and relationship and reputation work to reduce purely self-regarding conduct. Yet, as discussed above, the relational aspects of current financial markets are severely impaired, and the threat of corporate exit to safe havens reduces the ability to bring market players into a dialogue with other stakeholders. If not at the bargaining table, peoples' views may have to be engaged in the street, in public meetings, and in the social media. Judith Butler has observed that "as much as we must insist on there being material conditions for public assembly and public speech, we have also to ask how it is that

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[111] Jürgen Habermas has observed that the impartiality of judgment is expressed in a principle that constrains all affected to adopt the perspectives of all others in the balancing of interests Jürgen Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (Cambridge, Mass.: MIT Press, 1996) at 65-66.
[112] Stefano Pagliari, "How Can We Mitigate Capture in Financial Regulation" in Stefano Pagliari, ed, *The Making of Good Financial Regulation: Towards a Policy Response to Regulatory Capture* (London: Grosvenor House, 2012) 1 at 22.
[113] N. Gunningham, 'Private Ordering, Self Regulation and Futures Markets: A Comparative Study of Informal Social Control' (1991) 13 (1) Law and Policy 287; M. Abolafia, Making Markets (Harvard: Harvard University Press, 1997).
[114] John Braithwaite, "Accountability and Governance under the New Regulatory State" (1999) 58 Australian Journal of Public Administration 90; John Braithwaite, *Regulatory Capitalism How it Works, Ideas for Making it Work Better* (Cheltenham, U.K.: Edward Elgar, 2008) at 3.
[115] *Ibid.*

assembly and speech reconfigure the materiality of public space",[116] and that the escalating "precaritization" of working people has created a need for new voices to be heard; "in acting together, the body displaces its own perspective with a more collectively constructed perspective, mobilized in new ways to address the demand to provide for basic needs and redress the unequal distribution that renders populations differentially precarious and disposable".[117] Her views suggest the possibilities of a broader collective engagement, given the very direct consequences of financial market failure, but she locates that acting in alliance within the context of much larger historical and structural inequities.

Julia Black argues that the post-crisis regulatory agenda is developing piecemeal technocratic solutions without a clear analytical framework or fully revised conception of markets; and that a social conception of markets offers the basis of a systematic analysis of the dynamics of financial markets, drawing attention to the interdependencies that exist between participants within markets, and to the endogenous and unpredictable effects that regulation can have.[118] She argues that markets are mechanisms and places of coordination and exchange that may take different organizational forms; and the preferences and behaviour of those actors are shaped by the institutional structures and the social networks in which they are situated, which influence, and are influenced by, the decisions those actors make and how they interpret their own interactions and those of others in the markets.[119] Black suggests an analytical framework for how regulators understand the behaviour of actors within markets, the function of markets, their structure and organization, the role of calculative devices in price formation and governance processes, the power relations and interconnections between actors within markets, their own role in shaping decisions that market actors make, and the relevance of internal organizational dynamics to understanding behaviour of organizations within markets.[120]

Black argues that regulators need to build what she calls alternative cognitive frameworks, new ways of seeing and knowing financial markets; otherwise they risk regulating a mirage: a false image of markets and the institutions, organizations and individuals that comprise them.[121] She observes that the post-crisis regulatory agenda is bringing to the fore the lack of calculative capacity on the part of firms, rating agencies, regulators and central banks to measure and manage risks within the market on a macro-basis.[122] Regulators are trying to develop new methods of calculation in order to achieve financial stability, such as how to calculate the impact of the failure of a large financial institution on the market and so calculate the cost that should be internalized by those institutions, how to calculate the appropriate risk weights for assets, how to revise risk models, and how to define capital under Basel III.[123] She observes that regulators face functional challenges of scale, knowing what they are regulating, and rendering it knowable, of governing at a distance in time and space from those they are attempting to govern, as well as broader challenges of power, authority and legitimacy.[124] Black argues that it is not creating complexity, but describing an existing complexity in order to try to make a difficult task more

[116] Judith Butler, "Bodies in Alliance and the Politics of the Street" (September 2011) European Institute for Progressive Cultural Policies (EIPCP), online: EIPCP <http:// eipcp.net/transversal/1011/butler/en>.
[117] *Ibid.* at 5.
[118] *Ibid.* at 46.
[119] Julia Black, "Seeing, Knowing, and Regulating Financial Markets: Moving the Cognitive Framework from the Economic to the Social" (LSE Working Paper 2013) at 1.
[120] *Ibid.* at 4
[121] *Ibid.* at 1. She develops a social conception of financial markets, drawing on institutionalist theories, social network theories, and the sociology of science and technology, including technical systems.
[122] *Ibid.* at 36.
[123] *Ibid.* at 34, citing P. Kupiec and C. Ramirez, "Bank Failures and the Cost of Systemic Risk: Evidence from 1900-1930" (Reserve Bank of New Zealand, 2011), online <http://www.rbnz.govt.nz/research/workshops/March2011/4360883.pdf>; and citing the example of Spanish banks suggesting that Euro 50bn of deferred tax assets should be allowed to 'count' as capital, which would improve their capital position under Basel III: "Spain set to spruce up banks with deferred tax change", Financial Times, 4 July 2013.
[124] *Ibid.* at 41.

manageable; and making explicit and comprehensive what regulators in practice often take account of, which in turn would aid in developing a socially enriched way of seeing and knowing markets to be able to regulate in a 'really responsive' way.[125] Her conception of the interrelationship of regulators and markets affords a more informed way of approaching the challenge of regulation of financial markets.

Arguably, there is a pressing need to deal with the ongoing and very real effects of financial markets wearing away at our society, while allowing for the possibility of a long-term regulatory process that engages broader stakeholder interests in a meaningful dialogic exchange. Community groups and non-governmental organizations (NGO) are very experienced in capacity building on limited resources and could be tapped for advice or directly engaged to assist with a massive capacity-building initiative. Investor groups, financial counselling organizations, community centres, unions, and community advocacy groups could be approached to help design the process and encourage participation of their members in a dialogic process. The arts can be engaged to assist in clarifying challenging concepts or offering insights. Policy-makers could ensure that there are educational documents that are plain language analyses of the structural and functional problems associated with the crisis and the range of potential options. Once information is in a form that is more readily comprehensible, and opportunities for discussion are created, individuals in the markets or affected by market changes would have some of the basic tools to deliberate options. Over time, those tools could be enhanced, as stakeholder engagement increases and the appetite for involvement and capacity for analyzing financial market information grows. These ideas are likely to create greater fairness. They present a tremendous challenge to achieve, given the structural barriers and information and resource asymmetries; but a change needs to commence somewhere, if fairness is to ultimately begin to become embedded in financial markets.

7. Conclusion

King Lear learned too late the inter-connectedness between property, power and capacity to influence decisions. It is only the play's fool that fully grasps these dynamics. Regulators could take a lesson from the narrative, and recognize that the current reforms are being generated by, and being severely limited because of, the principal market participants who are the same propertied interests that precipitated the crisis in the first place. A new conception of financial markets, embedding substantive norms of fairness in multiple aspects, would counterbalance these huge pressures to maintain the *status quo*, and really begin to address the challenges of constructing a market and regulatory framework that could prevent extraordinary harms that continue to occur globally in respect of individuals' economic security and the financial system's stability and longevity.

[125] *Ibid.*