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Scandal or Repetitive Misconduct: Payment Protection Insurance (PPI) and the not so Little "Skin in Lending Games"

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Abstract: Payment protection insurance (PPI) has shown people greatly value the assurance of being covered against any debt contingencies that could limit what they own. Starting as a risk diversifying mechanism to aid consumers with future debt management issues, the PPI market soon developed into a serious case of mis-selling. This article analyses the development of the PPI conundrum from regulatory, behavioral and ethical perspectives. It shows that while the PPI scandal exemplified asymmetric financial market relationships between PPI providers and UK retail banking customers, the initial large benefits reaped by the financial institutions involved in misconduct came at a price. While financial supervision and regulation over the sector lagged, consumer redress has been secured. In its aftermath, the PPI scandal has renewed the emphasis on pursuing resilient, crisis-resilient, and ethically grounded financial market cultures that help diminish people-related systemic operational risks such as those present throughout the PPI mis-selling scandal.

1. Introduction & Contextualization: PPI Explained

An eight year-long window to submit a payment protection insurance (PPI) redress claim to UK banks and credit providers closed on August 29, 2019. Yet, the passing of the deadline to inquire and claim for restitution did not abate UK retail banking consumers' mistrust nor did it terminate the stream of monetary losses and increased reputational costs accrued to the industry from one of the most expensive UK banking misconduct scandals.

Originally known in the industry as accident, sickness and unemployment insurance, PPI was a retail banking insurance product intended to cover borrowers unable to service payments on personal finance debt products such as mortgages, (unsecured)

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loans, credit card balances, and asset finance instruments in the eventuality of unemployment, prolonged sickness, disability, and redundancy.

According to a 2007 UK Office of Fair Trading (OFT) report, the underwriting of PPI policies was dominated by the insurance subsidiaries of the five largest UK banks. Standing at the interface of banking and insurance services, PPI was promoted by the biggest banks in the United Kingdom (Ouseley 2011). Most follow universal (integrated) banking models[2], which entail the provision and management of a range of financial activities including retail banking, investment banking, securities, wealth management and insurance services within the same large conglomerate.

Sold either as an overdraft product facility or as a disclosed and often un-disclosed add-on product to loans and to other personal finance debt instruments, PPI was moderately complex. Even though its design was not intuitively easy to understand by inexperienced and misinformed customers, PPI was widely popular amongst UK retail credit clients, particularly among consumers who earned less than the UK national average income[3] (Competition Commission (2008a, p. 7). At the same time, PPI was very attractive for insurers and lenders because it allowed for the accrual of high average commission rates (ranging between 50% and 80% of the PPI premiums sold) alongside low average claim-loss ratios from PPI sales. PPI distribution was also highly profitable because whilst incurring low additional costs from PPI sales, distributors earned a large proportion of the total income from PPI premiums. The value of any particular PPI premium depended on the type and size of coverage provided.

Regardless of the specificities of the contract, PPI's average claims loss ratio—that is, the average percentage of the net premium received by PPI sellers effectively paid out in claims—was much lower than that of related consumer finance products. According to a 2008 Competition Commission evaluation of the industry, the average claims loss ratio of PPI was about 14% compared to, for example, a 55% average claims loss ratio for household insurance (Competition Commission, 2008b, p. 132). PPI's large profit margin (approximate profitability of over 90%[4]), its relatively low-risk distribution and the low additional capital costs needed to support it helped steer a business model based on maintaining low costs and growing volumes (at the expense of due diligence) over the determination of product adequacy for customers (Competition Commission 2008b, pp. 3, 15–18).

2 Allfinanz, bancassurance, assurfinance

3 As per the UK Competition Commission, PPI purchasers and policyholders were likely to belong to socioeconomic groups C and D.

4 Intended to cover insurance company costs, distributors' commission and yield large profit margins.

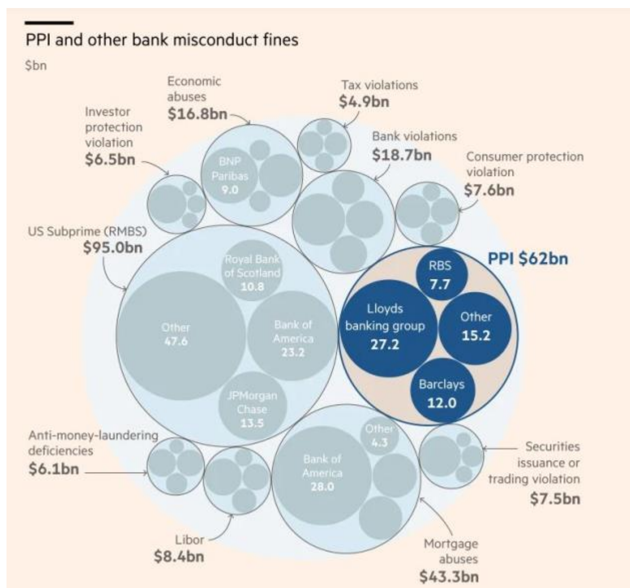
Emerging in the late 1960s and early 1970s, PPI sales grew particularly rapidly in the 1990s and, as the product's popularity heightened, its terms and conditions became relatively standardized across the industry. The 1990s and early 2000s saw widespread mis-selling of financial products and significant cases of financial misconduct (FCA 2011, p. 5). Aligning with the ethos of the banking culture of the time, the PPI market yielded to competition forces that pushed industry participants to seek enlarged PPI volume sales at the expense of due diligence and prudence when assessing the suitability of PPI for many customers.

Despite its wide uptake by UK retail banking customers, PPI's bad press developed in the mid-1990's as consumer groups and newspapers revealed anecdotal evidence that showed PPI policies being sold to customers who could have never been able to claim against them. Ultimately, the market seized up in 2011 as a result of people-related, systemic operational risks associated with the prevailing banking culture (McConnell and Blacker 2012).

2. Scandalous Costs

Compared to other cases of financial services' misconduct, such as the mis-selling and promotion of mortgage-backed securities, which contributed to the global financial crisis (GFC), the impact of the PPI scandal was relatively small. Its reach was bounded within the UK banking sector and it had modest effect on the local economy. Nonetheless, it has been considered one of the most serious mis-selling scandals around the world due to the magnitude of accumulated UK financial industry-wide PPI penalty costs. As Figure 1 shows, it is estimated that the £62bn-£53bn budget set aside by the industry to cover PPI fines, redress payments, and administrative costs is only second in quantity to the mis-selling costs of residential mortgage-backed securities in the U.S.

Figure 1



Source: Retrieved from FT & New City Agenda Briefing

At the same time, in the UK, the PPI misconduct scandal has been categorized[5] as one of the worst of its post-war financial system history due to the amount of unexpected costs accrued by it to the UK's financial sector. PPI's reparation cost provisions have been estimated at least 10 times as high as the next priciest scandal, thus making it the foremost expensive UK retail banking financial scandal.

According to analysts, PPI losses have been followed by the costs of mis-conduct scandals associated with instruments and behaviours such as: interest-rate hedging products (£4.85 bn), endowment mortgages (£1.9 bn), mortgages (£1.6 bn), packaged bank accounts (£1.6 bn), consumer credit act breaches (£1 bn), investment products and advice (£0.9 bn), pensions mis-selling (£0.6 bn), unfair and un-authorised over charges (£0.6 bn), ID theft and card protection insurance (£0.5 bn).

As the PPI August 2019 restitution claims deadline approached, banks, building societies and other creditors that once provided PPI policies saw a sudden rush in the volume of claims received, raising their overall operational costs.

The extent of the rush in claims during the last quarter before cut-off surpassed market predictions, causing top providers such as Lloyds, Barclays, Royal Bank of Scotland (RBS), CYBG and the Co-operative Bank to announce increases in their legacy PPI compensation provisions several times. Likewise, in order to make way through the backlog of inquiries and restitution claims, some lenders began operating PPI processing centers 24 hours a day, sometimes 7 days a week (both during the run-up and in the aftermath of the August 2019 deadline).

While in 2011 a UK High Court Judicial Review of the market forecasted that the PPI scandal would cost the UK retail-banking sector up to £4.5bn., the non-inconsequential early estimate has paled in comparison with the more than four times as big, PPI costs already accrued in the aftermath of the PPI claims submission deadline.

[5] Think tanks such as New City Agenda (see Table 1) have categorized PPI as the most expensive.

Top 10 financial scandals in UK retail banking *Table 1*

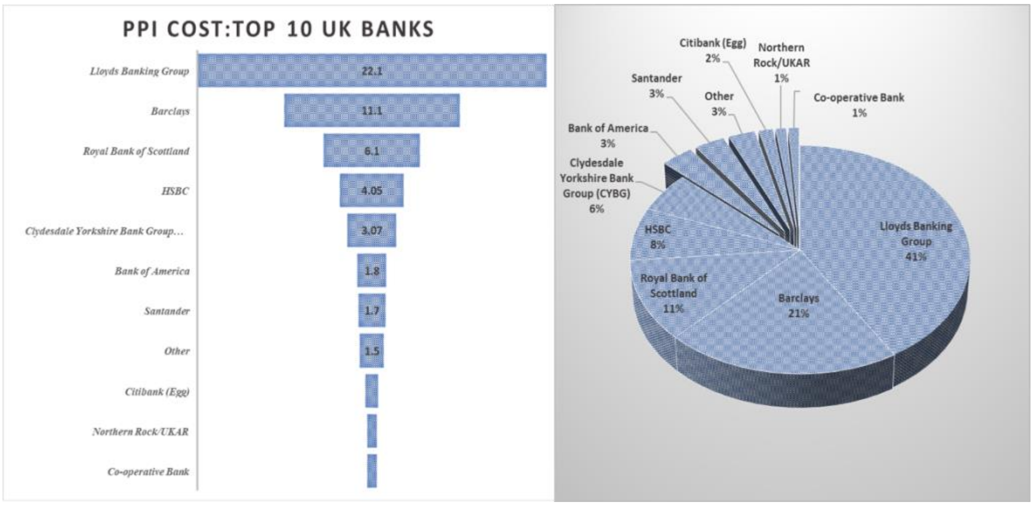
Type of Misconduct	Provisions (£ billion)	Years provisions were incurred
PPI Mis-selling	53.5-53.7	2010-2019
Interest Rate Hedging Products Mis-selling	4.85	2012-2015
Endowment Mortgages Mis-selling	1.9	2002-2006
Mortgages	1.6	2002-2019
Packaged Bank Account Mis-selling	1.6	2014-2018
Consumer Credit Act Breaches	1.0	2013-2015
Investment Products and Advice Mis-selling	0.9	2003-2015
Pensions Mis-selling	0.6	2000-2002
Unfair unauthorised overdraft charges	0.6	2006-2007
ID theft and Card Protection Insurance Mis-selling	0.5	2014-2015
Other issues / Miscellaneous	5.4	2000-2016

Source: Retrieved from New City Agenda Briefing (August 2019)

According to market observers and advocacy groups, in the aftermath of its ban[6], banks have upheld about 71% of the complaints made about PPI mis-selling. Roughly, 80 to 90% of the PPI claimants who actually held a verifiable PPI policy have received some compensation. Payouts have ranged over the interval of a couple hundred to about £15,000, with the average payout observed across the industry amounting to £2,500 (New City Agenda: PPI-briefing-note, August 2019).

The financial services' think tank New City Agenda estimates that by August 2019 over 87% of total PPI costs had been incurred by five banks. Lloyds losses took the lead, amounting to 41% of the total with £22.1 bn, Barclays followed with £11.1 bn (about 21% of total), Royal Bank of Scotland—RBS accounted for 11% of total with £6.1bn, HSBC took up 8% of total through £4.05 bn, and with £3.07bn Clydesdale Yorkshire Bank Group—CYBG incurred close to 6% of total costs.

6 Specially since 2014



Source: Based on New City Agenda Briefing (August 2019)

By October 2019, the total cost to banks surpassed £50bn[7]—with at least £36bn destined for customers' compensation and the remaining quarter allocated to cover administrative costs. The latter had surged due to an elevated influx of "low-quality" complaints stemming from professional claims management companies (CMC) which raised former PPI providers and distributors' claim-processing costs without leading to increased numbers of compensation payouts to customers (Megaw, N; Financial Times, 2019).

CMC's pursued cases on behalf of claimants against multiple PPI providers at once on a no-win, no-fee basis. In doing so, despite adding to the burden of costs to the PPI industry, CMC's rose in popularity because they were thought to indirectly empower retail-banking customers against their creditors. Some consumer advocacy groups contended that CMC's helped redress the balance of power in the bank–customer relationship. At the same time, scholars have argued that CMC's raised the stakes of reputational risk of financial institutions. By aggregating and publishing details of financial services providers' operational errors, CMC's helped pressure financial institutions to settle claims. However, as observed by market participants and regulators, CMC's unfortunately also clouded the efficacy and efficiency of PPI claims compensation processes because in many cases, they presented inordinate amounts of non-justifiable, incomplete, or repetitive claims and information requests to banks without necessarily leading to positive redress outcomes for their clients.

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7 A month after the 29 August PPI claims cutoff date some estimated that around £52bn-£53bn had been set aside by market participants to deal with PPI.

While the UK banking industry undertook genuine measures to set up PPI compensation schemes since it was statutorily asked to do so in 2011, by the fall of 2019 these efforts had already proved to underestimate the funding and operational allotments needed by the industry to fully redress consumers.

In response to the operational challenges faced by the industry in the aftermath of the PPI claims submission deadline, the UK Financial Conduct Authority (FCA) issued a PPI complaints handling update bringing into public awareness that the usual 8 week time limit for financial institutions to elicit a response to banking customers could stretch beyond at least 24 weeks. In order to prevent customers from facing further financial setbacks from delays, the FCA stipulated that customers would be entitled to further interest compensation (typically 8%) on the amount due by the bank which would accrue taking into account the length of time banks took to respond.

3. Chronology of Regulation

The evolution of the UK PPI market into a serious financial misconduct scandal was not an unexpected black-swan process[8] that could only be predicted retrospectively. Lessons from an early 1990's pensions mis-selling scandal involving similar features could have served to monitor the PPI market before it turned completely astray (Blacker 2001; Financial Services Authority 2002).

The recognition of mis-selling practices in the PPI sector can rather be seen as the result of self-reinforcing negative public evaluations through which consumer activism brought irregularities to light. Persistent cascades of denunciations by advocacy groups acting on behalf of PPI policyholders motivated greater attention to rule violations and amplified political pressures to regulate the market.

On April 2011 the UK High Court ruled in favour of a PPI assessment and redress policy proposal by the Financial Services Authority (FSA)[9], then the prime UK financial markets' regulator. The approved FSA PPI proposal unequivocally obligated banks to compensate customers from any PPI policies mis-sold, and established 2011 as the starting point of a roughly 8-years long PPI claims submission period ending on August 2019. However, it had taken more than a decade of public outcries regarding PPI sales misconduct before the market was reined-in and the procedures to restitute potentially harmed policyholders could be assured. Appeals to regulate the market can

[8] Former option trader and risk analyst, statistician and scholar Nassim Nicholas Taleb developed Black Swan Theory and coined the concept of black swan events to describe high profile, hard-to-predict, and rare events that apparently arise as a surprise, have a major effects, and are often inappropriately rationalised with the benefit of hindsight.

[9] The precursor of the current UK banks and financial markets regulator: Financial Conduct Authority (FCA).

be traced back to at least 1998 when the consumer association and not-for-profit organization *Which*? raised some initial concerns regarding PPI mis-selling through a grass-roots campaign.

Nonetheless, the inflexion point in regulatory oversight did not occur until 2005, when the FSA assumed responsibility for the supervision of general insurance services and the Citizens Advice Bureau (CAB)[10] published a "Protection Racket" report denouncing common problems faced by PPI holders. Charged with the mission of providing free, non-rival and non-excludable financial advice, through its "Protection Racket" report the CAB helped to direct financial regulators' focus toward what until then had only surmounted to anecdotal evidence of problems within the PPI market.

Following a decree of the Treasury Subcommittee of the UK Parliament, and shortly after taking responsibility for the regulation of the insurance sector, the FSA began institutional investigations into the selling of payment protection insurance. The investigations concluded in a series of yearly "Thematic Review" reports in 2005, 2006 and 2007 (UK Treasury Subcommittee 2005). The FSA Thematic Reviews revealed that the model of self-regulation followed by the PPI sector itself based on following the Codes of Conduct of the Association of British Insurers (ABI) and, from 2001 onward, that of the General Insurance Standards Council (GISC); had failed to re-orient the industry towards good practices with respect to disclosure, product suitability for consumers and other aspects of the sales process.

At the same time, following the "Protection Racket" report, the CAB presented a complaint to the semi-independent UK government competition and consumer protection regulator, the Office of Fair Trading, asking it to investigate market practices considered harmful for consumers.

In early 2007, the OFT published a report summarizing the findings of PPI "mystery shopper" experiences it had commissioned, business and consumer surveys, and the economic analysis of the PPI market. The OFT report found confirming evidence that banking codes of conduct were not strictly adhered to. For example, borrowers were given the impression that the granting of credit would be eased by purchasing PPI. Overall the OFT report suggested that "consumers got a poor deal" (OFT 2006; OFT 2007) as the lack of up-front information made it difficult for borrowers to determine whether they were getting good value for their money (OFT 2007, p. 3).

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[10] The CAB is a network of 400 independently registered (donations and government-grants funded) volunteer run charities spread across the UK that help "people resolve their debt, benefits, employment, housing, retirement and pension problems".

Claiming to have found harmful market features that either prevented, restricted or distorted competition, the OFT escalated the issue with the UK Competition Commission. In response to the OFT's statutory request, throughout 2008, the Competition Commission conducted price variation evaluations across PPI providers as well as economic and profitability analyses of: vertically integrated distributors, the underlying assets associated to PPI sales, and the underwriting component of PPI premiums.

The Competition Commission (2008b, p. 4) found that credit card and mortgage business lines were highly profitable whereas the personal loan business line appeared to have been loss making in the absence of income from PPI since 2006. In terms of the underwriting component of PPI premiums, the Commission found that capital allocated to PPI adequately reflected the risks being untaken by insurers, producing a reasonable 10–20% return on capital (Competition Commission 2008a, p. 4). Finally, contrary to what was expected from truly competitive markets, the commission found that, although prices did vary across PPI providers, there was "little [competitive] price movement over time and few examples of price decreases" (Competition Commission 2008a, p. 7). By July 2008, the Competition Commission declared the PPI market uncompetitive.

The Competition Commission evaluations served to justify the regulatory intervention of the FSA, who by 2009 asked financial firms to retract from the sale of single premium PPI on unsecured personal loans (UPL) and became increasingly active at prosecuting firms for general transgression of PPI rules[11].

Design features of single premium PPI policies allowed the insurance premium to be added to the principal amount at the outset of the loan causing interest to be charged on both the loan and its PPI policy. This early bundling raised the effective rate of interest incurred by borrowers and blurred consumer's awareness of the full cost of their PPI policy because most of their contract documentation were in terms of annual percentage rates (APR) that did not reflect the basis of interest accrual.

The deeply embedded nature of misconduct surrounding PPI was also confirmed by the Financial Ombudsman Service (FOS). Funded by fees and levies on the financial industry, the FOS was created by statutory action deriving from the 2000 Financial Services and Market Act (FSMA) and provides independent and free legal services to financial services complainants. While in the early 2000's PPI-related complaints constituted a relatively small share of the FOS total caseload, PPI-related complaints increasingly came to dominate its workload. Between 2006 and 2011, the number of PPI complaints to the FOS jumped from 1,315 to 104,597, amounting to a 7854.14%

11 For example, fining one of the medium-sized UK banks, Alliance & Leicester, £7 million for failing to inform customers of the full cost of PPI (FSA 2008b).

increase in PPI-related complaints within a five-year timespan (FOS, Annual Review 2010/11, p. 41). The nature of the complaints received also evolved from unsuccessful policy claims to complaints regarding original sale issues or problems with the product's administration. The FOS increasingly found that misconduct in the PPI sector threatened the financial well-being of a large number of consumers or firms.

The inordinate volume of complaints received by the FOS caused operational and financial strains and slowed down its claims resolution capacity. These challenges called for greater involvement of the FSA as a better solution to address the mis-selling, profiteering, inadequate controls, insufficient procedural systems, scarce suitability checks, and poor customer advice challenges posed by the PPI sector.

By late 2010 the FSA issued a new policy regime for PPI sales which asserted banks' "fiduciary duty of care" and necessitated them to "take action as a consequence of their neglect of root cause analysis and fairness obligations regardless of whether or not it had been made explicit by regulators" (FSA 2010a; BBA 2011). Banks resisted criticism for almost two decades. Through legal and public affairs engagements and via communications of the industry's main trade association, then the British Banker's Association's (BBA), banks prevented the enactment of regulation that would require them to incur PPI legacy restitution expenses.

Time and again the BBA affirmed that banks "implemented every reform on PPI sales and complaints handling required by the regulators" (BBA 2011). Hence, the BBA submitted the FSA's new PPI policy regime to a judicial review by the High Court on the grounds of it being unfair[12]. However, the low level of confidence in the financial services sector and the increasingly negative public perception of banking business ethics reinforced pressure to tighten formal regulation. On April 2011 the UK High Court decision over the judicial review was unequivocally in favour of the FSA policy banning PPI sales and demanding banks to make restitution to consumers.

The importance of the UK High Court ruling should not be overlooked. While the Competition Commission had attributed the decline in PPI penetration rates during the 2000s to regulatory scrutiny, therefore suggesting that the PPI market had not remained unaffected by the imposition of penalties and regulatory controls prior to 2011, conduct issues persisted until the UK High Court ruled to ban the product. Although the market for new sales of PPI was effectively moribund by 2009, it was not until the second half of 2011 that large-scale redress for past mis-selling started (Ferran 2012).

[12] The BBA argued the FSA's new policy statement required them to apply new rules retrospectively all which was out of legal scope and unfair.

4. Mis-selling & Mis-conduct Issues

While oversight of the PPI market was initially motivated by consumer complaints regarding its adequacy at meeting borrowers' needs, market operation concerns and the lack of effective competition observed in the market ultimately brought PPI mis-selling to a halt. A-posteriori, the PPI crisis has been attributed to the breakdown of due diligence during the face-to-face selling process and to neglect of fiduciary duties due to profit seeking greed.

By design, PPI stood at the intersection of several banking supervision and regulation lines including consumer credit, insurance coverage and competition policy. Some of PPI's product features crossed over diverse financial services business lines, complicating its oversight since no regulator seemed to have single jurisdiction over the totality of the PPI product. This confounded assessments over how to improve the product and rein in problems associated to its mis-selling. In turn, inquiries into the mis-selling scandal were multidimensional. The inquiries scrutinized the market from diverse viewpoints including the perspectives of: consumer and household finance wellbeing (CAB 2005; OFT 2007), financial regulation (FSA (2005a, 2006a, 2007), and market operations (Competition Commission 2008a).

Table 2 - Official PPI inquiries *(2005-2007)*

Year	2005	2005, 2006, 2007
Institution conducting review	Citizens Advice Bureau (CAB)	Financial Service Authority
Report	***Protection Racket Report***	***PPI Thematic Review Report***
Focus	***Consumer protection & household finance***	***Consumer treatment & compliance with FSA rules***
Problems observed	***Inadequate product*** : borrowers were sold PPI insurance inappropriate to their personal circumstances and needs. ***Insufficient documentation*** : complex documentation provided often late in the lending process & without time for consumer to obtain independent advice . ***Evidence of "pressure selling"*** ***Exclusions*** : PPI sold to customers who would not be eligible to claim the policy due to exclusions they were either not informed about or that were not made salient at the sales point (age exclusions or employment status exclusions: self-employed contractors were not eligible). ***Inappropriate bundling*** : PPI was often sold as an add-on product bundled to the primary loan or credit, therefore clouding customers' discretion over its non-compulsory acquisition as well as their understanding of the various costs involved. ***Excessive cost*** : PPI considered *"poor value for money"* product due to excessive premiums for the cover received or for cover borrowers were not eligible for. ***Delayed claims*** : regardless of exclusion stipulations insurers would delay payment of PPI claims.	***High overall risk:*** consumer protection objectives observed in the practices of the majority of firms sampled. ***High risk of 'inappropriate sales'*** : over half of sampled firms were found to fail taking steps to avoid inappropriate sales. ***Poor quality advice about PPI*** Reliance on cumbersome, unclear and lengthy product documentation at the expense of explaining the policy to the customer orally. ***Inappropriate incentives to employees*** : level and structure of inducements and targets for sales staff found to encourage mis-selling in some small and medium-sized firms. ***Insufficient information provided*** : majority of firms selling single-premium policies did not give customers sufficient information on the lack of refunds ***Insufficient product knowledge and competence of sales staff*** ***Variable and poor monitoring*** of PPI sales in each sampled institution ***Inappropriate management information systems:*** to support internal monitoring of sales performance and quality which also complicated regulatory compliance monitoring (FSA 2005a, p. 27).

Sources:
Citizens Advice Bureau (2005) *'Protection racket Report';*
Financial Services Authority (2005a) *'The sale of payment protection insurance: results of thematic work';*
Competition Commission (2008a) *'Market investigation into payment protection insurance provisional findings report';*
Competition Commission (2008b) *'The profitability of PPI working paper'.*

Official inquiries evaluated the extent to which either the product, process, price or people involved in the mis-selling were flawed. Inquiry findings corroborated each other. Different official PPI inquiries revealed that the end-to-end process, from PPI sale to resolution over policy claims, was not always efficient and the back-end process of settling PPI claims was consistently identified as the most contentious part (CAB 2005; FSA 2005a). If borrowers needed to make a claim in order to arrange restitution of the payment amounts included in their policies, they normally interacted with the insurance division of the financial firm they were clients of. If the claim was refused, borrowers typically had to settle with the credit and loans divisions of the firm. Even if these service units were different business lines of the same financial institution, the consumer had to address each one independently.

Table 2 - Official PPI inquiries (2006-2008)

Year	**2006 & 2007**	**2008**
Institution conducting review	Office of Fair Trading	Competition Commission
Report	*2006 Report on the market study & 2007 Market Investigation Reference to the Competition Commission*	*Market Invesigation*
Focus	***Structural market features & consumer treatment***	***Market operation & consumer treatment***
Problems observed	***Little competitive pressure*** at the point of sale and there was little product information prior to point of sale. ***Scarce transparency*** : the extent of cover for a given cost was not transparently communicated. ***Vertically integrated market*** with 60% of providers, undertaking both distribution and underwriting within the same group. ***High entry barriers*** to the PPI market because of the strength of entrenched players. ***Higher commissions*** to distributors than those of other insurance products. ***Sellers' distinct negotiating power advantage*** over PPI purchases. ***Codes of conduct not being adhered to*** (OFT 2007, p. 3): • Borrowers were given the impression that granting of credit would be eased by purchase of PPI • Lack of up-front information clouded borrowers' evaluations of the products value for money • Point-of-sale negotiations centered on the Annual Percentage Rate (APR) of the credit being sought without factoring in the impact of the PPI which affected the effective APR upward (cost of PPI over the term of the loan was greater than the interest payable on the loan).	Identified PPI as a highly profitable add-on product. Distributors earned a high proportion of the total income from PPI premiums. No problems identified in the underwriting process: capital allocated to PPI adequately reflected risks taken. Firms with inadequate management systems to assess different components of PPI profitability and to differentiate its costs from those of underlying asset. PPI was not considered as a separate business. Sales staff viewed loan and PPI as a single sales opportunity. Distributors faced little competition for the sale of PPI when sold in combination with the credit it insured. Little competitive price movements of PPI over time and few examples of price decreases across the industry.

Sources:
Citizens Advice Bureau (2005) *'Protection racket Report'*;
Financial Services Authority (2005a) *'The sale of payment protection insurance: results of thematic work'*;
Competition Commission (2008a) *'Market investigation into payment protection insurance provisional findings report'*;
Competition Commission (2008b) *'The profitability of PPI working paper'*.

PPI coverage was not indefinite and policies stipulated a maximum payment period (typically six to twelve months) after which it was expected that borrowers would recover (if sick or injured) or find new employment to service their credit responsibilities. Additionally, PPI policies had an "initial waiting period" used by the insurer to determine and confirm the policyholder's eligibility to the payment claimed. Cases in which the policy exclusion clauses had not been properly communicated to borrowers at point of sale often led to increased waiting periods, and to delayed or eventually denied PPI disbursements, causing claimants to service their loan repayments from savings or further debt. The longer the delay (whether justified or not), the more likely some claimants could spiral into escalating debt even if this was the situation they had aimed to avoid by acquiring a PPI policy. Due to the preponderance of unclear exclusions in the policies and to deficient sales staff advice, many customers acquired PPI policies they were not eligible for. Frontline bank staff, lending managers and insurers had no incentive to check the suitability of PPI for customers and they often evidenced insufficient understanding of the PPI policies they advanced. Moreover, the reliance on inadequate operational and information management systems, that precluded the differentiation of PPI costs from customers' lending products, led bank staff to consider PPI and the underlying lending product it would cover as a single sales opportunity.

5. Systems Thinking and Operational Risk

The financial industry, along with its markets and institutions, can be thought of as conformed by "open systems". As such, its constituent parts simultaneously influence and are influenced by their environment, engaging in ongoing feedback interactions with several social actors including other industry participants, their clients, regulators, internal trade associations, and other members of the economy.

As a retail financial services product, PPI straddled several business lines along vertically integrated universal banking structures. Therefore, analyzing it from the perspectives of systems thinking, people risk, and operational risk losses helps to disentangle the implications of misconduct in the PPI market for all the systems and actors it interacted with.

The chain of market participants in the PPI sector, from lending creators to distributors, were subject to operational risk losses. According to the Basel II international regulatory accord, these losses likely result from inadequate or failed processes[13], systems and technology, from people risk or from exogenous external events. Research on systems thinking during the 2008 global financial crisis (GFC) showed, for example, that the largest operational risk losses associated with the crisis were due to people risk, rather than to process eventualities. Research has also shown that people risk normally arises at the industry level with significant harm accruing in the form of regulatory fines.

The majority of the official inquiries into the PPI scandal described in the prior section focused on the process problems described in Basel II. However, prior to the cessation of PPI sales, information from the Operational Risk-data Exchange Association

13 Either internal or external

(ORX)[14] and the Basel Committee typology of operational risk loss-events showed that only a quarter of gross operational risk losses in markets were attributable to process failures.

Nonetheless, it is possible to see from Table 2 above that the series of official inquiries into PPI also identified recurrent people-related risks associated to PPI policies mis-selling. Activities identified as problematic by the multiple formal PPI evaluations, such as aggressive sales, product unsuitability, consumer disclosure violations, know your customer (KYC) disclosure issues, and fiduciary breaches, can be classified under the 'Clients, Products & Business Practices[15]' people-related operational risk loss-events category of the Basel framework.

In broader markets, at least 65% of the 75% share of people-related operational risk losses were directly attributable to the 'Clients, Products & Business Practices' loss-event category (the specific loss category under which PPI sales could be classified). More granularly, data from 2011 show that 87% of the total operational risk losses associated to 'Clients, Products & Business Practices' problems were tied to retail banking operations, 2% to private banking and 1% to commercial banking practices. At the same time, 'Clients, Products & Business Practices' losses accounted for 76% of the total operational risk losses related to retail banking business lines. Conversely, operational risk categories focusing on problematic processes such as the 'Execution, Delivery & Process Management' category only accounted for 15% of the total contribution of retail banking practices to operational risk losses (BIS 2001 Quantitative Impact Study—Operational Risk Loss Data; BCBS 2004; ORX 2012 Report on Operational Loss Data).

Relying on the Basel II definition of operational risk,[16] McConnell & Blacker (2012) analyse the PPI scandal at the "systemic level" rather than at the level of individual firms (as it was originally stipulated in Basel II). In line with the research findings highlighting the effects of people-risk on other markets, their analysis concludes that a systemic breakdown of responsibility, accountability and ethics specifically propagated by people-related operational risks across the UK retail banking system led to the PPI scandal.

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[14] A not-for-profit industry association dedicated to the measurement and management of operational risk in the global financial services industry.

[15] The category is defined to encompass *'losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product'*.

[16] It includes legal risk but excludes strategic and reputational risks.

6. Psychology of Misconduct – Analysis of Behavioural Aspects Linked to the PPI Scandal

Behavioural economics and finance analyses can shed light on the diverse ways in which the psychological biases of different actors engaged with the PPI market interacted to unfold the crisis.

6.1 Demand-Side Decision-Making Biases

A salient observation from behavioural studies on the demand side of the market stressed the limited understanding of PPI by UK retail banking borrowers. Policyholders' imperfect understanding of PPI was also acknowledged by the official evaluations of the market conducted prior to its statutory standstill. For example, OFT consumer surveys found that UK retail credit customers owning PPI contracts were largely unaware of many details regarding the extent of coverage their insurance provided (OFT 2006b).

Even agents working for institutions formerly offering PPI seemed to show some awareness of their clients' narrow understanding of PPI. The latter became more obvious as soon as the UK High Court demanded banks to restitute consumers in 2011. To illustrate, part of the process to make a claim for PPI restitution involved the submission of an information request to former PPI providers. These early requests served a double purpose. First, they helped to protect former PPI providers from free-riders' unjustified or unverifiable claims for restitution. Secondly, information requests entailed that banks and other PPI providers had to search on their internal sales' systems for records tracing PPI products to the requestors' accounts and to communicate to customers, or to the CMC's acting on their behalf, their findings on whether the requesting consumer ever held a PPI policy with them. If PPI products were traced, banks were also obligated to disclose the details of all the PPI contracts the requesting customer had had with them at any point in time. Following FCA guidance, such information requests were ultimately intended to lead to formal claims based on factual knowledge—by both parties to the policy—of any PPI product customers had verifiably acquired. As early clarifying procedures, the existence of information requests partly reflected the scarce comprehension a large portion of PPI purchasers had of the contracts they undertook as well as their PPI provider's awareness of it.

Whereas PPI holders' misinformation and weak product understanding could be attributed to the breakdown of prudence, lending responsibility and integrity of advice from the supply side of the PPI market, other factors were also at play. PPI buyers tended to come from lower socioeconomic groups or earn below the mean income.

Borrowers were not completely blameless during the PPI saga. In many cases they displayed weak money management skills and failed to take on the responsibility to shop-around diligently in search for PPI policies that best fitted their particular circumstances. Many relinquished their financial autonomy by entering into PPI contracts they did not fully understand nor did they demand proper explanations (OFT 2007, p. 4).

Cognitive biases and reliance on heuristics help explain consumers' feeble understanding of PPI as well as their relative passivity at improving their financial decision-making. Both of these decision-making processes have been largely explored by bounded rationality theory. The latter argues that due to people's limited cognitive ability to assign precise probabilities to events and to accurately evaluate the losses associated with complex risks and uncertainty, they instead construct simplified representations of insurable events and of their consequences. These mental representations are based on past personal or secondary information and often neglect considering the totality of people's personal finance credit instruments, their insurance policies' specifications and applicability.

Consumer behaviour research and personal financial risk management scholarship (Raynard & McHugh 2012; Raynard 2007; Ford 2000) argue that the decision to purchase PPI was not driven solely by economic considerations such as: cost affordability, relative costs, levels of cover, eligibility, and terms and conditions. Instead, the choice to acquire PPI was greatly influenced by factors such as borrowers' risk preferences, previous insurance and credit experiences, their cognitive and subjective appraisal of ability to service financial obligations, concurrent and anticipated emotions related to credit default, as well as by attitudinal perceptions towards insurance and the banking system.

Research on personal finance decision making under risk and uncertainty says that to manage perceived risks people rely on risk-defusing operators. Examples include pre-outcome compensation schemes similar to PPI, through which people plan ahead of any eventuality by incurring an up-front cost to purchase protection that would compensate them for the negative outcome if it occurred. Conversely, other risk-defusing strategies do not entail incurring forthright costs but rather consist of drawing a strategic plan to limit the effects of risk-related losses if they occurred (Huber & Huber, 2003; Kirchler, Hoelzl, & Huber, 2010). The choice over risk-defusing mechanisms depends in turn on: (1) subjective perceptions of the probability of occurrence of a negative outcome such as the risk of facing future difficulties servicing one's debt payments and on (2) risk tolerance attitudes. Subjective cost appraisals whereby the costs associated with risk-defusing operators are compared to each person's anticipated loss tolerance thresholds (shall risky events occurred) also play a role.

PPI can be thought of as a planned, pre-outcome compensation risk-defusing operator since, from the purchaser's point of view, the decision on whether to incur the forthright PPI costs was based on personal belief about the probability of the insured events. At the same time, the latter were weighted against borrowers subjective perceptions and understanding of PPI's effectiveness at defusing the risk of future repayment difficulties.[17] Yet, PPI product features, sales staff misconduct (information omission, pressure selling, deficient advice), borrowers lack of inquiry regarding their policy claim eligibility, or the scarce due diligence exercised in the search for the best PPI policy, could hamper the effectiveness of the risk-defusing capabilities of PPI.

According to CAB's "Protection Racket Report", PPI evoked the idea of a relationship of trust, value and mutual support between lenders and borrowers as, from the perspective of borrowers, lenders were selling them a "relationship" through which they acquired 'peace-of-mind' rather than just a mere product (CAB (2005, p. 13). Analysing the results of an OFT commissioned behavioural consumer survey, academic psychologist Rob Raynard provided indirect evidence of how some of the activities associated with misconduct over PPI sales indirectly guided UK retail banking customers' engagement with PPI. The survey findings documented that: (1) PPI borrowers did not decide on the basis of comparisons but considered PPI as part of a package and (2) although cost seemed to be a major concern, more than half of borrowers did not know the amount that they paid on a monthly basis. Moreover, because of the perceived complexity of PPI products, borrowers simplified the decision to purchase (or not) through affect-biased heuristics regarding the probability of negative outcomes, loss aversion, the fear of default on credit payments and their trust on PPI distributors. The survey results thus suggested that the prime factors driving the decision to acquire PPI were not economic considerations. PPI was understood as a pre-event risk-defusing mechanism (Huber, 2007) that while "considered expensive by most purchasers, they also recognized its emotional benefits" (Raynard, OFT 2007, Annex C).

The above results highlight the importance of emotions in consumer considerations over credit arrangements. Emotional tensions are built into insurance claims processes. Whilst insurers seek to minimize their claim-loss ratios, potential claimants want to ensure that they are paid. CAB's "Protection Racket Report" found that PPI providers understood the role of affect-based (emotional) financial decision-making as they used people's risk aversion, fear of not meeting credit payments, sense of job insecurity, or borrower's doubts to target advertisements to induce PPI purchases.

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[17] The framework relates to Savage (1954) subjective expected utility (SEU) theory taken as the appropriate form of rationality for cases in which probabilities of events cannot be objectively known by actors.

Whereas the importance of point of sale (current) emotions such as fear and worry about future repayment difficulties have been widely studied in consumer credit studies, scholarship has recently increased attention on the relationships that expectations of future emotions have in personal finance choices involving risk. Studies find that anticipated regret, loss regret, and anticipated disappointment do influence uncertainty and risk-based decisions (Loomes & Sugden 1982; Zeelenberg, van Dijk, Manstead, & van der Pligt 2000).

Prior to obtaining a credit product, people may avoid alternatives according to the extent that they anticipate such alternatives to lead to different negative emotions. Conditions on loans, credit card debt, mortgages and other financial products that can be expected to cause repayment worry to customers, helped raise the value of different risk-defusing operators such as PPI in order to reduce credit anxiety. Raynard's behavioural survey of PPI for the OFT documents the "peace of mind" effect, noting that borrowers were likely to decide to purchase PPI "driven more by worry than by a rational appraisal of the options, and…by anticipation of the reduction of worry, or peace of mind, that it could bring" (OFT 2007, Annex C).

Other scholars contend that the role of emotions in financial decision making is linked to experiential, rather than to analytic mental models (Slovic, Finucane, Peters, and MacGregor 2004). It can be argued that if risk management decisions are emotion-based then path dependency of choices in prior similar decision scenarios can drive current choice patterns. Research on choice path dependency and PPI acquisition have been mixed. Ford and Kempson (1997) argued that consumers getting PPI showed path dependency in choice since those insuring were also more heavily insured overall, sometimes covering the same eventuality more than once. However, those findings also give evidence on the relationship between insurance and risk aversion. Croucher et al (2003, p. xi) found the reverse effect as consumers with negative attitudes towards insurance in general were found unlikely to take out PPI regardless of their perceived risk of servicing their credit, loans and mortgage commitments.

6.2 Supply-Side Information Asymmetries and Profit Seeking

A number of misconduct and people-related operational risk activities were also observed in supply side of the PPI market, among PPI sellers and distributors.

Instances of "moral hazard" and "adverse selection" behaviours were most prevalent. Both are cases of "information asymmetry" where one party has better or more information than the other party of the contract. Moral hazard[18] was identified in situations in which, pressured to increase sales volumes, PPI arrangers and distributors

[18] When a party's behaviour changes if insulated from risks than when exposed to them.

had low incentives to perform full diligence. Instead they short-circuited evaluations of PPI product suitability because policy claims would be met by the insurance side of the business (Competition Commission 2008a).

Adverse selection occurred because of information mismatches between the parties of the contract. The most informed party (here PPI providers) chose to sell the product options most aligned to their personal interests. That is, sales staff presented potential buyers the PPI contracts that increased sales volumes with the highest return without regard for the products' implications for borrowers. Instances of adverse selection and conflicts of interest were also observed amongst PPI sales staff when they either concealed the quality, level of cover or exclusion restrictions of PPI policies from buyers, motivated the purchase of one type of policy rather than another, or when they sold a policy that was not needed by the buyer.

Other misbehaviours prioritising capitalization on PPI's large margins over customers' needs included: improper use of pressure-selling tactics, negligence in determining customers' PPI policy eligibility, leading borrowers to purchase PPI as part of a bundle, and misguiding borrowers into thinking PPI was necessary to obtain credit. Additionally, misconduct was also propagated by the lack of comprehensive knowledge about PPI and the lending products it was usually tied to needed to properly inform potential PPI buyers.

While the numerous examples of misbehaviours listed above are now considered intolerable, they were once widespread and acceptable primarily due to psychological biases related to: group-think, herding, and systems-think observed in employees of the supply side of the PPI market.

Group-think refers to the apparent consensus developed within firms operating in the PPI market that instrumental behaviours they followed to raise profit margins were needed, justified and acceptable. Herding was observed in the pursuit of almost identical strategies across PPI providers, sellers and insurers, all driven by the need to balance the profitability of the industry.

Finally, as a whole, the PPI sector was characterized by "systems-think" since behaviours and procedures coincided both within firms—thanks to group-think—and across them—through herding—such that changes in the business culture of the PPI sector could only emerge from exogenous challenges to the industry's viewpoint.

The momentum provided by nearly two decades of evidence of PPI providers taking advantage of information asymmetries and regulatory loopholes eventually attracted the attention of competition-based regulatory bodies. Appealing to moral psychological foundations concerning fairness, trust, and reciprocity in lending-borrower relationships, the authorities pronounced in support of UK retail-banking consumer complaints and put a stop to the lingering misconduct surrounding PPI sales.

7. Ethical Review of PPI Market

In the aftermath of the PPI scandal, the set of guidelines put in place to monitor financial institutions' internal culture with respect to consumer protection principles have been aimed at: (1) reducing the pull of conflicts of interest, (2) decreasing people-related risk conducts, (3) enhancing the fairness of buyer-seller relationships[19], and (4) at rebuilding trust in the banking system.

Much of the new regulatory architecture relies on general principles of good business conduct rather than on strict rules of conformance. To gauge its effectiveness, it is first important to understand what is meant by 'good business conduct' principles and how they relate to prior misconduct cases.

While the PPI mis-selling scandal has been scrutinized from the perspectives of political economy, law, finance, and behavioural economics; less research has been pursued on the morality of the market. Adopting a philosophical framework of evaluation can clarify the sense in which a large portion of PPI sales were unethical and were deemed intolerable.

As an offspring of neo-classical economics and of its neo-liberal framework, modern finance theory, from which the design of PPI sprouted, views itself as a positive science, independent, and separate from any normative adjudications. Nonetheless, scrutiny over financial instruments in the domains of personal finance, debt and insurance (to which PPI belonged) via the application of ethics and moral principles is of especial importance given that these are arguably the spheres of financial activity that most directly affect the welfare of households and consumers.

To understand progress in regulation and prevent similar misconduct episodes, we must first understand which were the 'intangibles'—the objective norms and principles—that PPI mis-selling violated.
In the interest of providing a preliminary moral understanding of the PPI scandal, the conduct of the involved parties can be reviewed from the principles of several ethical approaches including: utilitarianism, justice and virtue ethics theories, and sentimentalist ethics.

[19] Borrower-creditor relationships.

7.1 General Utilitarian Analysis

Utilitarianism, as a teleological theory, is consequentialist and takes the outcome or end-result of actions as the fundamental parameter upon which to ascribe morality. The goodness or wrongness of conduct is determined from the net sum of the good and bad it produces to all the implicated parties[20]. Based on the principle of utility, the most enduring form of utilitarian theory—Bentham's classical utilitarianism—purports that the ethical guide to action consists of following that which produces the greatest happiness or well-being to the greatest number. So long as the total amount of good resulting from a behaviour or choice surpasses the sum of the bad, the conduct is considered ethical.

The general steps to guide ethical choice of the utilitarian approach are as follows (based on Tan Bhala 2019):

	Classical Utilitarian Decision Procedure
1	State conduct in as morally neutral a language as possible so as not to bias the evaluation.Formulate a maxim that enshrines your reason for acting as you propose in the given circumstance.
2	Identify those directly and indirectly affected by the conduct.
3	Evaluate the good and bad outcomes of the conduct on the individuals and entities identified in above. Starting with the consequences on those immediately affected identify the most striking consequences first.
4	Extend the outcomes as far into the future as possible.
5	Weigh the total good versus the total bad outcomes with due consideration given to the quantity, duration, propinquity, intensity and purity of each value and the relative importance of these values.
6	Sum and compare the approximated good and bad consequences.
	If the conduct produces more good than bad, then the conduct is ethical. ***If the conduct produces more bad than good, then the conduct is unethical.***
7	Consider an alternative action or actions.
8	Perform a utilitarian assessment of the alternative or alternatives.
	If the evaluation demonstrates one of the alternatives produces more good than bad, choose this action. ***If the evaluation demonstrates the alternatives all produce more bad than good, choose the conduct that produces the least bad.***

Given our limited cognitive bandwidth and the expediency of financial markets' decisions, it is highly improbable that one can calculate all the consequences, to all potential affected people, for as far back in time as a given action is traceable. While the above suggests that the general decision framework proposed by utilitarianism is rather time consuming, unrealistic and impractical, utilitarians concede it is difficult to

20 Including assessments of net goodness throughout time or in as far a time-period as it is possible to gauge, at least theoretically.

estimate precisely and accurately all of the above. Nevertheless, given its structure and consequentialist nature, it is used as the normative framework of neoclassical welfare economics which takes maximization of social welfare as the aim of public policy. Utilitarianism presents a system to help analyze and resolve ethical issues and to support arguments behind moral judgement, especially when the ethics of an action is uncertain. Hence, some private markets practitioners and policy decision makers do find utilitarianism useful.

A posteriori, it seems highly unlikely that parties involved in the PPI misconduct scandal followed the above framework. Moreover, in environments fostering group-think, herding and systems think behaviours such as those observed in the PPI sector, normative evaluations are clouded or directed by the objective values of leading movers.

To evaluate strategic action, higher ranked financial services decision makers likely engaged with cost-benefit assessments and the analysis of the key performance indicators (KPI's) across banking service lines. However, KPIs define good and bad outcomes according to the instrumental goals of profit maximization, branch sales performance, and increases in retail banking market shares rather than on maximizing consumers' welfare.

Hence, it is more plausible to presume that it was regulators who might have relied on utilitarian social welfare functions to shape policy action after comparing the (positive) welfare impacts on consumers of bringing the PPI market to a halt and of obliging banks to redress versus the costly damages (negative welfare) the latter rulings would cause to the banking and insurance industries.

However, herein lies one of the major criticisms toward utilitarianism, pointed at first by the influential economics thinker Lionel Robbins. He contends welfare economics faced the problem of deciding in favour of maximizing a particular group's social welfare function (in this case that of PPI holders) over the social welfare function of another group (retail banking credit and insurance conglomerates). He further reasons that welfare economics can only make claims regarding information about revealed preferences of wealth distribution at the individual level. Yet, he cautions that in terms of welfare magnitude comparisons, economics cannot scientifically prove that all individuals have the same value scales of welfare magnitude. In his view, this precludes regulators and policymakers from formulating any meaningful assertions about how much a given monetary and wealth redistribution would precisely affect total aggregate welfare. Based on his rejection of the scientific validity and reliability of interpersonal comparisons of welfare magnitudes, he argues that reaching an optimal distribution of resources would always be problematic for welfare economics.

Following the Robbins critique, public policy economists should refrain from making moral prescriptions over social welfare functions. As applied to the PPI scandal, this would mean economists and policymakers should have avoided deciding to focus on enhancing foremost the welfare of retail banking consumers. Instead, according to Robbins, only means-ends inefficiency claims regarding PPI should have been scientifically permitted. That is, Robbins would have argued that regulators should have concerned themselves solely with evaluating alternative policies in response to the PPI scandal that had the same end of protecting consumers but achieved it in a different way, or with lower costs (and no other negative consequences) than those brought by the 2011 UK High Court's PPI ban and redress rulings to the banking and insurance industries. Robbins would also have supported looking for policy alternatives that would not only help restitute and protect consumers but that would have offered other valuable ends to the industry (with no negative consequences to consumers) for the same amount of forgone resources (such as PPI margins).

One could argue that almost no public policy would be possible if only "scientific" (commensurable, reliable, certain and precise) judgments on welfare could be made, as Robbins advocated. Additionally, it would be hard to deny the precedence of the welfare increase to consumers deriving from the monetary restorations obtained from their former creditors and PPI providers due to having been mis-sold a PPI policy, over and in spite of the costs to the industry (which were arguable self-induced).

Another important critique to utilitarian analysis was raised by the libertarian political philosopher John Rawls who argues that utilitarianism fails to account for justice as it does not take seriously the distinction between persons. Rawls argues that utilitarianism improperly treats society as though it was akin to a single individual. Maximization of a simple aggregate or egalitarian social welfare function could lead to policy choices without a proper regard to justice in redistribution of wealth and welfare. This critique is cited as the Separateness of Persons Objection to utilitarian welfare economics and through it Rawls importantly argues that individuals have certain rights that cannot be sacrificed merely for the sake of greater social welfare.

In the case of the PPI scandal, the sanctions and reparation costs experienced by the banking and insurance sectors do not violate any of their individual rights and in fact constitute a morally acceptable resolution at least in terms of restorative or corrective justice (as is explained below).

7.2 Virtue Ethics Theories: Aristotelean views on Justice

In the *Nicomachean Ethics*, Aristotle addresses how an individual can live as part of a community. In Book V, whilst attempting to reason for 'the basis of fairness in the exchange of goods', Aristotle turns to the exploration of economics concepts as part of his discussion of the virtue of Justice.

Aristotle approaches the ethical problem of differentiating between three types of economic justice, namely: distributive justice (NE, V.3), restorative or corrective justice (NE, V.4.) and justice in exchange (NE, V.5.).

Aristotle defines distributive justice as concerned with the allocation of common goods by a central authority in proportion to the recipients' worth and determined by equating geometric proportions. Distributions were 'just' if equal persons received equal shares. He thought of restorative justice as applying to cases in which parties considered to be equal had received an erroneous allocation which was corrected by equating arithmetic proportions (Kaye 1998, pp. 41–43; Broadie and Rowe 2011).

In contrast, Aristotle uses the norm of proportionate equality to distinguish 'justice in exchange' from distributive and restorative justice and determine what was fair in associations for exchange. He argues that exchange is a reciprocal arrangement, and that reciprocity in exchange is important for social cohesion purposes, not merely to generate a profit. Furthermore, he argues that the equality of the goods exchanged is fundamental to the principle of proportionate equality underlying exchange and that there is no corrective aspect with no "giving in exchange".

In other words, while under the Aristotelean framework, distributive justice depends on the determination of the recipient's worth and restorative justice is concerned with correcting the difference of what is lost by the victim to the perpetrator, for Aristotle, justice in exchange is based on proportionality in terms of the things exchanged. The above definitions amount to defining justice broadly as giving each person her due, treating equals as equals, and un-equals unequally (Tan Bhala 2019).

Time and again evaluations of the PPI market found it a poor value money option for PPI buyers. Hence, it is hard to argue that contractual exchanges of PPI insurance fulfilled the proportionate equality criterion underlying the Aristotelean sense of fairness in associations of exchange. Likewise, the widespread instances of adversely selected PPI sales and pressure selling based on incomplete information disclosure contradicts the idea of reciprocity in exchange advocated by Aristotle. This follows from the understanding that no act in which a party treats the other party as a means by which to increase a profit goal can be deemed as a socially cohesive reciprocal force that respects the humanity and autonomy of the parties involved in the exchange.

Similarly, PPI mis-selling did not abide by the fairness principles of commutative justice (not explored by Aristotle) which: (1) calls for fair pricing in transactions, (2) rejects price grouping (such as the bundling of PPI to credit costs at point-of-sale), (3) requires full information disclosure to both buyer and seller (lacking in the PPI mis-sale scandal) and (4) expects both parties to enter freely in exchange. The latter was also not completely respected in the PPI market since, due to the effects of misinformation, pressure sales, and lack of due diligence, it is hard to reject the claim that some buyers were manipulated into getting PPI.

Nonetheless, the statutory imposition of PPI redress to rebalance the checkbook in favour of consumers affected from the mis-selling does seem to follow the principles of corrective (restorative justice). It also abides by principles from the related notion of compensatory justice which requires that people are fairly compensated (often through monetary means as is the case for PPI reparations) for their injuries by those who have injured them. Finally, the sale of PPI did not respect procedural justice's concerns for fairness and transparency in decision-making processes, practices or financial agreements. Nonetheless, procedural justice has been sought a posteriori, through financial regulators' attempts to modify conduct to avoid operational people risk and their emphasis on procuring the fair resolution of disputes and ensuring equitable PPI redress outcomes for UK retail banking customers.

7.3 Justice and Fairness in Financial Exchange

Timothy Johnson (2015) provides a useful way of analysing the PPI scandal from an ethical framework emphasizing the role of justice in social exchange. He argues that problems revealed through crises 'under the hood of the black boxes of finance' are, at the core, ethical problems.

H. Putnam (2002) disagrees with the view that developments in financial engineering and the increased mathematisation of finance have rendered the field of finance a value-neutral, truth-teller science. Instead, finance is a means of discourse. T. Johnson (2015, 2013) synthesizes contemporary financial mathematics with history and pragmatic philosophy to ethically evaluate financial markets. Echoing Putnam, Johnson contends that solutions to problems in modern finance require changing our understanding from regarding markets as competitive arenas to seeing them as centers of cooperative, democratic discourse. His main claim is that financial markets should be regarded as centers of 'communicative action' governed by rules of market discourse.

Beckert (2009) points out that the coordination necessary for markets to function, incorporating its valuation, cooperation and competition features, rests on the "stable expectations" of participants. To deal with the uncertainty characteristic of financial markets, the expectations of its participants rely on the norm of reciprocity.

T. Johnson (2013, 2015) explains how 'fairness' in financial markets' contractual relationships (including PPI and credit contracts), is tied to different, yet related norms of discourse. He further argues that the predominant norm of discourse depends on the type of market relationship held by the agents involved.

Johnson posits that when a buyer is offered prices by more than one seller, the norm of discourse between buyers and sellers in competitive financial market relationships is reciprocity. Likewise, he proposes that the norm of discourse between sellers in financial market relationships is sincerity while the norm of discourse between agents of different monetary or information wealth status is charity.

As has been widely addressed by regulators including the OFT, the Competition Commission and the FSA, misconduct in the PPI sector certainly posed challenges to the competition discourse. However, in light of Johnson's financial ethics framework, it is easy to see that the PPI scandal also consisted of conduct that negated values highlighted by Johnson as essential for healthy and fair market interactions. For example, instances of misconduct driven by information asymmetries, bundled PPI sales, or nudging especially broke norms of reciprocity between PPI providers and UK retail banking consumers.

Johnson's framework builds on the work by economist Paul Rubin who, in the aftermath of the global financial crisis (GFC), cautioned against a phenomenon he termed "emporiophobia" or the "fear of markets". This fear manifests itself as legislation which, contrary to its intent, has economic implications detrimental to society's well-being. Rubin argues the fear of markets has gained momentum partly due to the narrow overemphasis of financial economics on competition as an end goal instead of recognizing it as a tool through which other important norms needed for healthy, inclusive and resilient socioeconomic exchange can be attained.

While Rubin's perspective is fundamentally utilitarian, for he argues that "[the market] system is moral because it maximises human welfare"; Johnson's viewpoint is more extensively grounded on Aristotelean ethics' understanding of fairness in exchange. In line with Rubin, Johnson recommends a shift in the focus of economics and finance away from an over-reliance on the competition metaphor toward emphasizing the idea of cooperation procurement within markets. The framework does not invite the complete replacement of financial economic theory but rather calls for a re-interpretation of the canon of financial economics through holistic prudential supervision that endorses broader ethical norms of financial market discourse than the competition and efficiency prerogatives.

This analysis is especially pertinent given that regulatory action over the PPI market was eventually crystallised due to its competitive failures. The emphasis on securing competition as an instrument to guarantee better financial markets capable of servicing the needs of consumers was palpable in the endeavour of UK regulators to improve competitive features of the PPI market before its cancellation. Through the 2002 Enterprise Act, the Competition Commission ordered a number of changes in the PPI market "for the purpose of remedying, mitigating or preventing the adverse effect of misconduct on competition and of any detrimental effects on customers [so far as they resulted], or might be expected to result, from adverse effects on competition" (Ferran 2012). In the aftermath of the start of redress payments by financial institutions to PPI holders, the Financial Services Act of 2012 continued the dual impetus in regulation seeking to safeguard consumer protection and market competition. The act split FSA's responsibilities between the Prudential Regulation Authority (PRA) of the Bank of England and the Financial Conduct Authority (FCA) endowing the new UK retail banking regulator (the FCA) with a competition objective and with new consumer protection and competition-oriented investigation powers (Ferran 2012). Likewise, the HM Treasury has acknowledged that "securing effective competition in the market for financial services is a key mechanism for improving outcomes for consumers".

Scholars and practitioners agree that the PPI experience has served to highlight that combining competition and consumer protection functions within a single overruling organization, as is now the statutory role of the FCA, can be advantageous at removing inefficiencies while producing valuable synergies that foster consumers' financial well-being as goal. A regard for values such as reciprocity, sincerity (or transparency), and charity (generosity), could likewise help to shed light on how to design new financial market architecture that, whilst still advocating for fair and increasingly competitive markets, help them generate consumer trust, and enhance other features of responsible financial development like cooperation and justice in exchange.

7.4 Artificial Virtues & Hume's Sentimentalist Ethics

Thus far, our ethical analysis of the PPI scandal has focused on rationalist moral perspectives that take reason as the culprit behind moral action and judgement. However, given the behavioural biases observed in the patterns of misconduct in PPI sales and the relevance of psychological factors for consumer credit and payment protection insurance decision making, it is important to also take into consideration the views from ethical theories that treat morality as grounded on something other than reason. The ethics found in the sentimentalist empiricist tradition promoted by David Hume[21] (1711-1776) provide a good starting point. Hume's project attempts to explain the ways in which we understand the world, ourselves, and our moral duty with reference to three spheres: (1) our human nature or natural laws, (2) the workings

[21] Renowned Scottish Enlightenment philosopher, historian and economist also influencing Adam Smith's moral conceptualisations surrounding wealth and trade.

of our mind, and (3) our artificially created social conventions—including virtues such as justice in exchange. His viewpoint might thus provide relevant insights into the social and cognitive psychology factors underpinning the people-related operational risks found throughout the development of the PPI scandal.

As one of the leading sentimentalist moral philosophers of the Scottish Enlightenment, Hume contends that the criterion of the rightness of an action is the motive (inner state) that lies behind it. Following from him, moral sentimentalists emphasise the role of motivations in guiding behaviour and argue that morality can be grounded on motivationally active feeling rather than solely on being rational. The Humean virtue ethical account is of particular interest because he differentiates virtues according to their source motives. Firstly, he acknowledges our disposition to act morally on the basis of our natural psychological predispositions. Additionally, Hume devised a way to ground our dispositions to abide by norms of justice that can tap into the sources of motivation surrounding self-interest.

Hume's views are of also of particular relevance because, in contrast to rationalist views such as the Kantian emphasis on autonomy or the contractarian assumption of separate individuals coming together to forge a social contract; the Humean account emphasizes that any ethical disposition develops from a sense of 'us' in connection with, rather than 'separate from', other people.

In Book III, part I (sec. ii) of the Treatise of Human Nature (1735 and 1737) Hume argues that moral distinctions are felt: "to have a sense of virtue is nothing but to feel a satisfaction of a particular kind from the contemplation of a character." He further explains how through sympathy (an involuntary process through which people's feelings become passively our own) the basis for our moral judgment is formed. According to Hume, sympathy is distinguishable from other similar concepts such as empathy and benevolence in that it constitutes a natural capacity to experience fellow-feelings of 'resonance' with the feelings of another. Through sympathy we are able to harmonise our emotions, opinions, and moral judgement with those of others. Hume argues that sympathy gives rise to moral judgment when we reflect on the consequences that a character trait or action tends to have on the agent who acts and on those affected by his traits and actions. If the consequences are good, through our sympathy with the actors and those around them, we approve of the action or character-trait. If they are bad, through sympathy, we feel an unpleasant emotion, and therefore disapprove of it.

However, sympathy is an imperfect and insufficient source for moral judgement because it varies from person to person. Additionally, given that the process of sympathy depends on an inference from outward signs of emotion to an idea of that emotion on others, we tend to sympathize more with people we know and who are close to us than with strangers. This feature can thus explain the sustenance of misconduct behaviours observed on the supply side of the PPI market which relied on groupthink, herding and systems thinking. The banking and insurance sales staff's reference point for moral action was more likely guided by salient fellow-feeling with colleagues and with the culture of their respective financial institution than by empathy towards the many different potential PPI buyers with whom no interaction other than contractual was pre-established.

In an attempt to solve these problems, Hume combines our disposition to act morally on the basis of our natural psychological inclinations with the predisposition for ethical acting that derives from our sense of duty to shared norms of morality[22]. From this he proposes that to reach agreement in moral judgments, instead of relying on our subjective, variable and partial point of view we aim to adopt the critical and impartial worldview of a 'judicious spectator'. According to Hume, such equidistant viewpoint helps de-bias our moral assessments and align them to what is conventionally understood as righteous.

In other words, Hume argues that in so far as we manage to take as our own the moral judgments that a judicious (impartial) observer would make (still based on sympathetic reflection of the consequences of actions) our moral judgments will tend to be impartial, cohesive and intersubjective (shared).

Admitting the role of the impartial spectator in the scenario of the PPI scandal, Hume's account unfortunately does not seem to explain why the profit making interests of the PPI industry were adopted as the dominant worldview of 'impartial observer' standard for action, rather than reciprocal notions of fairness towards consumers.

As a counterpoint, we can raise the distinction Hume makes between natural and artificial virtues. He defines the first as the instinctive or immediate dispositions native to human beings such as benevolence, gratitude and charity. Artificial virtues encompass the dispositions of character to comply with certain social rules or 'conventions' out of a sense of duty. Current day banking codes of conduct, know your customer principles and consumer protection guidelines all fall under the realm of expected conventions of Hume's artificial virtues. However, according to Hume justice is itself an artificial virtue. Hume believes that large-scale modern societies create conditions of relative anonymity and complexity which weakens the efficacy of natural virtues to guide action. Therefore, shared artificial virtues such as justice emerge as moral guidelines through the ethical standards of an impartial spectator.

22 In Book III of the Treatise Hume argues that the reasons we have for acting morally stem from: our human nature, our history and our present circumstances (conventions).

However, under this framework moral obligation to justice could at times override the dictates of natural virtues. He famously cites the case in which a person is obliged to do justice by servicing any outstanding debt owed regardless of the person's level of material deprivation or pecuniary necessity relative to their creditor's possible affluence.

The appeal to artificial virtues highlights how the sense of morality of actors involved in the PPI scandal was highly reference dependent. On the one hand scarce ties and understanding towards PPI buyers explains the diluted fellow-feeling towards customers and the strengthened pull of natural virtues and empathy towards fellow co-workers and PPI industry partners. On the other hand, Hume highlights how human psychology is such that, through sympathy, we also tend to internalize others judgments about our character traits and actions. This can lead us to disapprove or approve of our own morality based on the standards of what others in our closest or most salient group think. Consequently, if the dominant motivation of PPI providers was profit maximization and greed-infused market share expansion, the moral judgment of staff involved in misguiding and mis-selling PPI to UK retail banking consumers could have primarily responded to self-interested prerogatives that served employees attain the approval, respect and praise of colleagues in their immediate professional environment.

Conclusion

Much of the criticism regarding the PPI scandal has a dose of regulatory hindsight bias. Widespread grievances have been made regarding failed proactive supervision and financial regulation enactment to forestall the inevitable mis-selling outcome.

In light of the sequence of problems and losses experienced after the product's ban, analysts and practitioners question whether financial market providers and their users have learnt much from the PPI episode. Critics argue that PPI redress payments are acting as quantitative easing handouts, worth thousands of pounds, to millions of retail banking customers, who mostly have gone on spending the extra cash provision rather than saving it or using it to repay other debts.

From the perspective of banks managerial and cultural change, Jonathan Davidson, director of supervision for retail and authorisations at the Financial Conduct Authority (FCA) remains skeptical of the extent of the shift toward resiliency in banks' operational risk cultures. He acknowledges that as soon as "banks' sources of income are constrained, they take on more credit risk and engage in conduct risks" associated with the treatment of their customers. Despite recognizing the genuine efforts undertaken by the industry since it was forced to set up PPI compensation schemes in 2011, Davidson has expressed concerns regarding the robust progress of consumer finance reforms towards antifragile ethical frameworks. In line with research from the originator of the concept of antifragility, Nassim Nicholas Taleb,[23] a truly antifragile ethical framework involves systemic cultures that can help the financial industry thrive when exposed to shocks and crises, instead of breaking into misconduct in uncertainty and pressure filled circumstances.

What is needed is to help banks and other credit institutions to both capitalise on a positive or relatively stable environment (as was experienced since 2011) while also being able to derive strength in servicing the needs of consumers when hit by unexpected negative events (as is the case amidst the financial strains emerging due to the COVID-19 pandemic).

Adding that "culture doesn't just come from the top [but] from history" Mr. Davidson alludes to the path dependency of mental frameworks, working cultures, and regulation in financial markets. Hence, since 2016 the FCA has increased the number of formal investigations over cultural failings as well as introduced stricter accountability rules.

This paper's sections on the psychology of the scandal and its ethical review invite us to keep in mind that financial product innovation and dynamism in the financial sector's culture, are driven by ideologies or belief systems that evolve and spread through their ability to appeal to the psychological and moral biases of financial actors.

The above analysis demonstrates the importance of shaping banking cultures that can respond to and be accountable for the interests and needs of their ultimate customers first. It also highlights the need to redefine the purpose of financial institutions based on well-defined and agreed upon ethical finance benchmarks in order to align financial institutions codes of conduct with employees' natural psychological tendencies to act in ways that both favour the industry's sense of identity and be of service to the wider public.

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