

# The nun who knew first

Chris Blackhurst meets Catherine Cowley, the banker-turned-religious sister, whose predictions about the moral and economic hazards posed by complex financial instruments have come shockingly true

In 2006, a book was published that said this: “Derivatives have quantifiable benefits but unquantifiable risks. In part, this is due to lack of transparency and complexity, together with the dynamic nature of the risks which can spill over into many markets. This is compounded by the market structure and the moral hazard of volatility, whereby the financial sector can generate more business and make bigger profits if assets have a volatile price.”

The author continued: “Whole economies can be destabilised by speculative cross-border capital flows, often in the form of derivatives ...”

It would be nice to think the writer was Gordon Brown, then Chancellor of the Exchequer, or Alan Greenspan, the former chairman of the US Federal Reserve, and that these views were affecting their thinking. Alas not. Nor was it the Sage of Omaha himself, Warren Buffett – although Buffett, currently the world’s greatest investor, who did equate derivatives to “weapons of mass financial destruction”, would doubtless approve of the sentiment.

Neither was it Vince Cable – although he, too, would presumably be proud to attach his name to such a view. No, this prophet was Dr Catherine Cowley, a nun and member of the Congregation of the Religious of the Assumption in London. She is well qualified to dissect the City. She worked there for several years; she is very coy about where exactly, but let us say it was in a high-powered job in the



sort of institution that many people now regard as the embodiment of capitalist greed. Cowley studied theology at the Gregorian University in Rome. Following some years in pastoral ministry, she took an MA in philosophy and religion, and then a doctorate, at Heythrop College, the specialist philosophy and theology college of the University of London, based in Kensington Square. Her thesis was entitled “The Application of Catholic Social Teaching to Business Ethics with particular reference to the Finance Sector”.

It was this study that provided the basis for her subsequent work, *The Value of Money: ethics and the world of finance*.

We’re sitting in Wodka, the Polish restaurant notable for its list of vodkas (she doesn’t have any but chooses a glass of wine) round the corner from Heythrop, where she teaches Christian Ethics and is assistant director of the college’s Institute for Religion, Ethics and Public Life. The venue was her choice and says much about her character. She dresses simply, with a plain cross, and combines a sense of fun with a fierce, rigorous intellect.

“My doctorate was in ethics in the finance sector, looking specifically at derivatives and

risk. I entered the convent at 30, then did the doctorate. I wrote the doctorate in 2000, which makes it even more prescient.”

Her eyes sparkle as she says: “My section on risk, risk measurement, risk evaluation – actually most of it is there, most of what happened is there.” She adds: “I read my chapter on risk recently and thought, ‘Catherine, you were absolutely right.’”

She talks in a direct, forthright, confident manner – as well she might for someone who came closer than anyone in predicting the financial disaster that would befall us. At the heart of her study is the danger of risk, the fact that too little attention was being paid to it in the pursuit of profit. Cowley gained motivation, she says, from being there and from reading the German sociologist Georg Simmel’s most famous work, *The Philosophy of Money*.

At the same time, in 1998, she saw the collapse of the hedge fund Long-Term Capital Management (LTCM), founded by the supposedly brilliant Wall Street trader John Meriwether. It went down owing investors US\$4 billion. It was the first major hedge fund failure and carried uncanny parallels with the implosions in the financial system a decade later. Cowley observed that although LTCM crashed, the industry shrugged and moved on – nothing changed as a result. “I saw that no lessons were learnt and realised that ‘this is the issue.’”

Some of the talk Cowley is hearing now is fatuous. Yes, speculating on financial instruments created by bundling together sub-prime loans in the United States was to blame, but to suppose that ending their trade creates a totally safe market is wrong. “Searching for a risk-free life is a nonsense doomed to failure,” she says. “Reading the non-technical literature about the credit crunch and the impact of derivatives, you really still get the impression that you did at the time of the

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LTCM fiasco – that there was no risk until derivatives popped up. But the briefest glance at history shows that's not true. The risk of derivatives has to be measured against risk of any alternative that would replace them. I don't think a risk-free system exists."

Neither does Cowley feel the future shape of the markets should be left to a small group to determine. What we have experienced is a systemic failure, where a failure to appreciate and restrict risk in one area threatened an entire economic meltdown – it's too big a problem to be left to a few.

"What I do want to argue very strongly is that risk is not purely a 'sectoral' issue to be decided by a technocratic elite of experts, it's actually a public issue. Just as nuclear issues, genetic, biotechnical issues used to be seen as the preserve of the expert, we now rightly say, 'No, the public has got a voice in this' because of who bears the risk. I don't think there's been anything like enough attention to the risk bearers. We know who benefits from the risk – for example, the companies making whacking big profits. They've sat and benefited from the risk, but the actual risk bearers was a much, much wider pool of people, of society as a whole."

Cowley is also a great believer in the frailty of human beings – that no matter how theoretically brilliant the structure, ultimately it is people who will decide the outcome. Critical in that, she argues, is our treatment of money. "A large part of what I looked at is: what the mere fact trading money does to you and does to society; the very nature of money, the way that it brings distance into relationships, the way that it supports particular understandings of independence, autonomy, freedom – what ever word you want to use – and the way that can feed into relatively young, therefore relatively emotionally immature financial practitioners."

Traders were dealing in derivatives that were "so complex that no one understood them". As a result, "no one knew where the risk actually lay. It was assumed it was dispersed but even as far back as 1999, the Bank of International Settlements, in one of its documents dealing with high-leveraged institutions, was pointing out the possibility of risks actually being amplified through the system rather than contained and dispersed by the system."

That formed part of her "beef" as she puts it, but Cowley also admits to being taken aback by the scale of the bad or "toxic" banking business that has emerged. "I didn't take sufficient account of how many people in the sector didn't understand what they were doing. I argued that there were some derivatives that were inherently so complex and dangerous they should not be sold, and I would maintain that still. If you do not understand what you are doing you should not be doing it."

It was there that the seeds for the disaster that followed were sown. "They didn't know who was bearing or buying this risk and therefore their own positions were unstable. If you don't know who the counter-party is and the risk that counter-party is bearing, how can you possibly assess how much risk there is in the

system, in your little slice of the pie? We saw that with AIG [the giant US insurer] with its great default – no one realised how dependent on AIG was the entire market."

Listening to Cowley, you wish she had a bigger platform, that her book was made required reading and could be produced in pocket, best-selling, form. Here she is, for instance, on how that ignorance combined with further human weakness. "I point to a whole range of issues hinging around what was then a key factor in the FSA-approved person regime [the Financial Services Authority's test of who could practise in the City] such as the call for integrity which it has to be able to prove but you can't. What is meant by integrity? How do you measure integrity? What factors within the finance sector – employment practices, its remuneration packages, pressures – militate against integrity? Yes, you can get people who are honest and trustworthy, but they haven't had time to develop integrity. Integrity takes time. So it's not surprising if you get people sailing close to the ethical edge."

Cowley's sense of disappointment in others is palpable. "There's been a lack of certain virtues, for example, justice, and a lack of understanding of certain virtues, for example, prudence." She shakes her head, laughing. "Prudence has had a slightly distorted life since Gordon Brown was Chancellor. When Aristotle wanted to give an example of the prudent person, he chose a successful general, because prudence involves looking at all your options and working out what the most effective means are to achieving what one wants to achieve. So the good general will deploy troops in an effective way. It's got nothing to do with over-cautious bean counting. That is not prudence. I think the way we have lost sight of what prudence originally meant means we can't develop prudence very easily." She chuckles again. "Which is why it's simple to use another term which is practical wisdom."

Cowley also has strong views on her own Church. On Catholic social teaching, she says: "Even though it has got some good things to say about the common good it can be too woolly. It says things like 'the state should' and 'society must'. It only talks about the state and the individual, and not the myriad intermediary bodies. For example, there is a

difference between the particular good and the common good. The particular good is the good of an individual group – like the finance system. It may be that the particular good of a group or a sector militates against the common good – so what do you do then? Is the group going to take a self-denying ordinance? How you juggle conflict between particular goods to arrive at the common good is something Catholic social teaching must address. It's got some wonderful uplifting things to say, but you try turning them into practice. The complexity of social issues cannot be addressed from merely one perspective. Catholic social teaching needs to draw on a wide range of social sciences, a wide range of opinion, because without that it will not receive respect."

When Cowley's book first appeared, she was accused of being detached from the real world. When reminded of this reaction, she almost yelps: "I try to expunge insults from my mind! The gist was that I was naive and this was simply a result of wishy-washy, left-wing Christian idealism, and that if I had really understood markets then I would see that ... What they were also contesting was my analysis of the situation. So that what I was saying about the complexity of derivatives, what I was saying about risk, what I was saying about mis-application of resources, they were saying was wrong." She shrugs: "People were patronising."

There cannot be many nuns who relish the *Alex* cartoon in *The Daily Telegraph*, about the trials and tribulations of a City slicker, and call upon it to defend their corner. But Cowley does. To the question as to how the sort of virtuous, pure banking she espouses can hope to succeed, she says: "I was reading *Alex*, about a very boring bank which said it was so far behind the curve it didn't get anything, and then in the other frame that bank was now the fourth biggest bank in the world." She adds, grinning: "Competitive, aggressive, macho banking was around for the last 20 to 25 years. I'm not sure it will be around for the next 25."

*Additional reporting by Christopher Lamb.*

**Chris Blackhurst is City editor of the London Evening Standard. *The Value of Money: ethics and the world of finance* by Catherine Cowley is published by T. and T. Clark.**

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