Financial innovation and the descent of money
Reading Niall Ferguson on Siegmund Warburg[1]

Professor Sam Whimster, GPI Working Paper, 23 March, 2015

Niall Ferguson's biography of Siegmund Warburg probably came out just in time, in 2010, to be taken up as a topical work on a major City figure. Now some five years later one has to doubt whether the name of Siegmund Warburg signifies much at all. What was intended as a work to mark and celebrate the life of a financier now reads, just as validly, as an important work of historical scholarship. The attraction now lies in seeing how a career of heroic financial innovation has become submerged by a world of financial mayhem on an industrial scale to the extent that it is no longer possible to talk in terms of the banking values that so animated Siegmund Warburg - what he called the *feu sacré*.

Learning from Weimar

Unlike his famous uncles (Aby, Max, Paul, Felix and Fritz – the so-called *Mittelweg* Warburgs) who belonged to a particular bourgeois Jewish milieu in Hamburg, Siegmund was brought up in pastoral Swabia some miles south of Stuttgart. Work and a reflexive perfection in work were traits implanted by his mother. He was 17 when the Wilhelmine Kaiserreich fell to pieces, and his youthful heroes were the action man figures of Max Weber and Walter Rathenau, the one creating a political framework for a new Germany, the other an economic model for regenerating a backward economy.

Siegmund belonged to the 'gebildete' class, fully educated in the classics, Schiller and Goethe, but especially drawn to the modernist novels of Thomas Mann. Warburg was a *Persönlichkeit*, that is he had attitude and never left his literary, political and commercial attitudes unremarked. Interestingly his first vocation could have been politics. Although he went to work in Hamburg in the family firm, led by his uncle Max Warburg and then one of the leading private banks in Germany, he joined the German Democratic Party - the centre party for the educated classes - and would have been quite happy putting his banking and economic skills at the service of the Weimar Republic. What has to be appreciated is that although the Weimar Republic was a victim of the Nazi power grab, as a young man Siegmund Warburg was exposed to and part of its huge

[1] Niall Ferguson, *High Financier. The Lives and Time of Siegmund Warburg.* New York: Penguin Press, 2010.

intellectual, cultural and political vitality. As late as October 1930 he was speaking of the "enormous strength in terms of life and ideas that there is still in Germany..".[2] Weimar was not a failed state, it was an abrogated state.

Although a member of an international banking dynasty (New York, Hamburg, and Berlin), it is valid to think of him as a Weimar intellectual: he was social democratic in outlook, he had philosophical and cultural ideals, he was devoted to Freudian psychology and Nietzsche, he was an acute observer and he made his mostly progressive views known to leading figures, whether in banking, industry, politics or the arts. This is what makes his career in the City of London interesting. To adapt a German philosopher of the early 20th century, Edmund Husserl, Warburg's horizon of meaning extended far further than his fellow bankers. He designated reference points in his outlook within which a rich world of possibilities and opportunities could be opened up.

The contrast between the environment he left behind in Berlin, as a junior partner in the private bank of M.M. Warburg, and the environment he entered in the early 1940s in the City of London is striking. The business of the pre-1930, pre-crash world of M.M. Warburg was based on loans and bond issues to corporations, municipalities and states as well as the discounting and acceptance of bonds; it was also a deposit taking bank. The Warburg family was a network of contacts in banks, businesses and governments spread across the world. Capital controls did not exist, currencies were convertible according to a fixed exchange rate, and moving money and bills between banks was a private, unregulated matter.

M.M. Warburg's profitability was fatally undermined by non-performing loans to a weakening German economy and the extent of its dollar foreign deposits, which were withdrawn by fearful investors as the German mark became non-convertible. Siegmund was critical of the leadership of Max Warburg who had routinised the firm around loans to prestige clients. Siegmund wanted the firm to be led from Berlin not Hamburg, and the growing international business had to be secured by close links to political contacts in Berlin. He was also critical of the family dynamics within the firm, which was based on what Max Weber termed family communism. Reward did not follow individual competence but was invested back into the family enterprise as a whole. Young Siegmund saw the firm had to change to survive, and he was equally pro-active in giving advice to the Weimar government on its economic policy.

The weakened M.M. Warburg firm was forced to aryanize. Max Warburg, a pillar of the Weimar establishment, on whom the Nazis for a long period were

[2] Ferguson, *High Financier*, p. 62.

dependent for export and import credits, was forced out and had to resign his numerous directorships. He had an especially close and constructive relationship with the Hamburg-American shipping line (HAPAG) over decades, and he was expelled from the board on the orders of the Nazi mayor of Hamburg. The expulsion was formally confirmed at a board and lunch meeting, and on such occasions valedictory speeches were given. No one rose to thank Max Warburg for his years of service, and quick as a flash Warburg himself sprang to his feet, tapped his glass, and launched into a peroration: "Liebe Herren, Lieber Herr Warburg… To our great regret, we have learned that you have decided to leave the board of the company and consider this decision irrevocable."[3] The story went round the world press, outside Germany. Max Warburg was a man of great aplomb and courage.

Starting up in the City of London

Siegmund Warburg left Germany in March 1933 for a visit to New York and decided from there to go to London and not return to Germany, well aware of the lethal nature of the Hitler regime. The environment of the City of London was stunted by contrast – to both Hamburg and New York. The New Trading Company was set up there in 1934 as an offshoot of the Warburgs' Amsterdam bank, and nursed into a free-standing bank by Siegmund and his partner Henry Grunfeld becoming S. G. Warburg & Co. Ltd in January 1946. City sentiment was hostile to German-Jewish émigré bankers. Also, the Bank of England did not approve of the methods by which German émigré fortunes were moved to safer waters through the Amsterdam office. It is not clear whether the Bank of England was in a moral position to make such judgements when its own Governor, Montagu Norman, was a friend and supporter of the head of the Reichsbank, Hjalmar Schacht, and Norman backed Chamberlain on appeasement. Morality, however, has little leverage in matters of international capital transfers. What is more interesting is how S.G. Warburg & Co. expanded in a restrictive environment, and more generally how scruples embedded in local situations were overridden by Siegmund Warburg's drive to create something from more or less nothing.

It is surprising to note that Norman hung on as governor until 1944. His insistence on the return to the Gold Standard in 1925 had alienated him from all the British political leaders. Unlike the United States' Federal Reserve, no new governor was appointed with new powers to resuscitate the economy. By 1946, however, the Treasury was in firm control of the Bank of England (still formally a private company) and the Treasury's overwhelming priority was to keep interest rates low as a result of its huge war loan issues. These were predominantly held

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[3] Ron Chernow, *The Warburgs. A Family Saga*. London: Random House, 1993, p. 380.

overseas by sterling area countries, e.g., Australia, India, Singapore. Britain had deficits in its trade balance and a wrecked industrial base. It was not able to break out of this uncomfortable situation for many years. Sterling could not be allowed to be made convertible – though in 1947 on the demand of the US it temporarily was, with disastrous consequences; capital controls were enforced, and British governments were periodically forced into devaluations of the pound that were politically embarrassing in the face of its wartime allies in the sterling area. So, the Treasury controlled the Bank of England, and the Bank of England kept the banks – both countrywide and in the City – under a tight leash. That Westminster directed the Bank was resented by both the Bank and the City.[4]

Siegmund Warburg was confined to providing advice to British industrial companies and establishing credit arrangements for firms that were importing and exporting. By 1943, in cooperation with N.M. Rothschild, it was able to lead on syndicates issuing shares and offering short and long term loans. The firm, then named New Trading Company, confined itself to fees and – minimizing its risks - to small amounts of equity in share issues. As Grunfeld later explained, the New Trading Company had little room to operate in, and it could not afford to step on the toes of larger established City firms.

So, how was it to expand? In 1951, Bank of England officials regarded S. G. Warburg & Co. (as it had become) as a finance and investment house but not a merchant bank. That transition required membership of Accepting Houses Committee and this was achieved in 1956 by buying Seligman Brothers, an existing merchant bank with an account at the Bank of England. At a stroke this reduced the risk vulnerability of S. G. Warburg when it accepted bills of exchange from clients. Ever since the Overend Gurney triggered bank run of 1866, the Bank of England had offered a permanently open liquidity window for bills of exchange, either discounting them or taking them on repo. Using the facility had become a closed shop for the merchant banks of the Accepting House Committee.

Buying itself into the closed shop, then, was one strategy. Another strategy was to break the informal rules of business of City bankers. Siegmund Warburg, given his experience and survival, had few qualms about trampling on scruples. Warburg later recounted, in an interview with George Steiner, the prevailing attitudes. "Michael Berry, a partner at Robert Fleming and one of the then leading City bankers, said to me: 'if it can happen that somebody can buy shares and obtain influence in a company and then change the management, which member of the management can sleep quietly in his bed?' I replied to the effect that was no reason for someone to sleep quietly in his bed if he was not doing a

[4] David Kynaston, *City of London. The History*, edited D. Miller. London: Chatto and Windus, 2011.

good job."[5] Merchant banks did not launch hostile bids for companies, it was against the informal club code of the City. S. G. Warburg, however, led one of the first hostile bids for a company, British Aluminium. This divided the City's merchant banks into two warring camps, as each outbid the other in gaining a controlling interest of the shares. S.G. Warburg & Co. played its hand carefully, secretly and, for many, duplicitously. Warburg was able to mobilize clients of Kuhn, Loeb in New York – which bank was part of the wider family Warburg – to enter the market and buy large quantities of British Aluminium shares, so that in January 1959 the take-over was complete. Welcome to the age of investment banking red in tooth and claw and the prosperous business of mergers and acquisitions.

The failure of "rationalization"

In reviewing the "Aluminium War", Niall Ferguson reckoned that the firm Warburg's were acting for (Reynolds-TI and its backers) had paid too much and that Warburg had overestimated the growth potential of aluminium for the decade ahead. And on its acquisition of British Aluminium, Reynolds-TI sold off the most profitable division, in Canada; i.e. investors' profits came from asset stripping. S.G. Warburg did well, despite the venomous rancour left in the City. They, as a firm had arrived, and it was the merchant bank to go to for those industrial firms with ambitious finance directors and chief executives that wanted to buy their way to greatness. S.G. Warburg's profits almost doubled from 1959 to 1960, and the 1960s were the golden financial age with rising share prices and take-over business.

Warburg had no scruples leading the way in take-overs. He regarded the management of most UK industrial firms, whose actual industrial processes he understood little – "never visit a factory" was his motto, as dunces who paid themselves too much money out of profits. This did not prevent Warburg from flattering the business leaders who came for advice outrageously – asking them to assume a world free of constraint and what they really wanted to do. Goethe's Faust had its uses. Rationalization was the thing and Henry Grunfeld was the expert. Rationalization in industry did not derive from Max Weber's famous concept which placed the emphasis on intellectual intensification of an idea or belief and its inner dynamic. Grunfeld had been heavily involved in the "modernization" of the German economy in the early years of Weimar and this process was dubbed rationalization: merging firms into larger units and improving inter-firm coordination. S.G. Warburg acted as banker for the many mergers in the 1960s in the British car industry – British Leyland and Rootes. Niall Ferguson judges that the hoped-for economies of scale failed to materialize, as once famous marques in smaller factory units vanished into large anodyne

[5] George Steiner Interview, Archives of LSE Library, Warburg/14/37, p. 2.

entities where mass unions and management slugged it out; while pride in design and workmanship became forgotten modes of conduct. A different economic policy would be for unprofitable firms to disappear, rather than being scooped up into some artificial entity, and the effective and profitable firms would still survive.

Warburg pronounced: "We will move… to still bigger units in economic life of the Western world which, of course, from a human point of view is very regrettable but in the light of the technical developments of recent decades appears unavoidable." [6] But as Ferguson poses the question: "was rationalization better for the bankers than the UK economy?".[7] Warburg-led rationalization blazed a scorched trail through Britain's industrial sectors: cars, metals, shipbuilding, aircraft, textiles, newspapers, hotels, breweries and electrical engineering (though Warburg was outwitted by Arnold Weinstock on the take-over of English Electric[8]). S.G. Warburg's fees for an uncontested takeover was half of 1% and for a hostile bid 1% of the acquisition price. From 1959 to 1969 the firm's profits in real terms rose sixfold. S.G. Warburg started a trend that has continued unabated to this day; to the extent that it is no longer plausible to talk about an indigenous industrial base in the UK economy. Will Hutton brings the lamentable narrative up to date: "Over the last decade, a fifth of quoted companies have evaporated from the London Stock Exchange, the largest cull in our history. Since 2004, £440bn worth of British companies have been sold overseas".[9] Rationalization via mergers did not turn out to be the panacea of economic policy, as Prime Minister Harold Wilson believed, but it was the making of investment banking.

Innovation through communication. The case of Eurobonds

It would be wrong to assume that Warburg's success was inevitable. As noted Warburg had to ride roughshod over existing City norms, and there was no one consensus in the UK Treasury or the Bank of England that the national and international funding of merger activity was a desirable economic policy. Clearly, what above was referred to as Siegmund Warburg's horizon of meaning,

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[6] Ferguson, *High Financier*, p. 291
[7] Ferguson, *High Financier,* p. 304
[8] Warburg opined of Weinstock: "Weinstock comes from small surroundings. His is outstandingly straight, not calculating, in fact remarkably so, but the passion of bigger aims beyond making money is not in him." Warburg/14/37, p 11. Weinstock's accounting mentality, reducing GEC to profit centres, meant that it became competitive in its parts but failed to develop a forward looking competitive industrial strategy. Though how GEC came to be vaporized, after Weinstock, remains one of the great mysteries and scandals of UK industrial history.
[9] Will Hutton, 'British capitalism is broken. Here's how to fix it', *the guardian* (11 Feb 2015).

outstripped those of other agents in the economic sphere. To make things happen and for them to go Warburg's way also involved a conscious strategy of information gathering and communication; communication within the firm itself – early morning meetings where activities had to be shared and all decisions agreed to by more than two partners; communication outside the firm where Siegmund Warburg was prodigious in courting industrial leaders, Bank of England officials, politicians – he wrote speeches for Harold Wilson, civil servants and, of course, his continuous correspondence with and visits to his extensive European, American and Japanese contacts. He insisted to partners and its public school recruited employees that the firms' reputation was built on "intensive … high quality personal services".[10] In the Aluminium War it was the personal style of lobbying – of Bank of England officials, and members of Harold Macmillan's Cabinet that was crucial as well as, obviously, major investors and protagonists – and briefing the press. The financial reporters came to the bank on a daily basis to speak with Warburg, and Warburg himself wrote the communiques for Reynolds–TI. Communicative investment was deployed in creating and making the market for take-overs, and the best medium of communication was the face to face meeting, preferably over lunch.

This can also be seen in Siegmund Warburg's greatest innovation, the Eurobond market – another first that structured the future growth of the City of London. International financial transactions were in lockdown during the late 40s and early 1950s. The commodity and future exchanges remained closed, capital controls were in place, the Bank of England, against its will, was told to enforce the capping of loans by the banks. Memories of the Depression in the 1930s were strong and attitudes venomous towards the City of London and its less than glorious role. Above all, a citizen nation had been created in the postwar reconstruction, and national purpose was not to be undermined by the pursuit of particularistic financial interests.

The two major reserve currencies in the post-war period were the US dollar and the pound sterling. David Kynaston in his history of the City of London notes the City's and Bank of England's presumption that because sterling was a reserve currency it was the basis for a return to its international profile. But what was not grasped was the fundamental difference between the US dollar, which was able to take advantage of its "exorbitant privilege", and the pound sterling whose holders faced the risk of the devaluation. Warburg's opinion, quoted by Kynaston, was that Britain had become a debtor nation instead of a creditor nation, and a reserve currency status did not make sense for a debtor country. "It's a very expensive luxury for us to have." Warburg's opinion was resented by the Governor of the Bank of England, the then assumption being, as Kynaston

[10] Ferguson, *High Financier*, p. 249.

writes, "sterling and the sterling area represented Britain's financial ticket to the world's top table".[11] The Treasury and governments were against the return of London as an international capital market, for any movement of domestic savings into other currencies and countries would heavily reduce the value of the pound. The Bank of England had, reluctantly, to follow Treasury policy though one of its officials, George Bolton, was in discussion with merchant banks, including Warburg's, on how to restore the old international City. As early as 1952 Bolton was advocating the full convertibility of sterling and the floating of the pound, the consequences of which would have been "disastrous, politically and commercially" in Alec Cairncross's view.[12] Bolton was intent on bringing back international finance in the same way that Kim Philby was working for international communism.

Siegmund Warburg looked for new ways forward and he realized early on that European companies and banks in the course of international trade were holding US dollars as cash in their treasuries with no opportunity to obtain a return on them. (Short term deposits in New York were capped at a very low rate in order to discourage flows of hot money.) National governments quarantined these short-term holdings from being converted, else their own currencies would be sold in exchange for dollars. Warburg's idea was to observe the quarantine, but allow a market of corporate bonds, to be funded by dollars held in Europe (eurodollars). The first Eurobond issue, handled by S.G. Warburg, was a $15 million loan to the Italian steel company, Finsider. As Ferguson explains: "To avoid UK stamp duty, the bonds were formally issued at Schiphol Airport in the Netherlands. To avoid UK income tax, the coupons were payable in Luxembourg."[13] The coupon was free of withholding tax and was anonymous. This had the dual advantage of a dividend free of tax at source and a cashable and tradeable bond. "…the main ultimate buyers of the bonds were individuals, usually from Eastern Europe but often also from Latin America, who wanted to have part of their fortune in mobile form so that if they had to leave they could leave quickly with their bonds in a small suitcase." The quote is from Ian Fraser an employee of Warburg's at the time.[14] The bond was sold with a 5.5% return. With stamp duty avoided – 2% in the UK – and the income not having to be declared, this was an attractive proposition. By 1968 the volume of new bond issues was $5.5 billion. Other banks quickly followed S.G. Warburg and foreign

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[11] David Kynaston, *City of London.* p. 429.
[12] Alec Cairncross, *Years of Recovery. British Economic Policy 1945-51*. London: Routledge, p. 270.
[13] Ferguson, *High Financier*, p. 220.
[14] Quoted by Ferguson, *High Financier*, p. 220.

banks flocked to London. The basis of the City of London as an off-shore financial centre, and conduit for tax evasion and money laundering, had been secured.[15]

Warburg's motives were in part political. He really did want to establish a large and effective Europe-wide capital market that would form one of the pillars of European integration. This was a delayed version of Stresemann and Briand's pre-war efforts in that direction, of which Warburg was a full supporter. Integration of capital markets was only weakly supported by the European Commission and it was not encouraged by European national governments. Hence the Eurobond was an imaginative solution, but whether this was the optimum way of developing a European capital market will be a matter for economic historians to consider. As a financial innovation, it was brilliant – it put the hay where the donkey could eat it (as the Swedes say). But seen in terms of critical path dependency as well as the way financial minds were bent to think, the long term development was not completely felicitous, as we now know.

Seen from Warburg's perspective the critical path analysis should have led to a Europe wide capital market, and in a confused way it did eventually. But one cannot possibly think it proceeded in the manner – the road of haute finance and its relationship values – that Warburg hoped for. The two-dimensional line on a piece of paper starting with Eurobonds, and that arrow meeting another labelled removal of national capital controls, eventuating in Europe wide capital markets, is not how it worked out. Here we can recall Edmund Husserl to our aid. Husserl's notion of meaning was a good deal more prosaic than Siegmund Warburg's proclivity to surplus meaning, whether in his disquisitions on Hamlet's uncertainty or the depth psychology of Freud. We – anybody and everybody – make sense of the world by having reference points in the world. These are both explicit and implicit. We fill in our sense of reality within a horizon of meaning and this includes us in events and experiences that we never anticipated. The world in its brute empirical complexity is not intelligible – by anyone, even economists.[16]

Warburg innovated a marker, the Eurobond, that became a beacon and not just a reference point for profit-driven banks. Warburg was quite clear that the profitability of his innovation would soon be reduced by imitators. The imitator banks changed the institutional habitus of the City of London. The sheer quantitative expansion of the Eurobond market placed deals beyond a relationship forged between merchant banker, the firm that required funds, and consideration for the customers who would buy the bonds. Warburg had not just created a financial instrument, he had inaugurated a new market – and not of his

[15] See Nick Kochan, 'Hedge Funds and Tax Havens', in S. Whimster (ed.), *Reforming the City. Responses to the Global Financial Crisis*. London: Forum Press, pp. 133-149.
[16] David Woodruff Smith, *Husserl*. London: Routledge, 2007, pp. 286-294.

own making in the sense of his own predile§ctions. Out of the many Eurobond issues developed a secondary market, and out of the dealing in secondary markets developed the portfolio analysis of the *konvolut*: risk and return, interest rates, and when to crystallize paper/trades. And out of that developed the derivative markets of call and put options, and out of them the insurance market of collateral debt obligations. Bulk meant that deposit taking banks (*Universalbanken*) were the new thugs on the block with their armies of traders and bond salespersons. The sharp lines of critical path analysis give way to the ever-expanding cross-hatching of dense confusion.

Warburg had a sharp sense of himself as the man of the moment. When he semi-retired to Switzerland in the 1970s (taking two secretaries with him to monitor the office and maintain the correspondence), Warburg got his friend George Steiner to interview him on his life and his views on the same. On the terrace of Blonay overlooking Lake Geneva, Steiner explored the serendipity of the great innovator: "Would it be fair to ask whether the British Aluminium war changed the fortunes of your personal life, of your firm and the City?" S.G.W. replies: "It certainly did. To take the City: To change the aspect of the City was not in my mind at the time. It was a semi-automatic result of what occurred. What really happened was that a very good friend of mine in New York, Hans Vogelstein [an executive of American Metal], … often talked about the fact that so many of the top British industrial companies were badly managed and that their shares were basically highly undervalued since earnings could be greatly improved if it was possible to re-organize the management.".[17] Lord Portal, the chairman of British Aluminium at this point, was a war hero and ex-admiral, and commerce did not appreciate the unreflective bravery of the Navy. Portal did not countenance hostile bids, and he probably did not sufficiently realize that if predators buy your shares in sufficient quantities you lose your command. One world of meaning erases another.

Looking to the future, Steiner asks: "What in your view is the general economic and special function of a merchant bank within the general economy?" S.G.W: "In my view within the next twenty years, there may no longer be merchant banks as we understand them today but rather joint banking/accountancy firms. I could visualize, for instance, mergers between merchant banks and the big accountancy firms such as Price Waterhouse, Peat Marwick." This is almost prescient, since the cartel of accountancy firms were instead merely co-opted to approve the solvency of banks, which in 2007 and 2008 were insolvent (something, in the UK, that is against the law). Warburg continues: "Merchant banking is already changing radically, and in this respect my firm has made a contribution. This has been acknowledged to me by both Cobbold and O'Brien.

[17] Warburg/14/37, p. 1.

Maybe one day we will go out of the money lending business altogether, leaving this side of the business to the joint stock banks. At present the mixture of money lending or borrowing with advisory functions fits well together and the two sides enrich one another but this may not remain so."[18]

The uncertainty of second order reference

Siegmund Warburg was slightly too paradoxical for the good of his own firm. He regarded handling other people's money as the work of the cheapskate *Börsianer*. Unnoticed by him the rise of money manager capitalism had become a dominant and profitable activity in leading financial centres. Citizens' pension funds, sovereign wealth funds, and illicitly gained money all had to be managed. Mercury Asset Management became the profitable division of S.G. Warburg, and when it was eventually sold off, it was seriously underpriced, perhaps reflecting the disdain of the high financier. Weimar values no longer counted, the horizon of meaning had moved elsewhere, projected by entirely new financial agents.

The Ferguson biography was launched at Gresham College in June 2010. A retired banker (ex-Warburg and Lazards), the Gresham Professor of Commerce Kenneth Costa, made a plea for the return of relationship banking as typified by Siegmund Warburg. He also called for a new attitude in banking based on the values of respect, honesty and service.

Five years on *Lebensreform* has not happened and it will not happen. Siegmund Warburg's moral stance as a banker, as comes out from the Steiner interview, was pharisaical, which is an understandable stance for a banker. The avowed Christian, Stephen Green, ex-chairman of HSBC, is at present regarded in public opinion as a rank hypocrite. Major banks have been revealed as being directly involved in tax evasion, money laundering, engineering odious loans, mis-selling products, and countless examples of the manipulation of markets and transactions rigged in the banks' favour. And even with a roulette wheel with ten zeros they still managed to become bankrupt, saved at the last hour by massive Treasury cash injections. These behaviours are so extensive and prevalent, and intrinsic to London's competitive regulatory arbitrage, that it is hard to discern what would now count as fair dealing.

Costa argues that the cause of the financial meltdown was neither integration nor size of the institutions. "The crisis from which we are slowly emerging was the outcome of duties owed but not met, responsibilities incurred but not fulfilled. At bottom, it is about good moral practice as well as good business practice. It is about finance's relation with society at large, the silent partner to

[18] Warburg/14/37, p. 8.

any transaction who in the end legitimises what we do and makes it possible. It is integral to the moral basis of capitalism… This means that relationship banking is not a subset of behaviour, suitable for parts of an institution when convenient. It has to be embedded in the DNA of the whole institution."[19]

Viewing financial agents in complex networks as responding via embedded informational structures is an interesting analogy – though quite beyond the genetic engineering Costa envisages. The question to ask is what comes after relationship banking, what is the horizon of meaning that encompasses the new world of "transactional banking"? One answer is to suggest that the point of reference is no longer direct and knowable, as was the case when bankers dealt directly with their clients.

One seeks to understand, as a sociologist, why it is that a transaction between a banker and client can no longer be thought of in terms of trust, morality, competence or some knowledgeability of the other party's behaviour. It is quite hard to explain the executives of Lehman Brothers[20] making huge but idiotic deals when they *knew* the firm was about to explode. Likewise, regulatory agencies operate to expedite the financial system. Financial agents are no longer predictable, their rationality no longer decipherable. The reference points through which the world is taken to be meaningful no longer hold. Relationship banking assumes a world where meaning is no longer configured as once thought. Stephen Green may well have assumed his values were shared throughout his banking empire and from this stance his sin is a misplaced sense of organizational coherence and consensus. Relationship banking assumes that individual agents are underpinned by order and value and an accompanying institutional solidity, but this no longer is the case.[21] This was starkly revealed in the UK House of Commons Select Committee that called before it another executive of HSBC, Rhona Fairhead, whose "area" of responsibility was private banking. The issue for the Select Committee, and an increasingly indignant British public, was why HSBC's private bank in Switzerland handled the accounts of so many tax evaders - even a possible 14,000 accounts. The Select Committee found her excuse risible that she had no knowledge of the bank's tax evasion

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[19] Kenneth Costa, 'High Financier: Sir Siegmund Warburg and the Art of Relationship Banking'. <http://www.gresham.ac.uk/lectures-and-events/high-financier-sir-siegmund-warburg-and-the-art-of-relationship-banking>

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[21] Niall Ferguson offers a history of Warburg as a City house. Another explanation for Siegmund Warburg's excessive emphasis on order as control was his larger ambition to build an international banking house in the manner of the Rothschild empire. Siegmund Warburg's frequent visits to Kuhn, Loeb in New York and Brinckmann (as M.M. Warburg was aryanised to) as well as link ups with Banque de Paris et des Pays-Bas come across as something of a distraction from the City operation. But it was true Weimar cosmopolitanism that Warburg strove for, not the limited charms of the City of London.

schemes: "frontline staff", she said, had ignored "structures" and there was an absence of a "controlled environment". This merits sociological investigation, though clearly the British public are demanding simple direct responsibility.

Siegmund Warburg placed a particular stress on order. It comes out in his interview with George Steiner, who had asked in what way merchant banking was increasing “the amount of freedom, i.e. is the mixture moving forward to socialism?” After some nostrums on the mixed economy, Warburg continued: “The world is unjust. I believe with Henry Kissinger that whilst justice is very important, order or balance is at least as important as justice. The two do not always go together although we try to combine them. A merchant bank can help in bringing about more order, balance and stability.”[22] Niall Ferguson brings out very well the organizational structure and control of S.G. Warburg & Co. Warburg was an obsessive not just on the forms of politesse but of knowing exactly where things stood at any moment. He preferred fees and commissions than risk the firm’s capital in taking propriety positions. Markets as he knew can turn against you and devastate the over-exposed – a lesson completely forgotten in the post-Warburg financial world.

The premier sociologist of the late 20th century, Niklas Luhmann, argues that order comes before society.[23] The social world exists in various states of complexity and the sociological achievement of reducing entropy has as its outcome a sense of society. Warburg’s whole career was dedicated to resisting entropy and disorder. To create order in the world of finance, he built a tight organizational structure with clear rules of behaviour and conduct.

Luhmann’s major thesis was that achieving order and thereby creating society is increasingly difficult under modern conditions. In a traditional world of estates and castes, everyone knows their place and order is secured. In the transformational period of the 18th century Enlightenment, order was secured by assuming that the social world is peopled by autonomous and rational subjects. Society, then, was the Enlightenment. In 20th to 21st century modernity, so much change is occurring at the structural level that individuals, or agents, no longer can trust the points of reference and meaning which they grew up with or were educated into. “Life-long education” is a despairing admission that contemporary modernity is always changing and that grounding lives in a pre-existing patterns is no longer possible. While Costa, and Ferguson, praise the values of S.G. Warburg, by the 1980s the firm was becoming an anachronism, overshadowed by universal banks, money managers, and derivatives trading. It disappeared into the maw of UBS via the Swiss Bank Corporation, its name eventually

[22] Warburg/14/37, p. 9.
[23] Niklas Luhmann, *Social Systems*, trans. J. Bednarz Jr. with D. Baecker. Stanford: Stanford University Press, 1995.

disappearing. S.G.Warburg's was run by the "uncles" a generation of émigré German businessmen who recruited public school men after a very selective interview process. This quaint form of authoritarianism could not survive, just as the social norms of the gentleman's club in the City did not survive beyond the 1950s.

Niklas Luhmann died in 1998, before the global financial crisis. He perhaps would have been one of the few people to welcome the crisis, since it confirmed his thesis of the tendency to increasing complexity and entropy under modern conditions. Using Husserl's idea that our consciousness is tethered to points of reference, the sociological version of this is that reference points in the social world are unhinged. We cannot rely upon them. For example, trading in derivatives operated through the illusion conferred by the rating agencies that the financial product had the value as was stated on the label. But in the crisis, each banker could not trust the word of another banker. The realization had dawned that they did not know the true value of their own financial assets and *pari passu* neither did their competitors. Radical uncertainty prevailed.

Bankers may be able to draw some measure of exoneration from Niklas Luhmann because, in a narrow interpretation, this lack of reliable reference is the modern condition: one has to rely on the unreliable, what Luhmann terms second order reference. The larger interpretation infers that finance is unable to reform itself. The virus of uncertainty spread most quickly in the informationally fecund environment of the financial world. There is no solution to modernity just as there is no cure for the dysfunctional entropy of finance.

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