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PRO PONTIFICE

THE DUBLIN GROUP ON FINANCE AND THE COMMON GOOD

THE MALTA FINDINGS

Short Summary and Conclusions

of the Consultation held at the Central Bank of Malta, January 2016

A year after issuing its "Proposals on Finance and the Common Good"[1], the *Centesimus Annus pro Pontifice* Foundation once again invited the *Dublin Group on Finance and the Common Good,* a group of bankers, banking supervisors, financial economists and specialists in financial ethics to a consultation meeting, this time hosted by the Governor of the Central Bank of Malta. A full summary and the papers presented will be made available on the Foundation's website www.centesimusannus.org.

The call from Pope Francis

The crisis context is still more urgent and tragic in 2016 due to the European refugee influx which is not an isolated problem, but forms part of a broader set of social problems we face in a post-secular society. In this context, with long term views postponed by the urgency of immediate needs, Pope Francis has "an emotional connection with people around the world, whether Catholic or not"; he was described as "the most prominent figure addressing issues that have dominated global debates since the financial crisis began"[2]. This gives added audience to Catholic Social Teaching and opens new possibilities of change, but the challenge remains: how are these calls to be implemented?

Pope Francis starts from an anthropology where primacy is given to the human person, and where money should not be idolized. These principles have universal value. He says that the market will not, by itself, succeed in bringing about greater justice and inclusiveness: in fact, economists know that choices concerning common goods cannot be solved by regulation or price, but only through a decision process based on ethics. The preferential option for the poor is essential to the Christian view, but not to foster a passive state of dependency on welfare; the Pope says that helping the poor financially "must always be a provisional solution in the face of pressing needs. The broader objective should always be to allow them a dignified life through work"[3].

The Group was asked two sets of questions: *Does financial reform entail real change? For whom? And how?* and *Internally-driven Ethical Reconstruction: is it happening?* The third subject was an action-oriented idea: how to promote new Voluntary Solidarity Funds.

[1] The Dublin Proposals on Finance and the Common Good, *Centesimus Annus pro Pontifice* Foundation, 2014
[2] *Worth* magazine, 5 October 2015.
[3] *Laudato sí*, 128

1. Does financial reform entail real change? For whom? By whom? And how?

No doubt, financial reform does entail real change and banks are in the middle of a resource-consuming implementation process. The financial sector is stronger. But there are also some unintended negative effects.

The two phases of the policy response were, first, stabilization by means of liquidity injections by the Central Banks and, second, strengthened regulation, unified supervision, resolution, data gathering and stress tests. Contrary to popular belief, the carnage wrought on bank valuations shows that public money was used essentially to protect depositors, not shareholders. The system is now better capitalized and more solid. But is stabilization all that needs to be done? And must the policy response address only banks?

While successfully reaching their immediate aim, the stabilization plans however have left a legacy of problems: a possible risk of new asset bubbles, excessive bank holdings of public debt and an unsustainable overall debt mountain. Increased capital requirements are causing credit rationing and high spreads for low-grade borrowers (often SMEs). An increased weight of compliance risks is squeezing out smaller financial agents and bringing about more concentration. On a longer view, the hidden causes of the crisis, which made the system so vulnerable, still need to be addressed: they ask for a rethinking of the functions society requires of a good financial system and how resources should be allocated.

Conventional banks today are just one variety of financial agents. A large sector of unregulated lending is developing in the corporate world. The digital revolution, with the creation of an indefinite number of new means of payments and the increased knowledge of potential customers by financial institutions will pose a number of new regulatory and ethical questions.

The next steps in the reform process will probably lead to extend the supervision perimeter and set additional limits to some purely speculative activity. However, the problem is not so much to introduce more regulation, but better regulation. There might be a degree of *hubris* in believing that regulation is sufficient to reform the financial system. A good regulatory framework can be a complement, but never a substitute to a solid set of ethical values. There is a need to rethink regulation holistically in view of the aims and to find a balance between previous deregulation and present re-regulation.

The principles set in reform programs adopted by the G20 or the European Union are ambitious and truly intend to put finance at the service of the economy, but the actual process does not yet meet all of these aims and there still is a big accountability gap. There being no “perfect” financial markets, the remaining problems of the past and the new problems posed by digitalization and an integrated approach to inclusive finance will need more than ever the construction of a financial professional ethos underlying a continued, permanent reform effort.

2. Internally-driven Ethical Reconstruction: is it happening?

Some large financial institutions are showing the way by committing publicly to responsible finance and stewardship. They organize intensive communication from the top about corporate ethics, as well as mechanisms allowing employees to report on inappropriate conduct of peers or managers. Employees are asked to explicitly adhere to the corporate Code of Conduct, translated in the different languages, in spite of strong linguistic and cultural differences. They also organize specially designed training programs on conduct risk management. It is essential that these cases of best ethical commitment are duly circulated in the business world.

Many institutions are also developing philanthropic programs geared at consumer financial education, non-profit and community led innovation, and support for the most financially excluded. A question is raised in this respect: are the social goals set for these programs best served by the corporations themselves, or by independently managed organisations? There may be a point for economies of scale and independent supervision in larger, professional solidarity organisations. A dialogue between corporations and charities should be developed in this context, where both can learn from each other.

Philanthropy should not prevent the ethical questioning from reaching the mainstream operation itself: some banks have started to assess the economic value of products from the point of view of customers and systemic risk, thus addressing one of the traditional CST demands, that every business decision has an ethical dimension. For some products, it is feared that excessive complexity may impede such examination. Also, some financial institutions are introducing products that respond to the needs of the undeserved, unbanked and youth entering the mainstream, often informed by the work of non-profit and community organisations. Thus a pro-active attitude is possible where inclusive finance becomes a business policy, not just a philanthropic plus.

As on other points, opinions on ethical reconstruction differ: for some the changes in corporate culture are more difficult, especially when recent management trends develop a mercenary soldiers' attitude in the ranks of business organisations. The high number of recent cases of financial misconduct and consequent sanctions show persistent ignorance of the *economics of ethics*: short term investment perspective with no ethics ends in shareholders' suffering. Ethical reconstruction also needs to be supported by education: there is a permanent need for reform in economic and financial teaching. Ethical literacy needs to be part of economic and business administration studies in an integrated way so as to make economic teaching closer to real world problems.

The re-regulation trend has developed the "ticking boxes" approach of ethics, which is the opposite from a true ethical construction. The ethical culture of an organisation must start from below, but example of accountability and social impact criteria must be given at the top, and it is urgent that contents issues, as opposed to formal matters, return to the boards. Management selection criteria need to include the capacity of ethical discernment. In financial matters, Churches are expected to be especially transparent and socially minded.

3. Voluntary Solidarity Funds (VSF)

In its previous document the Dublin Group proposed to promote Voluntary Solidarity Funds, rather than levies on financial turnover or capital. The Group continued discussing this idea with the aim of presenting a practical proposal to the *Centesimus Annus pro Pontifice* Foundation, to Church authorities, and to Christians world-wide.

In the Rapporteur's view[4], recent IMF and OECD findings show that income inequality in developed countries is growing, hurting economic growth and squeezing the middle-class: previously attained levels of security in our societies are now under threat because of slower growth, young and middle-aged unemployment, and *socio-economic decay*. In the meantime, in spite of substantial progress in average income in different parts of the world, needs continue to be pressing for large parts of populations in Latin America, Africa and Asia. Sustainable solutions, as indicated by Pope Francis, require empowerment of the poor: "We must allow

[4] *Inequality and Growth, the Road Ahead. Setting up a Voluntary Solidarity Fund.* Report by Josef Bonnici, to be published on the CAPPF website

them to be dignified agents of their own destiny"[5]. Training for entrepreneurship, micro-credit and support for start-ups seem three ideal ways in this direction. The report proposes to focus specifically on the lower income category or families that are being dragged towards the brink of poverty. It should try to mobilize the vast amounts of liquidity now sitting idle, a "talent buried underground" which through the VSF initiative could be utilized to "make better fishermen".

One can observe an explosion of foundation giving, and the "warm glow effect" for very rich donors is every day in the news. But the idea is not so popular among relatively well-off Christians: solidarity still moves around traditional charities, which rather focus on families in extreme poverty, and whose very important role one should never attempt to *cannibalize*. But there may be space for new funds aimed at entrepreneurship and the reintegration of the excluded, where average people regularly contribute a small part of their income, and where the use of funds and the evaluation of success is made totally transparent through independent evaluation.

The proposal was met by the Group with enthusiastic support and also with some *caveat* and suggestions:

- The best existing examples in this field are using loans, not gifts: confirmed micro-credit organizations show a very low level of bad debt. Very small credit, associated with professional and voluntary coaching can give extraordinary results in real life personal recoveries.
- Church money participation could have exemplary impact, but the new funds must be lay-led initiatives, with intensive professional involvement of experts and with highest accountability standards. They should develop separately from State structures, although the question of tax deductibility must be approached in different jurisdictions.
- The danger would be to duplicate existing efforts with a 'crowding out' effect. The new funds need to be clearly different from existing relief organizations. They should not be just a new asset class of social impact investment, although they could benefit from the discipline of market validation. In future, they could issue solidarity bonds, for which there is demand.
- There could be a wide range of national or regional funds coordinating into some sort of common structure. As a first step, however, it is recommended to start on a trial base, with a relatively limited universe of contributors and recipients. This will require extreme precision in the definition of aims, focus and methodology.

It is unlikely that any initiative of this kind will substantially change income distribution. But it is worthwhile to take the risk: a Voluntary Solidarity Fund, deeply rooted in Christian principles, may show that things can be conceived differently in the search for sustainable ways to escape from poverty: idle funds can be put to work and the needs of the poor, who lack access to bank credit, can be included in a more ambitious reform of the financial operation and legal framework.

4. Action points and future meetings

- A task-force composed of members of the Group will discuss and submit a proposal on Voluntary Solidarity Funds to the *Centesimus Annus pro Pontifice* Board. The proposal will be discussed at CAPPF's international conference (May 12th-14th, 2016), during

[5] Meeting with Delegates to the UN General Assembly, Address by Pope Francis, September 2015

which a meeting with Pope Francis has been confirmed, as well as at the conference to be held jointly with Fordham University in New York City (September 23rd, 2016).

- It was suggested to prepare an intervention to submit to the European Commission and Central Banks on the question of facilitating inclusive finance and micro-credit as part of the financial reform program.
- The present full dedication of the banking sector to implementing new regulations should not prevent the sector and its industrial organizations from discussing about a new definition of the ideal balance between different functions (payments, intermediation, risk management) in a good financial system. This could be a subject for future meetings of the Group, which could then channel its findings through international organizations like the World Economic Forum and through national financial sector bodies.
- Another subject for future meetings is Digitalization, the new financial world and its emerging ethical problems.

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