A Dialogue on Finance and the Common Good

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Seminar Summary

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A - The Role of Ethics

The participants gathered in Dublin – a city heavily transformed by the financial industry – for a Seminar on Finance and the Common Good, engaging in a dialogue between theological reflection and practice in order to foster social concern. Monsignor Martin clarified the focus of the Seminar as follows: how can we best place people, created in God's image, at the centre of our vision of the economy and society. Poverty is not simply lack of material resources, but also the inability of people to realise their God-given potential.

A1.Reading the facts

The Dublin seminar is part of that on-going dialogue between economics and ethics, which is so important in today's world where theological reflection can make a contribution. Love is the essence of Christian life because God loved us first. The commandment of love of neighbour, grounded in the love shown us first by God, is clearly a responsibility for individual Christians. But it is also a common responsibility, as the practice of love must be a distinctive mark of each expression of the life of the Church. Moreover, one should ask: can love be organized and become an ordered service to the community in today's world? Love is not an element added on to the work of charitable organizations. In all professions, competence is a fundamental requirement, but it is not of itself sufficient. We are dealing with human beings, and human beings always need something more than technically correct care. They need humanity. They need heartfelt concern.

The challenge to constructing solidarity is that it must take place within the concrete realities of the world. It must try to identify the optimal management of various elements within that reality as times change; it must develop a framework where human labour is prioritised. This is especially important in European countries where levels of youth unemployment are extremely high.

To be at the service of the human person, economic activity requires both an ethical and legal framework. In particular, the market can only work within an ethical framework of trust. That ethical framework needs to be consolidated in juridical norms which guarantee fair-play, competition and transparency. The legal framework must also ensure that economic freedom is placed within a wider system of fundamental human values, that certain "collective goods" (CA, #40) – including the rights of workers - are protected, and that certain fundamental human needs which "find no place in the market" (#34) do not remain unfulfilled. Wherever the rule of law is not respected, it is almost always the poor who pay the highest price.

As God created humanity as a family, globalization will be worthy of its name if it enhances the unity of the human family. Any form of globalization that breeds exclusion, marginalization, instability, indifference and crass inequality has no right to call itself global. How an economic system generates inclusion is the fundamental measure of its success. What does the centrality of the person imply in the financial world? **(Martin)**

A2. Ethical dilemmas faced by staff in financial services

Adam Smith presumed that each individual involved in the market exchange brought with him to the transaction not only his strictly defined individual interest, but all his ethical and moral background. We seem to have forgotten that and yet we know, as individuals, that there is nothing more lonely and meaningless than a life lived only for oneself. Each of us wants to feel valued and respected, and to feel we are making a contribution. While some are satisfied with 'just a job,' many of us think in terms of careers and vocations even in defining ourselves. Yet in the financial profession we observe a dehumanization of the relationship with employees: by the 1990s, a "hire and fire" mentality had largely set in, based on short term results, and the training programme had been dropped because staff were no longer 'loyal' (why train people for competitors? the typical employer would say). And as anonymous and mechanized relations became dominant, dehumanization was also directed towards customers.

We need to reintroduce the individual to the corporation, but we also must change the collective - the corporation. Even for a motivated professional supported by family, faith and community, it is difficult to work every day, if asked to act against one's beliefs and ethics. How can you be fair at home and unfair at work; straightforward with friends but not with colleagues or customers?

While searching for the common good in a pluralistic, globalized society we need to find a vocabulary that works for all faiths and none and without it losing its value and meaning. The Christian vocabulary of the common good, equality and stewardship, which is very powerful, may even be usurped by businesses in order to whitewash their behaviour. On the contrary, truly adopting that vocabulary will be shown in changed behaviour in the treatment of employees and customers, in the retention of staff, as well as in the treatment of outsourcers and their environmental footprint. The challenge (CV #45) is not only to create 'ethical' sectors or segments of the economy or of finance, but to ensure that the whole economy – the whole of finance – is ethical, not by virtue of an external label, but by its respect for requirements intrinsic to its very nature. The first step in embracing the challenge is remembering there is a human being at the beginning and end of *any* and *every* transaction. (**Ridpath)**

A3. Dimensions of Subsidiarity in financial institutions

One aspect of subsidiarity in finance refers to the size and functioning of financial institutions, suggesting small size, decentralized functioning, and personalized interactions.

Concerning this, there is an ambivalent relationship between the effort to fight dehumanization and re-regulate the financial system. Bank regulators have sought to reduce human fallibility and increase accountability by systematizing the underwriting decision-making and demanding a fully auditable paper trail intended to ensure the transparency and fairness of each underwriting decision. But this has encouraged systems that remove human judgment and where financial concentration and undercapitalization persist. While many regulators defend aggressive systematization as the only way to manage our undercapitalized, concentrated and culturally troubled banking sector, we should remain open to a better long-term solution. The alternative is a return to a well-capitalized and decentralized banking system that would not invite such heavy regulation; a possible solution could mean allowing asset-light financial intermediaries to perform more bank-like functions, as, for example, in the "peer to peer" lending systems. Without taking loans and deposits onto their balance

sheets, these institutions perform the essential underwriting function of a bank in a very human fashion. Decentralized solutions are likely to be vigorously opposed by the large undercapitalized banks that dominate the banking system and heavily influence regulators; yet, they can be seen as a practical realization of subsidiarity. **(Fieler)**

Another aspect of subsidiarity that deserves major attention concerns governance structures in financial institutions, as many instances of governance failures contributed to generating and exacerbating the financial crisis.

We should emphasize the crucial role of subsidiarity in the internal and external governance of financial institutions for the proper functioning of these financial institutions. Accountability, transparency, equitability are some of the main characteristics which can be considered good governance. An important but less talked about characteristic of good governance is the capacity to include and make each stakeholder feel an important part of the institution's mission. Subsidiarity in governance can acquire a tangible effect in two different but complementary dimensions. The first dimension is internal to the institution and refers to the capacity to promote the persons involved in the working of the financial institution: the person is not an instrument for some end in itself, but is instead a value *per se* originating from his/her freedom. The second subsidiary dimension is external, and concerns the institution's relationships with the external world.

While appropriate organizational structures, policies and other controls may contribute to promote good corporate governance, they by no means ensure it. Effective corporate governance is the result of both "hard" structural elements and "soft" behavioural factors, the latter being represented by dedicated people - directors, managers, employees, etc. - performing faithfully their duty of concern for the institution. The key is therefore to create in the organization an atmosphere promoting competent persons who have a clear understanding of their role allied to a strong commitment. (**Marseguerra)**

A4. A different financial education

Consequently, education is the key. Economic and financial professionals can and must be men and women of vision: how can the education of economists and financial managers contribute to making this happen? We basically need to rethink the paradigm – which tends to be formulaic dominated and sets history aside. The dominant individualistic and strictly utilitarian model has to have a prescriptive and (especially in finance) even a *performative*

power. We need to challenge the claim, that the paradigm be purely positive, and to engage with an interdisciplinary perspective in an in-depth epistemic debate.
The way ahead includes finding a balance between conservative and loose education, providing for both the transmission of existing knowledge and the provision of critical tools which facilitate innovative actions. This balancing act requires a multidisciplinary ethics-based perspective that is key to bringing out the fundamental driving force of human actions which students need to discover within themselves in order to become creative professionals.
Serious obstacles remain in pursuing this educational path both in academia and the business community; it requires improved cooperation and alliances (for example in the IFCU network).
But we can find profound inspiration in the rich tradition of Christianity: in the Benedictine tradition (*ora et labora*), in Ignatius' call to discernment, in the Franciscan tradition of care for the excluded. (**Dembinski)**

Discussion - Section A

On decentralized banking:
Once the attractiveness of decentralized banking and peer to peer finance has been recognized, then the downsides must also be considered. There should be rule-based decentralized lending **(Gonzalez Páramo)**; moreover, one should consider the ambivalence of decentralized banking between subsidiarity and possible loss of control. If regulation is light, then the courts system must be very effective in solving controversies **(Rossi di Montelera).**
Desirable lines of action include: raising the standards for consumer protection; making simple information available; providing advice for independent consumers where the human element is key; and improved lending standards **(Ceyssens)**.

On quantitative versus qualitative methods of financial assessment:
As good lenders need to find a balance between automated models and human evaluation, good regulators need to balance rules and human judgement – including discerning the different regulatory perspectives for large and small banks **(Ceyssens).** Despite the fact that it is quite possible to observe a high correlation between credit scoring and lending outcomes, a financial system at the service of people should also care about processes; in a humanized transaction, a relationship is created, possibly implying early warning of emerging problems.

(Coffman). Rules and human judgments are both necessary for good regulation. The crisis has clearly indicated how important it is in risk management to use a blend of qualitative and quantitative techniques. What is required today is "responsible" risk management – and responsibility is a word which refers to humans, not machines or algorithms; it is a word closely connected to subsidiarity **(Marseguerra)**.

On financial education:

Starting with undergraduate studies, we should provide a sound multi-disciplinary and not an overly specialized and fragmented program for business & finance. **(Coffman).** There is a trade-off between specialized, fragmented technical expertise and overall perspective. Qualitative understanding allows for improving quantitative approaches also in research and in education **(Pammolli)**.

As the educational strategies of Business Schools also respond to the expectations of the business sector **(Sugranyes)**, we need to address the cultural void of enterprises which are overwhelmingly focussed on financial returns **(Pujos)**. Investing in education includes providing meta-competencies to mediate technological change, and help understanding of both text and context – quality teaching which educates both youth and adults in understanding and knowledge **(Marseguerra)**.

Media is the key in addressing the cultural void of self-referential attitudes in both academia and businesses. An overall perspective on education includes educating educators in a lively spiritual community. Innovative academic activity and media initiatives can be very effective in shaping the aspirations and expectations of people involved in finance, of customers and professionals, and in changing the corporations' culture **(Zahra)**. Moreover, they are needed to attract young motivated people to become a 'new generation' of professionals in finance and business, with technical expertise and intrinsic motivations open to the needs of the human family in our rapidly changing world. **(Sugranyes)**.

B – Addressing Global Urbanization and Poverty

B1. A framework for addressing Global Urbanization and Poverty

We have two basic policy choices when facing global "mega-issues" such as urbanization and poverty: either to look at approaches from the top (at the level of the international community and of nation-states); or to highlight approaches from the bottom (at the level of local

communities and gradually moving up to the bigger entities). These approaches need to complement each other; indeed, by getting them to reinforce each other, we significantly increase our chance of achieving better outcomes more speedily.

The top-down approach involves a strong, effective central authority, engaged in sensible macro-economic policies and connected to the international community whilst shoring up internal cohesion through active promotion of social equity. The alternative approaches to such top-down approach are subsidiarity and devolution. This is a much longer, often more challenging route; but it remains the only viable route for countries with weak, corrupted governments. Grassroots development at the local community level requires equipping and improving the capability of the lowest administrative and political unit of government for proper governance. Subsidiarity and devolution however, need some strong, central backbone. This is where instruments of the "state" can play an important role: in some countries, even the "military" can play the role of building peace.

The demands of such a "building up" process are enormous, as it requires the "entire community" approach, i.e. an active coalition of the social and economic agents in each community (including institutions, businesses and NGOs) for the "common good" of the community, embedding the "shared value" orientation within every local community program. In their strategy, coalition members should go beyond the narrow financial and monetary (budgetary) perspectives, embedding ethics, social responsibility and sustainability in all activities.

In short, good governance culture demands competence, commitment, professionalism; and "*pietas*" or love of community. At the macro social, economic, and political level, a governance culture demands respect for personal dignity; concern and contribution to the common good; subsidiarity; and solidarity. The biggest challenge is how to make both approaches (top down and bottom up) support and reinforce each other. **(Estanislao)**

B2. Scope of Global banking, Collaboration with UN MDGs

The role of the financial sector in the common good is to be of service to the entire economy, society, and polity. In practice, financial institutions show their commitment to inclusive and sustained development by identifying emerging enterprises, preparing them for the bond and capital markets and facilitating the organization of financial pools, available through retail outlets and widespread branch networks where individuals, small enterprises and organizations can have flexible, relatively safe, and easy participative access. The banking

sector has indeed the opportunity to play a key enabling role in bringing low-income families and communities into the financial mainstream and allowing them to participate fully in the global economy. This is not just wishful thinking. The combination of three megatrends - globalisation, urbanisation and digitisation - provides a major incentive for banks to mobilise their resources, know-how and connectivity to address decisively the issue of financial inclusion.

The crucial role of the private sector is to promote economic progress in world wide communities where they do business, thus supporting UN MDGs and post-2015 SDGs by sustaining growth, job creation and enterprise formation. Every bank of any magnitude has the capacity to make a discernible impact on financial inclusion, especially when working in a partnership approach with other agents.

There are three key areas where banks can make a difference by promoting financial inclusion. One is microfinance, especially in low-income communities with low density of banking infrastructure, where the poorest have no access to formal credit. The second is mobile money: the mobile phone, and with it the broadening acceptance of digital money, is a powerful tool in combating financial exclusion; moreover, digital payments appear to strengthen and expand an informal insurance network among poor households. The third consists in digitising the supply chain: some major corporations are making a commitment to ethical and sustainable sourcing ('impact sourcing'); others are exploring new ways of enlarging their distribution channels to ensure the participation of urban and rural poor.

Large financial institutions actively engage in microfinance, mobile money, and supply chain management even in needy communities. But this is not philanthropy; it is good business and an investment in communities where they operate. Their long-term financial success consists in delivering what their clients need. (**Vanni d'Archirafi)**

B3. Fight against financial crime

Alongside the virtuous involvement of large financial institutions in promoting economic growth and financial inclusion for human development, are the malpractices of banks that are also part of the scenario; these ethical failures tend not to be sanctioned by the political establishment. Among the conditions which facilitate immorally high levels of financial profits, three should be mentioned: *fiat* international money, central banks' independence (from society), and financial deregulation. These conditions forged a dangerous link between commercial and central banks; the enormous expansions of the balance sheets of banks left

financial markets over-dependent on central bank support. While it remains true that regulatory improvements need ethical actions to effectively improve the integrity of the financial system, different lines of actions are required to challenge the persistence of a crisis-prone financial market. They include bottom-up approaches (public opinion and media), top-down solutions (legislation, including for example regulatory arbitrage containment, stronger anti-money laundering and anti-corruption measures) and also international measures to increase resilience (strengthening prudential supervision, improving collaborative anti-money laundering efforts and internationally pursue financial crimes). **(Costa)**

Discussion - Section B

***<u>On top-down, bottom-up governance</u>*:**

This issue prompted a debate that occupied different sessions. Participants discussed how to bring about a bottom-up governance, so often invoked but not often spelled out. **(Sugranyes).** The governance process adopted in the Philippines was described as an example; it included bringing together the city councils, identifying common objectives (creating jobs, modernizing the city, and so on) and involving groups to actively contribute (the military were involved in educational programs, private businesses in professional training). There remains an issue of 'governance overflow': How do you get top-down ethical decisions to trickle down to individual accountability and performance? **(Estanislao)**

It was remarked that the quality of institutions (top-own dimension) is key for successful bottom-up implementation **(Pammolli).** The bottom up construction of the common good requires building an open society, affirming the centrality of the person which is not a subject of institutions – hence, an inclusive society requires markets as inclusive institutions in an open society **(Felice)** .

Further thoughts on the top-down/bottom up dynamics: the macro system can be reformed only by strengthening the micro building blocks: firms, civil society organizations, local government. This requires involvement of families and schools, and ultimately motivated individuals. Governance systems need to seriously address the fundamental issue of bridging personal dignity and organizational aims, and fostering discipline (accountability and ethical responsibility). This is the key to addressing three global challenges: facing the demographic winter, protecting the environment, fostering participation. Moreover, there is the need to change mind-set and culture as to the meaning of what 'national interest' is, on behalf of the whole human family. (**Estanislao)**

On supporting small/local business growth:

Discussion highlighted the challenges of supporting business growth. While development banks can play a role, it is hard to overcome the prevalent disregard of the SME in the lending strategies of banks. In the case of recent ECB targeted funding to stimulate SME borrowing, one must recognize both financial market fragmentation, and little appetite for funding on the part of the SME (**Bonnici**). The common practice of banks' disregarding micro-enterprises especially needs correction. These particular businesses represent 50% of enterprises and 30% of employment in Europe, but they are normally dealt with as if they were households, and treated within the retail business activities of banks **(Dembinski).** Strong local roots are very important in order to improve the process of evaluating the creditworthiness of Small Medium Enterprises as the positive experience of the cooperative banking system in Europe shows **(Marseguerra)**. Unfortunately, retaining locally high quality staff with in-depth local knowledge can be problematic, because larger, more central institutions can offer better salaries and conditions **(Coffman)**. Societal driven finance, despite its attractiveness, may face other risks, such as inefficiency and political interference**(Sugranyes)**.

***How can finance serve inclusion and development*:**

Microfinance with around $50b outstanding loans, is a good example among the ways finance can help fight poverty**(Rossi di Montelera) while** modern financial institutions can help avoid the risk of usury (**González Páramo)**.

The discussion highlighted that technological progress in finance can indeed be enabling for the disadvantaged, but it also has problematic aspects that could hinder inclusion **(Fieler)**. Diversity of financial institutions can also be good in principle with different roles played by different kinds of institutions; developing digitalized, non-formal banking may be interesting, but it may fuel the next round of failures (difficult to act against it, as in the Bitcoin case). **(Gonzalzs Páramo)**

***On how to fight corruption and crime*:**

During the discussions it was remarked, that corruption is essentially anti-poor, while rule of law is key for inclusion and justice **(Estanislao).** On the one hand, institutional efforts in fighting crime must be acknowledged and supported within the Church **(Sugranyes) while** on the other, one should consider that illegal actions can be taken despite fines, if expected benefits from illegal behaviour exceed the expected payment of fines **(Costa).**

A serious issue would also be how to protect individuals who want to expose wrongdoings (whistleblowing) **(Costa).** The term 'whistleblowing' was rephrased as protecting the right to disagree **(Gonzalez Páramo)**, expressing cultural disagreement **(Dembinski)**, exercising judgment when they see wrongdoings **(Sugranyes)**.

Moreover, anti-crime policies are clearly necessary but behaviour may be unethical even when not entailing 'criminal' activities **(Gonzalez Páramo)**.

C - Systemic Risk, Regulation and Supervision

C1. Who should bear the cost of deleveraging?

One of the legacies of the current crisis is a mountain of private debt slowly becoming public, which besides contributing to financial fragility, is a serious obstacle to growth and employment. This issue should be seriously addressed in public discussion, as high leverage increases the vulnerability of households, firms and financial institutions to possible shocks. Hence deleveraging is a priority but a costly one. Current financial arrangements put the entire burden of de-leveraging on the borrower, thus severely constraining growth for a long time. Allocating the burden of deleveraging is a key, and the main criterion for apportionment of the burden should be to ensure appropriate growth which can then sustain further debt reduction. In the EU in particular, providing debt relief for households and firms would help to sustain growth; this provision obviously impacts on banks, and in the end requires public funding. Incentives to support deleveraging for growth are weak at present; but efforts are needed to ensure that, in the future, debt contracts are less asymmetrical. Among the proposals are enhanced regulation (so that debt contracts become less asymmetrical); intra-EU fiscal transfers with accountability mechanisms; better informed public opinion (often misled in confusing fiscal problems as the cause not the consequences, of the financial crisis); and finally educating households to sound risk management (because life is not riskless!) and to prudent debt underwriting. (**Pastor**)

C2. Reading recent history: US and European approaches

During the post-crisis period, deleveraging and re-regulation prevailed in both EU and US but as the financial crisis changed into the Eurozone sovereign debt crisis, the relative performance of EU and US diverged. Regarding the underlying causes of divergence, macroeconomic policy (*'austerity' versus 'growth'* oriented policy decisions) seem to have

played a lesser role than more structural explanations (demography included). While the narrative referring to macroeconomic policy decisions was quite different on both sides of the Atlantic, the substance of macroeconomic policy actions was quite similar.

As financial policies, monetary policies, the network of international borrowing and lending and the current account positions and exchange rates dynamics are closely interconnected, no 'optimal' solution is readily available for imitation. Rather, we need to understand better the inter-sectoral and international transmission channels of domestic policies of large countries such as the US and EU by monitoring the structure of inter-institutional, international financial networks. The bottom line is that no 'strictly financial' solution to financial crises is viable.

Post-crisis re-regulation also followed similar trends with subtle differences in normative details between countries, which still allow regulation arbitrage and regulation gaming, benefitting large financial institutions with respect to locally 'connected' finance. Increased inequality, especially within-country inequality (with a clear North-South divide in the Eurozone), was also a common trend, due also to asymmetrical concentration of financial adjustment costs on the weakest partner (typically the debtor). Hence, more debtor-friendly deleveraging procedures could be explored. In all cases, inequality is likely to persist and to feed a vicious circle of marginalization and exclusion, further increasing systemic risk. This urgent problem needs to be tackled with an 'investment' approach which leads to a crucial, largely unaddressed issue in reforming finance within the so-called advanced countries: namely, how finance can contribute to providing inclusive growth, even in intergenerational and international perspectives. (**Beretta**)

C3. Balance sheet leveraging rules, credit risk assumptions and profit levels

As to financial regulation and systemic performance, one should note that banks play a critical role in the communities in which they operate: on the one hand, ample and reasonably priced credit is critical for business growth; on the other, deposits are essential stores of value for households. Financial deregulation weakened the virtuous link between banks and communities, as leveraged institutions focused on maximizing the short term return to shareholders. During the downswing, losses were similarly amplified with the degree of

leverage, and the sovereign debt crisis and banking problems fed on each other in a negative feedback loop that spread across national jurisdictions.

The fundamental overhaul of the regulatory and supervisory framework of the financial sector in the post-crisis period included ambitious new standards to limit excessive risk-taking and increase the banking sector's resilience. Recognising the global nature of the financial system, the reforms were coordinated globally at the G20 level. A significant part of the EU reform agenda has therefore been about implementing the G20 commitments, including measures to restrain bankers' bonuses and boost the amount of funds that banks hold in reserve. The establishment of the Single Supervisory Mechanism (SSM) in late 2014 is an important step towards a banking union in Europe with a view to establishing a common deposit guarantee system and a common resolution fund. Through the SSM, the European Central Bank is given the power to monitor all the major banks within the euro area thus avoid the weak regulatory stance of some national jurisdictions. In this framework, institutions such as development banks (including the European Investment Bank) can support local investment to play a remedial role because of the failure of monetary policy to extend into faster credit growth, as well as insufficient fiscal transfers in the euro area. Development banks in fact can channel cheap and accessible funds to investments or business growth where they are needed (SMEs, social housing, education, research and environmental investment), thus compensating also for the very low investment levels in the euro area and promoting inclusion, as low growth disproportionately hurts the poor. (**Bonnici)**

C4. A realistic framework for financial international governance

Interdependence and interconnectedness brought about by globalization are global challenges in a world where governance remains to a large extent local. How to develop a realistic framework for international financial governance? Two intriguing policy recommendations have been put forward: one is the realization of a global political authority in order to achieve "a fair distribution of world wealth, which may also derive from unprecedented forms of global fiscal solidarity" ("Towards Reforming the International Financial and Monetary Systems in the Context of a Global Public Authority"). The second proposal for improving financial governances by Thomas Piketty, comes in the form of a global tax on capital. This proposal requires international collaboration, unlikely to be forthcoming at the global level; but a more modest proposal with a regional implementation

might be feasible. Both recommendations offer pragmatic ideas for possible ways forward to bridge the financial and international governance deficit.
A realistic framework proposal can also be drawn from the European experience. First, it would require properly constructed institutions. The completion of the European monetary union (by way of banking, economic, fiscal and political union, embodying the principle of subsidiarity) represents a feasible path. Secondly, policy tools such as monetary policy innovation, a six-pack of economic measures, surveillance of national fiscal and economic imbalances) can contribute effectively to enhancing international financial governance. Regionalism might be an essential intermediate step in building up global financial governance. Finally, greater attention needs to be given to values in particular to the amalgamation of solidarity and subsidiary, as experience to date has painfully shown, institutions alone cannot guarantee good governance. Instead of a tax, a constructive charge on financial turnover was proposed: This charge would envisage voluntary contributions and would finance a solidarity fund to support meritorious causes, especially in favor of communities that were negatively impacted by financial malpractices. **(Bonnici)**

Discussion - Section C

***On the ethical dimensions of deleveraging*:**
The debate on deleveraging highlighted the fact that debt management is an intrinsically contentious ethical issue, between the duty to repay debt and the need for fairness in dealing with debt problems. Good intentions, leading to easy credit to disadvantaged groups, can lead to disaster, as in the subprime loans crisis **(Gonzalez Páramo)**.
Debtor friendly deleveraging should be cautiously considered, especially for the macro level, where issues are sovereign debt restructuring and access to new finance flows **(Schulte)**; in general, there would be the need for debtor/creditor friendly deleveraging, that is for a ‘fair’ deleveraging **(Pammolli)**, or a ‘responsible’ deleveraging **(Gonzalez Páramo),** or an ‘equitable’ deleveraging **(Dembinski)**.
In particular, one should highlight the connection between bank debt and household debt, especially in the case of house price bubbles. This is important in the EU, for both post crisis management (debt relief for households impacts on banks, and governments need to step in) and for preventing further crises. The latter task requires both enhanced regulations (prudence) and increased intra-EU fiscal transfers, better information for public opinion (often misled to think that fiscal problems were at the root of the EU crisis); consumers’

education along with stricter lending standards, and the introduction of new mortgage products (as contracts envisaging "leave the house and go" procedure in case of default) **(Pastor)**.

***On the macroeconomic dimension of deleveraging*:**

Deleveraging needs to balance stability and growth, prudence and innovation **(Garonna)**. Sustaining consumption growth may not increase GDP in the same country, as globalization of production implies that states do not control corporate behaviour **(Ridpath)**, and multilateral corporation tend to come and disappear, thus eroding national tax bases **(Martin)**.

With the deleveraging process, real wages tend to decline and the central bank cannot control the cycle by moving interest rates **(Coffman)**.

The notion of dynamic solidarity that was explored during the Centesimus Annus Foundation Seminar in Rome in May 2014, embodies a mature perspective for debt management promoting social justice, considering not only redistribution within the current generation, but also intergenerational imbalances (wealth transmission, cost sharing), and implicit liabilities (such as those related to pay- as-you-go pension schemes under the current demographic trends). Hence, the deleveraging process does not refer to a static amount of debt **(Pammolli)**.

***On bank equity and profit levels*:**

Return on Equity is likely to be very low in the future, but this should be considered along with the fact that a high ROE creates problems **(Gonzalez Páramo)**; if ROE systematically exceeds the economy's growth rate, de-linking and possibly collapse will follow **(Costa).**

Under-dimensioned bank equity remains a big flaw in the banking system **(Bonnici).** Between 1900 and today, capital ratios decreased from 25% to 7%, while profit ratios increased from 12% to 30%, alongside an increase in profit volatility **(Pastor)**.

***On appropriate supervision and regulation frameworks*:**

We need to assume a pro-market approach which implies regulation – not over-regulation. Regulation alone though is no guarantee of 'good' finance, and discerning right from wrong is more important than distinguishing compliance from non-compliance with formal rules **(Zahra).** Reforming structures is just a part of the solution **(Rossi di Montelera)**.

Some voices pointed to possible negative side effects of excessive regulations: when regulatory intensity on banks is very high, liquidity and credit allocation move to "shadow" banking – simply relocating the problem **(Vanni d'Archirafi)**. Shadow banking may exhibit a scary face, but can also be a genuine way to promote peer to peer lending – as in the case of Credit Unions organized by the Anglican Church. Licensing a new bank may take up to 5 years **(Ridpath)**. Massive, detailed regulation may curb desirable services; for example, complying with regulatory aspects may be costly to a point that compliance tends to penalize access to credit for Small Medium Enterprises **(Fieler)**. Moreover, one should ask: who regulates the regulator, and how to reduce the cost of public administration? **(Rossi di Montelera)**.

Despite possible drawbacks of excessive regulation, one should remember that the bulk of financial transactions (in foreign exchange, derivatives, bonds) are still unregulated – which is a problem, as trust comes from predictability. We need to avoid leaving financial markets to regulators alone – or to markets themselves; we need to find ways to meaningfully include civil society **(Pujos)**.

Banking, as other essential services (such as water, electricity, transport provision), may go through exuberance and excesses. Utilities went through forms of nationalization, and re-privatization as regulated competing initiatives with limited profitability. A similar process can be both desirable and possible for finance **(Costa)**. Yet regulation reforms face strong resistance, as unconditionally bailed-out banks still form the strongest lobbying group and at times exhibit arrogant attitudes **(Pujos)**. Estimates suggest $13million a day for lobbying **(Pastor)**. While lobbying is not wrong in principle, compliance and transparency are required for it to be acceptable **(Gonzalez Páramo)**.

***On Central Bank independence*:**

Central Bank independence does not exclude accountability: the European Central Bank is accountable to the EU Parliament and to society at large **(Schulte)**. The appropriate meaning of Central Bank independence is independence from political control not from societal control **(Costa)**.

Over the past decades, monetary and financial systems underwent extensive swings in regulation and in the degree of central bank independence, as countries distanced themselves from situations where Central Bank dependence on government could be exploited and lead to unsound macroeconomic policies. One needs to realistically acknowledge that a perfect system is impossible, yet progress is noticeable. **(Bonnici)**.

Finding the appropriate balance vis-à-vis the degree of Central Bank independence and the level of regulation is important, but even more important is the quality of the persons in charge, their culture and the human education they received in their family **(Zahra)**.

<u>On European and global financial governance</u>:

While one could be sceptical about world governance, the EU experience with financial governance is quite significant, although it is still work in progress. It still requires balancing common discipline and intra-EU transfers, and satisfactory communication to a largely national public opinion. Yet recent action by EU institutions show a degree of subsidiarity and solidarity that should not be overlooked **(Schulte)**.

In particular, one should recognize progress in dealing with EU institutional reform for financial stability. The newly created EU financial supervisory arrangements provide for standardized assessment of banks; the recent results, showing a significant strengthening of banks' positions, point to a safer financial system in Europe **(Bonnici)**.

Despite success, a "siege" mentality currently prevails in the EU, due to both public opinion sensitivity to financial wrongdoings and to unsustainable levels of long term unemployment **(Sugranyes)**. Thus the process of EU unification remains incomplete and fragile being exposed to changes in political majorities **(Bonnici)**.

Risk also exists in local banks: our capability to assess systemic risk, even at the regional level, should be improved **(Pammolli)**. Systemic complexity remains an issue that calls for humility. We should recognize complexity and pursue simplification, as societies may even collapse under excessive complexity! Transparency by itself is no solution to complexity **(Dembinski)**.

Single supervision is indeed key in addressing the 'too big to fail' issue. At the global level, a world authority would be required for single supervision; while it may not be happening soon, one should keep the idea in mind so that it can be achieved when times are favourable **(Ceyssens)**. At the global level, we can appreciate initial but significant elements of 'global' common rules, for example in the fields of ISO (international quality standards) or of international accounting rules **(Sugranyes)**.

<u>On finance and the global common good</u>**:**

The most urgent tasks in clarifying the global common good are addressing poverty and inequality and promoting inclusion. This is a call to all persons and institutions, including financial institutions, and much remains to be done. We are facing fragmentation and

paralysis of politics **(Martin)**, and inequality is so high that something must be done to contrast it **(Bonnici).** Financial exclusion is a part of the bigger problem of inequality **(Felice)**. The practical proposal of a solidarity contribution suggested by **Bonnici**, was also appreciated and discussed. Solidarity taxation is actually foreseen in different religious traditions; and solidarity contributions may be allocated to job creation, especially for unemployed youth **(Martin).** Moreover, the aforementioned notion of dynamic solidarity, developed in the May 2014 Centesimus Annus Foundation Seminar includes a proposal which improves on Piketty's views: it explicitly incorporates an intergenerational perspective **(Pammolli)**.

Finance needs to rediscover its mission, and explore how to perform it **(Rossi di Montelera)**. Concerning the recent past, there are broken relationships to be mended: the economic relationship between finance and the real provision of goods and services so that finance can serve productive investment; the social relationship between households/public opinion and banks – so that trust can be rebuilt; and, at the cultural level, the broken relationship between the present and the future. Reconnecting the economy, society and culture is part of a process addressing power asymmetries and complexity; and fostering inclusion – especially of the poor and the young **(Beretta)**.

The common good is about re-building trust in society, humanizing the economy, placing the human family before national interests **(Ridpath)**. It requires leaders with a long term perspective anchored in religion **(Garonna)**. In managing financial institutions for the common good, sensitivity to clients and virtuous leadership are key, as technical expertise is not everything and humility is required. **(Zahra)**

<u>On global governance issues</u>**:**

Pursuing the global common good requires appropriate institutions and processes.

As the structure of civil society is a 'poli-archy', the common good is an intrinsically 'plural' notion, where each institution is called to contribute. Take markets as an example: they will never be perfect institutions, but they can be made more inclusive by day to day action. As to regulations, we need to address who is the ruler and who controls the ruler in a 'stateless' society **(Felice)**.

In thinking about "global" authorities, it is useful to consider that the existing international structures are mainly focused on preserving national interests. So countries may shift to regional approaches when the multilateral perspectives become too attractive as in the case of WTO. Moreover, countries tend to take action for emergencies only if they represent a

threat to their security or national interests as in the case of Ebola; or in the application of the 'responsibility to protect'. At the same time, there is also an effective emerging "global" public opinion, which at times succeeds in bringing about change, as in the case of the Mine Ban Treaty, accepted and opened for signature in 1997, under significant pressures from global public opinion. **(Martin)**

No solution for global (and even European) governance will be found in an unchanging picture. We need to engage in a dynamic approach; but where there is no trust, there will be no positive dynamic. No society can function without generosity and fraternity **(Pastor)**. In other words, pursuing the common good is a matter of activating processes, as "time is greater than space", as in Evangelii gaudium #222) **(Beretta)**.

D – Cautious Lending and Service to Customer

D1. Finance at the Service of the People

While reform efforts are continuing and should be maintained and reinforced, we believe that something important is missing or largely neglected i.e. the focus on the ethics of finance, so that finance can truly be at the service of people. This lack of focus should be corrected by strengthening and rebuilding the ethical foundations of finance and promoting an ethical recapitalization of the industry, the institutional environment and the players and stakeholders of finance.

This needs to be done first of all by considering that change is with us and financial needs are changing. Family models are transformed: single families prevail and young people tend to live alone; territorial mobility and occupational mobility is increasing; new communities are developing, including virtual communities for the young. In this scenario, even the bank tends to become not a location but a package of services.

To deal with these changes, ten critical elements are needed for the rebuilding of ethical capital. They include: knowing the basic financial needs of people (including new customers such as the poor and the virtual communities of the young); promoting financial inclusion and equal opportunities; encouraging financial education; investing in human capital and training; exploiting new technologies; improving and diversifying distribution channels; making consumer protection legislation and all relevant institutions more effective; eradicating fraud, corruption, abuses and malpractice; developing independent, objective and responsible financial institutions; and finally, enhancing universal ethical standards for global finance.

With this in mind, inter-religious dialogue on finance and financial ecumenism should be promoted; the universal Catholic Church has a unique and fundamental role to play in forming the leaders of tomorrow **(Garonna)**.

D2. Customers' interest and information

Poverty of ideas as well as vacuous morality in addressing ethical issues are part of the explanation why traders fail to take these issues seriously. To substantiate what Sustainable Finance could mean, one should mention: 1) a movement for socially and environmentally aware financial practices; 2) a focus on reducing information asymmetries between institutions and customers; 3) a recognition that 'regulatory arbitrage' has been one of the largest sources of profits for the financial services industry and should be curbed; 4) the need to curb the influence of lobbyists for financial service firms; and 5) a focus on financial inclusion and consumer protection. At the micro level, financial literacy is a serious issue; financial education is necessary, but probably this is not enough. Besides the persistence of different sorts of cognitive biases, there is also a question of moral formation. Furthermore there is the challenge to make credit reporting more transparent: much information by credit reporting agencies is erroneous, and financial literacy in itself does not equip customers to read 1200-page contracts, sometimes not easily available to them. At the meso level, regulatory arbitrage also contributes to the socialisation of risk and should be curbed by aligning legal rules and regulations in a transnational and ultimately global context and putting a halt to the toxic 'race to the bottom' in financial centres (tax havens, though destructive, pale in comparison). The financial services lobby, particularly in the UK and USA, has been very proactive in curbing meaningful reform. Moreover, most Anglophone regulatory regimes have a bifurcated structure, where qualified, accredited, or registered investors are exempt from consumer protection laws. When essentially retail investors (with large stock portfolios or IRAs) are induced to accredit themselves, they end up being mis-sold a range of products, including toxic derivatives, with tragic consequences for the real economy. But, since this trading is more lucrative than retail activities, financial institutions have been abandoning the retail space as too expensive and thus jeopardize financial inclusion, which is a key criterion of success. Though microfinance and peer-to-peer lending can be very effective, they can also be predatory and need international standards **(Coffman)**.

D3. Ethics in finance: the Post-crisis Challenge

The post-crisis ethical challenge may be introduced by a quote from Aristotle: "We are what we repeatedly do. Excellence, therefore, is not an act, but a habit". A habit not easily acquired, as it requires both upbringing and perseverance. The financial industry has lost its reputation, but malpractices - which unfortunately are still with us - are less and less tolerated. Transforming ethical assertion into action is the big challenge, as trust is the main 'good' in finance. Ethics goes beyond regulation – actions may be unethical even when they are not illegal. The board and management are the first people responsible for ethical behaviour where transparency, integrity and prudence are key, and corporate governance has to go further than internal controls and compliance.

Supervisors are there as a safeguard; the Supervisory Review and Evaluation Process should consider not just capital and liquidity ratios, but also how sustainable is the business model, and the quality of corporate governance (overall internal framework, corporate risk and culture, the functioning of the management body, remuneration practices, risk management and internal control, information system, recovery planning arrangements). At the industry level, diversity – including a wider range of firms and business models - is valuable, as it is a customer-centric approach. In fact, the financial industry's function is to help companies and people to implement their projects and so contribute to social development. Ethical business is not contrary to profitability given it is an investment in clients' confidence **(Gonzalez Páramo)**.

Discussion - Section D

***<u>Facing the post-crisis ethical challenge</u>*:**

Non-negotiable elements of a desirable social model include: the priority of labour, entrepreneurship, a welfare of opportunities and responsibilities, quality consumption (as opposed to consumerism), and supporting family for intergenerational development **(Marseguerra).** We need to move from "transaction finance" based on anonymous trading, to finance based on relations and partnership over time; in other words, to move from narrow short term efficiency to long term productivity **(Dembinski)**.

In practical terms, we need finance to promote inclusion and address long-term unemployment **(Vanni d'Archirafi).** Identifying and implementing new forms of financing innovation and innovative projects (such as start-ups) is a short term priority **(Tiliacos).**

A complementary line of action focuses on the behaviour of households: promoting savings **(Zahra)**; even 'forcing' people to save enough **(Pammolli)**. More importantly, we need to highlight the importance of the family as the most significant environment where culture, belief, and the attitudes of individuals are formed. **(Zahra)**

In terms of culture and motivations, one 'meso' issue to be addressed is contributing through life long education to professional culture in business, and to public policy culture in governments – so that 'structures for the common good' can prevail, thus correcting existing wicked structures **(Dembinski)**. Trust and generosity including fraternity are needed for societies to function **(Pastor)**. Heeding the call to personal holiness is a condition for finding just structural solutions **(Fieler)**.

Conclusions and recommendations

The final discussion elaborated a possible list of conclusions and recommendations concerning ethics in finance and financial reform aimed at the common good. They were based on a list of key-words emerging from the discussion that had already been summarized in previous sessions. Discussing the list of conclusions and recommendations initially proposed by the Chairman Sugranyes, led to the unanimously agreed "Dublin Proposals on Finance and the Common Good" **which** the reader can consult.

The discussion also elaborated on the specific role of this group, described as a forum where it is possible to initiate processes **(Ceyssens)**; a group which is not a lobby - as it has no special interests to defend, but wants to serve truth **(Sugranyes)** and to improve the knowledge of CSD **(Gattamelata)**. The conclusions formulated by the group should address not just the Catholic community, but business people and bankers at large who have a missionary approach **(Zahra)**. The aim is to work together as an independent, ethically minded group engaged in seeking and testing the principles of Catholic social teaching and pursuing inclusion and social justice **(Martin)**.

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