FONDAZIONE CENTESIMUS ANNUS
PRO PONTIFICE

THE DUBLIN PROPOSALS ON FINANCE AND THE COMMON GOOD

> ***Economy and finance, as instruments, can be used badly when those at the helm are motivated by purely selfish ends. Instruments that are good in themselves can thereby be transformed into harmful ones. But it is man's darkened reason that produces these consequences, not the instrument per se. Therefore it is not the instrument that must be called to account, but individuals, their moral conscience and their personal and social responsibility.***
> *(Benedict XVI, 'Caritas in Veritate' 36).*
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> ***A financial reform open to such ethical considerations would require a vigorous change of approach on the part of political leaders. I urge them to face this challenge with determination and an eye to the future, while not ignoring, of course, the specifics of each case. Money must serve, not rule! The Pope loves everyone, rich and poor alike, but he is obliged in the name of Christ to remind all that the rich must help, respect and promote the poor. I exhort you to generous solidarity and to the return of economics and finance to an ethical approach which favours human beings.***
> *(Francis, 'Evangelii Gaudium' 58)*

Can these statements and other similarly strong appeals inspired by Catholic Social Teaching be followed by practical recommendations? To try and answer this question, the *Centesimus Annus pro Pontifice* Foundation organized two seminars attended by bankers, banking supervisors, financial economists and specialists in financial ethics. A full summary of debates can be found on the Foundation's website www.centesimusannus.org.

In spite of such a diverse composition, the group agreed on a few practical recommendations. These are not all-embracing, they do not pretend to explain the reasons which led the group to agree or expose all the numerous constraints which can make them difficult to apply. The publication of these recommendations aims rather at promoting further debate and elaboration at a time when there is a generally acknowledged need for an ethical renewal of the financial industry.

A. A GENERAL FRAMEWORK

- To be at the service of the human person, economic activity requires an ethical framework. The market can only work within an ethical framework of trust. Wherever the rule of law is not respected, it is almost always the poor who pay the highest price. Unethical behaviour hurts them too. The poor pay the price of corruption; they often pay the price of protectionism; they pay the price of inefficiency in public services and suffer the consequences of financial wrongdoing.

- Whether it be for financial reform or the fight against poverty, the bottom-up approach, which starts from local groups and from the people involved, offers opportunities which need to be systematically constructed and monitored. The bottom-up approach is always complex and sometimes digressive; it demands a governance culture based on personal dignity, concern for the common good, subsidiarity and solidarity; all these demands tie in well with the ethical and social teaching of the Catholic Church. The mainly technical macro-economic solutions are generally of the top-down nature, an area where the Church is not particularly competent. But the governance-culture related solutions, which need to come both from the top down and from the bottom up, are mainly of an ethical and social nature and fall well within the duty and responsibility of the Church.

- The debate in developed countries, marked by anxiety and a defensive attitude, is a prisoner of the/warnings threats of sceptics and populism under various forms. It is in the Church's genes to speak from a world-wide standpoint, well beyond the exhausting polemics of purely national discussions. On those lines, it is necessary to recognize and support the extraordinary steps accomplished within the European integration process, especially in the field of instruments and policies for financial reform.

- The publicity about some financial bad practice and the corresponding penalties contributes to a crisis in trust between finance and public opinion. A real "peace building" process is required, in which different parties agree to relinquish some positions and to convert to the goal of the common good. In terms of the financial and economic wellbeing of communities, this specifically means that the values of integrity, honesty and transparency must become part of the fabric of each business, and not just a public relations campaign.

B. GIVING CHANGE IN FINANCE A HUMAN AND ETHICAL PERSPECTIVE

No matter what the verdict is about their past role and the cost of the financial crisis, the fact is that banking and the financial sector are undergoing profound change, both through added regulation and through internally promoted reform. The call to give this reform a human and ethical perspective can be translated into practical ways and processes, both from the micro-economic and macro-economic standpoints. This includes an acknowledged ethical approach to finance, but it also involves another dimension, which can be summarized in the idea of "inclusive finance", i.e. "finance that helps fight exclusion".

1. Begin at the level of the corporation
In order to create ethical sectors or segments of the economy and world finance and thus build ethics into finance as a whole, the proper place to begin is the corporation: there is a human being at the beginning and end of each and every transaction – be it with customers, employees, suppliers or shareholders. This needs to be recognized, sometimes against the demands of technology and regulation, and it requires a change in managerial logics.

2. Helping job creation through decentralized lending
Work is the basic instrument for economic inclusion, and the greatest possibilities of job creation lie at the level of small enterprise and in a more flexible redistribution of employment among adaptable and creative companies. This requires from banking and financial institutions a renewed approach to decentralized lending, which can come about either through greater autonomy of local branches or through non-regulated credit intermediation. The process is complex when at the same time more cautious underwriting conditions need to be applied and when excessive regulation can lead borrowers to use less secure financial resources. Existing banks and credit institutions need to make this an objective and lead the process towards more personalized and decentralized lending to small and medium-sized businesses and to reorganization projects with one or several SMEs.

3. Seek reasonable levels of return on equity in banking and finance
A business model based on very high expected returns on equity that require excessive leverage must be revised. The financial sector must build a new business model, with reasonable risk-based return targets, consistent with the banks' essential role in economic development, but not excessively different from levels of profitability in the economy as a whole.

4. Fighting fraud, corruption, abuses and malpractice
To rebuild trust towards the financial sector it is essential that more comprehensive and balanced information be offered to all by the financial sector itself. Practices based on 'regulatory arbitrage' (taking advantage of differences in regulations) should be voluntarily curtailed. The Church's support is needed to clearly denounce fraud and corruption, especially through money-laundering.

5. Make consumer protection more effective
The complexity of financial products and processes in a globalized world require transparency, i.e. that financial institutions simplify and clarify product information and protection in such a way that consumers can clearly understand the risks and benefits involved. The way investors are categorized as "retail customers" requiring protection or as apparently well informed customers must be reconsidered in order to avoid risky mis-selling to unprepared institutions.

6. Explore fair and equitable deleveraging for households
Financial institutions need to maintain the ethical principle that "debts are there to be paid". However, to the extent that excessive leverage, especially in households, is a serious obstacle to healthy consumption, fair and equitable deleveraging should become a common policy where both creditors and debtors share the risk and the level playing field is respected among all financial institutions.

7. Integrate intergenerational perspective
All financial reform proposals, including those concerning bank bail-in and bail-out processes must take into account the effects on pension funds and the sharing of risk between present earners, pensioners and future generations.

8. Mobilize banks' expertise in the service of inclusive finance
Some are convinced that large banks can become leaders in the building of ethics into finance; others believe this will require the creation of smaller entities. In any case, and despite recent shortcomings, financial institutions have also become what they are in developing processes of risk reduction through diversification, good reporting and control, productive use of limited financial resources, applied technology and intensive training of personnel. These achievements can be of enormous value in the construction of a financial sector which helps fight exclusion.

C. FINANCE FOR THE POOR

9. Support financial institutions with a strong orientation to social development
Financial institutions with a strong development orientation have a supportive role to play: they can help identify emerging enterprises, they can prepare them for entry into capital markets and they can facilitate the organization of funds where small enterprises can have easy participative access.

10. Help and guide microfinance
Involvement of global financial institutions from developed countries can help control microfinance –avoiding the risk of usury – and help develop microcredit to deepen financial inclusion through programmes of partnership covering a whole range of suppliers.

11. Use mobile money for inclusion
Mobile devices and the broadening acceptance of digital money are a significant tool in fighting financial exclusion. Digitizing government disbursements, health services and supply chains can be decisive for inclusion and set the groundwork for further developments in credit, savings and insurance at the service of development.

12. Promote a solidarity fund rather than levies on financial turnover or capital
There is concern about inequalities growing wider among or even within countries, which leads many to support proposals for an international tax on financial turnover or on capital; but these would be difficult to apply and could be confiscatory. The Church could support and promote the idea of voluntary charges that would not end in the coffers of governments, but in an independent world-wide solidarity fund to support meritorious causes at the service of the poor.

D. ETHICS, MOTIVATION AND EDUCATION

13. Make unethical behaviour prohibitively expensive
A true construction of financial ethics can only be obtained through corporate-led internal change and education of the young. In the meantime, regulators are also focusing on ethics; while it is difficult to drive ethical behaviour through regulation,

unethical behaviour can however be made prohibitively expensive, both through regulation and internal corporate governance.

14. Set long term incentives

Incentives and bonus policies should be linked to long term group objectives, and never to short term profit performance. The incentive structure should be independent from short term share price performance.

15. Enrich business and financial education

Business and financial education should include substantially more history and philosophy to avoid transmitting an apparently “neutral” or “value-free” framework and to cultivate the capacity for critical analysis. This is in the interest of students and the financial industry’s sustainability. Teachers in these subjects should be valued and better remunerated.

16. Educate for free judgment

Financial institutions should establish the necessary structures to allow employees to express their concerns in a free and protected way. They should also feel encouraged to channel their suggestions for improvement.

17. Promote consumer education

To rebuild long term trust the financial sector should help in setting up initiatives for consumer education and financial literacy, especially from the point of view of family stability and careful financial management of family resources.

18. Reinvent mission and motivation

The financial sector needs to motivate young people to work in financial institutions; this will not be easily managed without rediscovering and reformulating a mission statement, where the financial sector, far from remaining enclosed and focused on itself, puts itself at the service of the entire economy and society: finance with a purpose.

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