How to make finance serve society

Finance Watch

Vision for a Reformed Financial System

Where we stand today

The fundamental reform of the financial system that was promised after the 2007/8 crisis has not been delivered. **New rules introduced have already been heavily watered down thanks to the powerful influence of the financial lobby**. More importantly, though, these rules have not clarified that the purpose of the financial system should be to serve the real economy and society, or addressed its size and reach. Financial firms therefore continue to privatise gains for activities that have no social benefit, whilst socialising losses. It also means that the new rules have not resolved the first issue they set out to tackle: the stability of the financial system.

This **unstable financial system** is also propping up an unfair, unequal society and an unsustainable economy. The warning signs that business as usual will not work are clear. The **rising gap between the wealthiest and poorest parts of society is made worse by a lot of the rent-seeking activities of the financial sector**. It is also contributing to the increasingly present and worsening effects of **climate change** on the environment by supporting the brown economy, as brown projects are more profitable. This will not change whilst fossil fuel subsidies and a very low carbon price continue to exist. We are sleepwalking into future financial crises and environmental collapse. The financial firms that operate the system have not been held to account for the last crisis and are not being held to account for the current issues in the system. This has to change immediately if the system is going to change.

Why we need change now

More and more of Europe's citizens are demanding change. They are voting against the status quo and business as usual. By changing the financial system we can use finance as a tool to address the **pressing and linked economic, societal and environmental issues** that urgently need to be solved for all citizens. We need to shift the power balance to collectively shape a new financial system that citizens can trust and support, that delivers a fair and sustainable future. It will ensure that multiple future crises do not break out and bring serious consequences for society.

What needs to be done

REFORM THE FINANCIAL SYSTEM

In order to restore the purpose of a financial system that serves society, we urgently need to make it more stable, to deconcentrate economic activity and risks, to find a better balance between public and private finance, to encourage long-term investment, to make its activities and impact on society and the environment more transparent and its actors accountable.

Financial institutions need to shrink to a size that is bearable for society and to become more diversified, which allows the system as a whole to be more resilient and to better absorb shocks.

Finance needs to go back to being simple and boring. An important part of this is ensuring that citizens are offered the financial products and services they need to participate fully and equally in society. These products and services should be simple, easy to understand, transparent, accessible, affordable and suitable for all citizens.

FINANCE A SUSTAINABLE ECONOMY AND SOCIETY

We need to re-direct capital to where it is needed for society as a whole. The most effective way of redirecting financial flows is to regulate and ensure that economic regulation is aligned with a democratically defined economic project.

To do this we have to redefine the role of central banks, individual banks and the financial system as a whole. They can be the driving force to shift investment towards building a sustainable economy and society. A high price on carbon (something that policy instruments have failed to deliver so far) and a high price on damaging the environment would help re-direct flows to a 1.5°C economy, that respects biodiversity and ecosystems. Such a high carbon price, or other tax, has to be first imposed on those firms, and their shareholders and financiers, which pollute most, so as to not put the burden of an energy transition on the poorest and citizens in general.

BUILD ON CONCRETE SUCCESS STORIES

There are sustainable finance pioneers who have proven that stable and ethical business models work. They are examples of how finance can enable the transition to a sustainable and inclusive economy. These pioneers need to be promoted, the ingredients of their success need to be shared and incentives put in place to replicate and scale up their achievements.

Our demands

To bring about the change we need,
Finance Watch makes these concrete reform proposals to the financial system:

STABILIZE

Stability needs to be ensured as it has an impact that goes beyond the prudential perspective. Instability affects the time-horizon of investors and lenders, encouraging them to focus on the short-term.

Policy measures:

- Ensure that no financial firm is too big to fail including by proposing legislation to separate traditional banking and investment banking activities.
- Regulate the governance of financial firms so that risks and stranded assets from social and environmental damage are avoided.
- Introduce regulation to discourage harmful speculation and credit-fuelled bubbles.
    - Implement proposals to regulate all shadow banking and reduce the amount of shadow banking activity by curbing the re-use of collateral and set minimum haircuts in securities financing transactions.
    - Introduce an EU-wide Financial Transaction Tax.
    - Bring an end to tranching of securities and prevent securitisation in infrastructure.

DEMOCRATIZE

Large, shareholder-owned financial institutions have little democratic accountability and are disconnected from a broader, coherent economic vision. We need more mission-oriented financial institutions such as public, development, community-based, stakeholder-owned and ethical banks, impact investors, among others. This will allow citizens to have a positive impact by putting their money into a range of different local, ethical, sustainable projects. We also need to ensure that finance serves the needs of all citizens, by achieving social inclusion and avoiding societal detriment.

Policy measures:

- Make private financial institutions accountable for the impact of their lending and investments on the UN Sustainable Development Goals, starting by implementing mandatory reporting of such impacts.

- Ensure a diverse banking sector by promoting small, local, community and ethical banks, different ownership structures and the representation of a broad range of stakeholders.
- Free up public investment capacity by adapting deficit rules, changing spending priorities and/or strengthening tax revenues.
- Investigate and if necessary redefine State aid rules and fiscal accounting in order to remove potential barriers to public banking.
- Increase the accountability of the ECB to the European Parliament as regards the effects of their policy on inequality, climate change, environmental depletion and sustainable development of the EU economies and societies.
- Ensure that all citizens have access to a set of basic financial services that are needed to fully and equally participate in society.
- Ensure that the public interest in properly represented in the regulation of the financial system, through sufficient representation of civil society organisations in expert and stakeholder groups and the transparency of the legislative process.
- Reduce the influence of the financial lobby by setting limits on access to policymakers, regulators, supervisors and politicians who should guarantee integrity of legislation and prioritise public and citizens' interests.

REDIRECT

We need to use all adequate means to shift capital flows from unsustainable to sustainable and socially responsible lending & investments, including alignment with biodiversity and ecosystems restoration and conservation: from economic to financial regulation, various penalties and incentives, improved reporting, increased consumer demand and financial employees engagement, among others.

Policy measures:

- Ensure that the EU Action Plan on Financing Sustainable Growth takes clear steps towards meeting the Paris climate objectives and the UN Sustainable Development Goals. All legislation should be aiming at phasing out the lending and investing in all social and environmentally damaging activities. This includes mandatory social, environmental and governance (ESG) impact assessments of all activities to be financed on the economy and society, throughout the lifetime of the loan/investment and beyond, including through due diligence and prudent person principles of all activities.
    - Ensure an ambitious and mandatory EU Taxonomy that fully integrates all social and environmental criteria.
    - Ensure that EU eco-labels for financial products will only be awarded to environmentally performing financial products beyond doing no harm.
    - Ensure that the reporting of non-financial information is subject to a mandatory, common and harmonised reporting framework.
    - Ensure that the scope of the set of legislations incorporates not only climate-related, but also environment-related, social and human rights risks and metrics.

- Ensure that central banks integrate climate and environment-related risks and impacts, as well as risks to raising inequality in the conduct of their monetary policy and prudential supervision tasks.
- Ensure that regulators properly take into account climate, social and environment -related risks and make full use of their micro- and macro-prudential tools – such as additional capital requirements, capital buffers, sectoral leverage ratios, credit guidance, large exposure limits and stress tests.

PREPARE

The long term effects of the current experimental monetary policy are still unclear, but what is certain, is that our economies have not recovered from the last financial crisis. Economic, business and credit cycles are indicating that we are overdue for another downturn, yet the decisions of policy makers do not reflect this situation.

Policy measures:

- Set up contingency plans to deal with another financial/economic crisis.
- Review the current regulatory instruments and ensure they are operational in the event of a major crisis.
- Build up national deposit guarantee schemes to sufficient levels and reduce the levels of non-performing loans to be able to eventually phase in the European Deposit Insurance Scheme.
- Ensure the full and proper use of the single resolution mechanism and avoid further precautionary recapitalisation.
- Reduce operational risk through strengthened governance, end the shifting of responsibility down the organisational hierarchy and ensure staff of financial firms are given the resources, time and training they need to properly meet necessary regulatory requirements.
- Improve the current stress testing to include not only banks, to include ESG factors and forward looking scenarios.
- Ensure the security and integrity of financial services IT infrastructure, which is essential for the protection of critical IT infrastructures at the national and European level.

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