

Triodos Bank on Money and Debt

Position paper for the round table discussion 'Money and Debt' with the Dutch Parliamentary Standing Committee on Finance, 13 June 2019

This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by:

(...)

(c) Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.' (Paris Agreement, Article 2)

Our monetary and financial system

The report by the Netherlands Scientific Council for Government Policy (WRR) 'Money and Debt. The Public Role of Banks' (2019) contains a broad analysis of our monetary and financial system and its shortcomings. It is valuable that the WRR also highlights the fundamental discussion about the current method of money creation. Triodos Bank recognises much in the analysis and recommendations of the WRR. The two key problems in our current system are the large amount of private debt and the imbalance between public and private interests. Important steps will be possible and necessary in the coming years to make the monetary financial system more responsive to current social challenges. We also see opportunities for greater stability and diversity.

Social service: transition to a sustainable and inclusive economy

The WRR rightly points to the paradox that while an increasing proportion of the banking sector has become a commercial institution over the past 50 years, the banking sector has - unnoticed - become increasingly of public importance. The WRR therefore recommends that the public dimension of banks become better embedded and that the interests of society are safeguarded.

The conscious handling of money and credit is at the heart of Triodos Bank's mission. Together with many colleagues in the international community of values driven banks (the Global Alliance for Banking on Values, GABV), we finance companies and projects that contribute to broad prosperity (people, planet, prosperity) with a long-term perspective. By considering impact, risk and return, we try to give substance to the central function of the financial system in an optimal and transparent way: service to society and the real economy. The social task of achieving a sustainable and inclusive economy is a major one and requires a substantial effort from financial institutions.

All financing is impact financing. Financing decisions always have an impact on the development of the economy and society. It is important that financial institutions act accordingly. Because time is running out. For example, with regard to climate change, there are no visible signs of any change. Global emissions of greenhouse gases are still rising, the impact on ecosystems - the indispensable foundation of our economy and society - is greater than previously anticipated, and limiting the global temperature increase to an average of 1.5 °C, as recommended by the Intergovernmental Panel on Climate Change (IPCC, 2018), is not yet in sight.

In addition, the United Nations Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES, 2019) recently published an alarming report on biodiversity. There are also challenges in the areas of food and agriculture. Financial institutions can make a significant contribution to the necessary transition to a system in which agriculture works together with nature, healthy food is promoted, and prosperity is fairly distributed.

These challenges are part of the broader global agenda for 2030 as set out in the Sustainable Development Goals (2015). These goals embrace not only a sustainable, but also an inclusive society in which everyone has the opportunity to participate through, for example, good education and health, and without poverty and hunger. Triodos Bank uses this SDG agenda as a guide when assessing proposals for reform of the monetary financial system.

Combating climate change and other challenges facing society requires the reorientation of private financial flows and the adaptation of the monetary and financial landscape. The Draft Climate Agreement in the Netherlands is a step in the right direction, which Triodos Bank has gladly supported. Financial institutions have demonstrated their willingness to make a clear commitment to the objectives of this agreement. The Netherlands can be proud of that.

Private resources are needed to finance the transition to a climate-neutral economy and society, and this requires maximum willingness on the part of financial institutions to play a facilitating role. In addition, institutions must continually and energetically work to reduce current financing of and investments in the old fossil economy. Explaining the 'carbon footprint' of relevant financing and investments, and formulating reduction targets, enables the institutions to get a grip on this. The supervisory authority (DNB) is also calling for urgent attention to be paid to this issue. In this way, the financial sector contributes to the transition, and transition risks are controlled, which contributes to financial stability.

In this context, Triodos Bank recommends that the European Central Bank also adopt such a methodology so that purchases made by the ECB under QE as well as the resolution of these portfolios are brought into line with the objectives of the Paris Agreement.

There are various options for linking financial institutions more firmly to the challenges currently facing society. Balanced governance with a sufficient focus on the long term is relevant here. This requires reinforcing the long-term perspective of shareholders. The structure of Triodos Bank is an example of this. Another suggestion is to strengthen the dialogue with stakeholders in order to give society a voice in the financial sector and in specific institutions. This can be done by means of a Social Advisory Board - as recommended by the WRR - which serves to emphasise the fact that a bank is not an 'ordinary' company.

Sound European financial rules and supervision can also make a difference. On the occasion of the review of the EU capital rules for banks (2018), Triodos Bank advocated a capital surcharge for fossil fuel investments. In response to the ongoing debate on a sustainable European taxonomy (part of the EU Action Plan on Sustainable Finance), we expressed our concerns in a letter to the Minister of Finance (copy sent to the Standing Committee on Finance). We fear a limited taxonomy that will mainly lead to more rules for those leading the way towards a green future, but will not contribute to the desired shift from private financing to the sustainable economy.

Money creation and debt levels

As the WRR rightly points out, the current monetary and financial system is the product of a long evolution, in which the creation of money has increasingly ended up in the hands of private banks. Nowadays, the creation of money almost always goes hand in hand with the creation of debt by private banks.

This may seem odd, because many people would initially consider money creation to be a public function to be managed by the government (or central bank). In response to this, various proposals are circulating (such as the Chicago Plan) that aim - among other goals, such as the prevention of bank runs - to bring the creation of money entirely into public hands. This is a fundamental change to the current system that, whilst it may offer opportunities, also raises many questions. For example, it is difficult to imagine the introduction of

'debt free' money, since social trust in money is ultimately always based on an (implicit) claim against third parties or the community.

The required transition to a (fully) public money system is such a big step that a better understanding of the social effects is desirable. In Triodos Bank's opinion, the discussion on this subject has not yet progressed that far. Parallel currencies or circular money probably offer more opportunities at the moment, because they can contribute to diversity and economic stability. For example, Triodos Bank is participating in the 'United', a pilot project with its own currency that is used for transactions between sustainable entrepreneurs in the Netherlands (United Economy).

Money creation via private financing is – fortunately - not possible indefinitely. Banks are constrained in different ways in the extent to which they create money and debt. There must be demand for credit and the government imposes prudential restrictions in the form of capital, leverage and liquidity ratios, with the leverage ratio in particular being relatively low.

The fact that the share of private debt in the economy has grown so much in recent decades is an issue that deserves the attention of those with political power. As the WRR rightly points out, financial deregulation, innovation (such as securitisation), tax incentives for debt capital, the VAT exemption for financial services, the (very) low inflation rate and compulsory pension savings have contributed to such high levels of debt that they can have a disruptive effect on the economy, especially now that this accumulation of debt is increasingly concentrated with families (mortgages) and financial institutions (finance for finance). The low interest rate to which many commitments have been made in recent years is also a potentially threatening factor. Triodos Bank recommends that the Minister of Finance draw up an agenda for sustainable private debt levels in which all the above elements are included. In addition to more equity (taxation) and controlled use of pension assets when purchasing a home, Triodos Bank believes that a further – gradual - adjustment of the mortgage interest deduction should be considered. The degree of sustainability (see the Built Environment chapter of the Draft Climate Agreement) will have to play an increasingly important role in the valuation of homes - relevant for financing.

Concentration, low capital buffers and high regulatory costs

In its position paper on the future of the financial sector to the Finance Committee of the Dutch Parliament (12 December 2018), Triodos Bank had already drawn attention to the low capitalisation (especially the leverage ratio) of the European banking sector. Although capitalisation has improved in recent years, it is clear that the buffers will have to gradually increase.

In addition, diversity in the banking landscape threatens to diminish as a result of increasing concentration. The ECB's preference to create even larger banks contributes to this. We think this is unwise.

This development (high concentration, low buffers) is currently encouraging regulators and supervisors to set more far-reaching supervisory requirements. While sound supervision of banks is of course indispensable and of great public interest, this dynamic is gradually leading to increasingly high(er) supervision costs, in particular for small and medium-sized players. Because of their size, they are actually condemned to the 'standard approach', which leads to much higher capital buffers compared to the large banks. It is common knowledge that greater concentration entails a much higher systemic risk. Increased supervisory costs also lead to higher entry barriers for new entrants and contribute to the creation of shadow banking (outside the scope of supervision). It is therefore very important that proportionality and diversity should be given a prominent place in the policy of the EU and the supervisory authorities. Instead of concentration, de-concentration should guide the ECB's actions in order to reduce systemic risks and reduce the number of systemic banks. Strengthening diversity and competition in the private banking sector and non-bank alternatives such as crowd funding are also relevant routes.

Renewal of the payment infrastructure

Private banks provide the payment infrastructure for the Netherlands. This is a public interest par excellence, but it is highly dependent on the (large) banks without which the payment system cannot function. That public interest proved to be an important reason for political and monetary authorities to keep private banks afloat with taxpayers' money during the financial crisis.

There are good reasons to look at a different, more public anchoring of the payment infrastructure. In view of the great public interest, this system must operate in all circumstances and remain accessible to private individuals and businesses. In addition, the integrity and fraud-proofing of this system must be guaranteed at the highest conceivable level. There is room for improvement here through greater cooperation between the banks themselves and between the banks and the government. In concrete terms, one might consider a 'Bankgirocentrale 2.0' in the form of a separate legal entity - a 'utility', jointly managed by banks and the government - responsible for the (digital) payment infrastructure. This creates efficiency benefits and thus also contributes to diversity because smaller parties can also benefit from the economies of scale. The interface for the customer remains the bank, which can supply the customer, for example, with smart management apps. In this area, competition is most appropriate.

Triodos Bank
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