

## Triodos Bank on the future of the financial sector

Position paper for Round Table Discussion of Standing Committee on Finance of Dutch House of Representatives, 12 December 2018

### Social focus and mission as a guideline

The financial sector is an essential part of society. It should serve the real economy and society as a whole: companies, social institutions, all of us as citizens and consumers. Consequentially, a bank, an insurance company or a pension fund is not an 'ordinary' company. A recognisable anchoring in society is required, as is also evident in every discussion about the role of banks since the financial crisis. Triodos Bank has taken this position since its foundation in 1980. Serving all stakeholders contributes to safeguarding this social role. A business model with a dominant focus on shareholder value or 'finance for finance' does not achieve this.

A social focus and engagement with the social challenges of our time should be the basis for the agenda for the future of the financial sector. This new course can only be successfully charted if financial institutions themselves take up this role and if they can rely on the support of adequate regulations and supervision. This interaction can help to restore public trust in the financial sector. Consciously choosing a new social role will lead to a new culture and set of behaviours in the financial sector. Triodos Bank sees opportunities for the financial sector to better anchor this role.

### Banks and the Sustainable Development Goals

At present, a lot of attention is being paid in the Netherlands and the rest of the world to the relationship between (global) social issues and the role the financial sector should play in addressing them. The Sustainable Development Goals (SDGs) and the Paris Agreement have become essential guidelines for the financial sector. Triodos Bank welcomes this. Together with fellow banks around the world, united in the Global Alliance for Banking on Values (GABV), we ask ourselves every day whether the projects and companies we are being asked to finance add value to society (people, planet, prosperity). This engagement with the real economy and the social agenda is deeply anchored in our mission. This approach creates a win-win situation: In addition to making an optimal contribution to the development of a sustainable, inclusive economy and society – thus answering the call to action to the (financial) business community made by the SDGs – we also see in practice that this approach is an increasingly important factor in assessing the stability of financial institutions. Financial regulators such as De Nederlandsche Bank (DNB) increasingly take this into account when assessing banks, for example when it comes to the impact of climate risks. The SDGs are a great opportunity to engage the financial sector more deeply with the social challenges of our time.

### UN Principles for Responsible Banking

The UN Principles for Responsible Banking (the 'principles' or 'UN PRB') were recently presented in Paris. These principles strengthen the engagement with the SDGs and the Paris Agreement. Banks that endorse the principles are asked to do more than only issuing a non-binding statement of intent, by presenting a plan for how they can improve in order to achieve the positive impact society wants to see. Triodos Bank was closely involved in the development of the UN PRB.

## EU Sustainable Finance agenda

Sustainable Finance is high on the agenda of the European Union. Recently, the Economic and Financial Affairs Council (Ecofin) adopted new rules for banks (CRD5/CRR2). This package includes the possibility for regulators to require higher capital buffers from individual financial institutions in case of inadequate risk management around the climate impact on portfolios ('Pillar 2'). In addition, Brussels is currently looking at addressing various other issues (duty of care, disclosure, taxonomy, etc.), with the aim of ensuring better control over and information about the social impact of financial products and services. Triodos Bank is happy to contribute to these developments by sharing our practical experience. We welcome the banking package as a step forward. The next step should be to impose an automatic capital buffer ('Pillar 1') on banks with an overexposure to fossil assets. Regarding the ongoing debate on taxonomy, we see a risk of focusing exclusively on 'green' definitions, whereas the top priority should now be to correctly identify fossil risks.

## Netherlands: Climate Agreement

There are also opportunities in the ongoing negotiation process around the Dutch Climate Agreement. Triodos Bank advocates a strong commitment from the Dutch financial sector to the emission reduction targets under this agreement. The necessary transition envisaged by the Climate Agreement requires that the financial sector generously facilitates green financing, as well as clear agreements on phasing out the existing fossil portfolios. The second report of the [Platform Carbon Accounting Financials](#) (of a group of financial institutions led by ASN/De Volksbank) recently presented to the House of Representatives provides further insight into the methodology various financial institutions, including Triodos Bank, want to use to calculate the carbon footprint of portfolios. This initiative should be followed up in the Dutch Climate Agreement, with a clear commitment from financial institutions to reduce this footprint (on the basis of, for example, science-based targets). This is crucial to ensuring a dynamic transition to a low-carbon economy and society and will contribute to reducing risks in the institutions.

We encourage the House of Representatives and the government to choose this social agenda as their central focus in formulating an agenda for the future of the (Dutch) financial sector.

## Stability, resilience, serving society and supervision

To further strengthen the stability of the financial sector, we also suggest considering the following points:

- Ten years after the financial crisis of 2008, the (global) volume of debt in relation to the size of the economy is greater than ever before. That is a potential source of instability. In addition, there is a structural surplus of savings linked to the ageing of the populations in the OECD countries, which, in addition to the highly expansive monetary policy of central banks, has a dampening effect on interest rates and – in the absence of sufficient investment opportunities – contributes to the inflation of securities and real estate in various countries and regions. The financial cycle is showing high and increased volatility, as noted in the report "Work in progress ("Werk in uitvoering"), published by the Sustainable Finance Lab in June 2018. This is also a challenge for the Netherlands, which has a very large financial sector.
- Limiting the risks of debt and volatility will not be easy. Diversification in financing (more equity of companies and households), controlling debts and ensuring an effective balance in handling the settlement of problematic debts will be relevant options to consider for policymakers and regulators. In addition, the sustainable transition of the economy and the impact of digital technology on the financial system are not without risks. That is

another reason why it is important that companies and banks must be able to fall back on a solid buffer. Tax incentives for debt financing are undesirable and should be restricted. A good example of this is the thin capitalisation rule.

- The policy response to the 2008 financial crisis has been far-reaching. However, there is room for adjustment and improvement. A sound market organisation and governance, adequate capitalisation and effective (not necessarily more) supervision are the starting points here.
  - A diverse financing landscape is a key pillar of a stable and effective financial system. This concerns not only the type of financing (debt/equity, large/small, specialised/universal institutions) but also the governance model of financial institutions. A banking sector that is predominantly driven by shareholder value is not a good idea. The high returns that are (inevitably) promised to shareholders reduce the desired long-term focus of financiers and contribute to unnecessary risks.
  - Triodos Bank has issued depository receipts for its shares since its foundation in 1980. Stichting Administratiekantoor Aandelen Triodos Bank (SAAT), which manages the Triodos Bank shares, has an independent Board which in exercising its voting right represents not only the interests of the shareholders, but also the interests and continuity of the organisation itself, as well as the social mission of the bank. These principles have been laid down in a charter and this works well in practice. In its advisory report "Restoring Trust" ("Naar herstel van vertrouwen") of April 2009, the Advisory Committee on the Future of Banks (Maas Committee) made sensible recommendations for the shareholder structure and governance of banks that are moving in this direction.
  - Banks fulfil an important social function. The payment system, in particular, is an indispensable utility for society as a whole. Not only the unconditional availability of the payment system, but also the safety and risks of misuse require a great deal of attention from banks and regulators. Digital technology offers opportunities to explore routes to segregate this utility aspect from more risky activities, regarding which PPPs should not be excluded. To ensure a healthy organisation of the financial sector, a distinction between the utility aspect(s) of banking and more risky activities is still urgently needed.
  - Sufficient capitalisation is an important key to a stable financial system. Progress has certainly been made in this respect over the last 10 years, but more is needed. Triodos Bank believes that a steady course towards higher long-term buffers is needed, especially where there is a high exposure to fossil assets. Triodos Bank's leverage ratio has exceeded 8% for many years.
  - Progress has been made with regard to the organisation and design of financial supervision. However, we still see that insufficient attention is paid to strengthening a diverse banking landscape and proportionality in supervision. The risks of 'near-banking', which have a significant impact on the system but fall outside the radar of supervision, also deserve a prominent place on the agenda of policymakers and regulators.
- It is very important that citizens are able to make well-informed choices when they are faced with big financial decisions. It is therefore crucial to provide good (financial) education and support for financial consumers, and to ensure a 'social voice' in the governance of financial institutions.

### Integrity, behaviour and culture

To promote ethical conduct in the financial sector, the following should be considered:

- Triodos Bank believes that a strong social focus contributes to ethical conduct of financial institutions.
- Promoting a culture of integrity within financial institutions starts with the management and is the responsibility of everyone who works in a financial institution.
- Diversity in terms of gender, background and expertise within the management and supervisory functions of financial institutions contributes to a more balanced and broadly supported policy.
- This is first of all the responsibility of the institutions themselves, but attention to this by regulators can help.
- We do not believe in incentives in the form of bonuses or other types of variable remuneration to achieve higher returns. In our view, this conflicts with the social role banks should play.
- A controlled development of remuneration is important to restore society's trust in banks. Determining the desired ratio of the management's remuneration to the average remuneration in the institution and reporting on this are important instruments to achieve this. Triodos Bank also uses these instruments.
- In unwinding the measures the government took in response to the financial crisis, the focus has been – understandably – on optimising shareholder value to achieve a maximum contribution to the treasury and to recoup previously used tax monies. Triodos Bank advocates that the social return should be explicitly taken into account in the further settlement of these interventions.

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