



Towards A Just and Sustainable Financial System: A Summary of Key Friends of the Earth Recommendations

November 13, 2008—The current financial crisis offers a historic opportunity to create new regulations, rules and architecture which create financial systems that support environmentally sustainable and socially just economies. This issue brief summarizes many of Friends of the Earth’s financial policy recommendations that have been offered over the past several years—recommendations that are need now more than ever.

On integrating environmental and social matters into financial regulation.

Banking and lending

- *Bank supervision:* Sustainability-oriented standards should be incorporated into all bank supervision, including the granting of licenses, and the extension of central bank-provided credit and insurance.¹
- *A sustainable Basel Capital Accord:* Banking regulators should mandate the inclusion of environmental and social issues into risk assessment processes for bank financing activities. One possibility is to include a set of sustainability criteria into the Basel Capital Accord’s capital adequacy ratios.²
- *Green screening of customers:* Know Your Customer (KYC) guidelines are anti-money laundering (AML) mechanisms used by banks to screen potential depositors. In a similar vein, “Green KYC” guidelines should be developed, which would require banks to conduct environmental and social due diligence for both commercial depositors and borrowers, with the aim of prohibiting lending to corporations that do not comply with environmental and social laws. In addition, existing AML requirements should be tightened to halt the proceeds of corruption, illicit natural resource deals and tax evasion from entering the financial system.³
- *Transparency:* Banks should be completely transparent about their risk assessment processes, decision-making procedures, clients, and transactions. For example, banks should fully disclose their financing activities in the extractive industries and infrastructure sectors, which often have high environmental and social impacts. In light of widespread public distrust about banks’ intentions, the issue is no longer how much transparency banks can allow, but how much secrecy they can afford. Such transparency is already best practice among some ethical banks.⁴
- *Increase lender liability:* In most countries, lenders generally are not held financially liable for the environmental and social impacts caused by client misconduct. However, as long as lenders remain fully shielded from the environmental and social liabilities of their corporate clients, they will not fully value environmental and social issues when

performing their due diligence and pricing capital. For example, in the past, lender liability laws in the United States have made banks responsible for clean up of hazardous waste disposal sites, especially if such sites are used as collateral for loans. This has prompted the widespread use of environmental impacts assessments among banks for real estate-related transactions.⁵

Securities and investing

- *Disclosure of environmental and social risks:* Securities disclosure laws and accounting standards should require reporting of material environmental, social and other corporate responsibility data.⁶ On an international level, the International Accounting Standards Board (IASB) and the International Organization of Securities Commissions (IOSCO) are currently working to harmonize corporate accounting and disclosure standards across major markets. The IASB and IOSCO should ensure that best practice in environmental and social financial accounting is promoted.⁷
- *Listing standards:* Stock exchanges and securities regulators should require corporate compliance with environmental and social standards as a condition of listing on public exchanges. Companies that are in flagrant violation of environmental, labor, human rights, anti-competition, or other laws should be banned from, or de-listed from, stock exchanges. Environment ministries should have the ability to investigate and approve potential initial public offerings, as is the case in China.⁸
- *Shareholder rights laws:* State and national laws, as well as company bylaws, define shareholder rights, including standards for filing shareholder proposals. Securities regulators should ensure that shareholders have the right to raise environmental and social issues with corporate boards, management, and fellow shareholders through the proxy.
- *Clarifying the definition of fiduciary responsibility:* In many countries, widely-held perceptions of "fiduciary duty" discourage investment managers and trustees from examining the social, economic and environmental dimensions of their investment choices. Regulators should clarify that consideration of environmental, economic and social issues is not in violation of, and in fact could advance the fulfillment of, fiduciary duty. Governments can also expand the definition of fiduciary duty to include the broader well-being of beneficiaries.⁹
- *Incentives for ethical investing:* Regulators should adopt incentives to encourage investment in environmentally and socially beneficial enterprises, and for activities that generate income for the poorest. For example, the Netherlands has introduced tax-free green funds (exempt from interest and dividend income tax) to encourage Dutch citizens to invest in environmentally beneficial projects. Similar incentives could be introduced for institutional investors.¹⁰
- *Disclosure in and of investment products:* In order to inform consumers in their choice of managed investment products, consumers need to know the ethical policies and impacts of such funds. Laws requiring the disclosure of a fund's ethical investment policies, proxy

voting policies and practices, and even portfolio holdings can assist consumers in choosing or benchmarking investment products. In the United Kingdom, pension funds must disclose their ethical investment policies and practices, if any.¹¹

On democratic processes to build a new global financial architecture.

- *Public participation:* All people should have full and meaningful participation in national and international economic decision-making. The public must be an equal stakeholder in deliberative and final decision-making processes.¹²
- *UN-led process:* Friends of the Earth supports a major international conference convened by the UN to review the international financial and monetary architecture, its institutions and its governance, but only if the meeting follows a process that is inclusive and participatory of all governments of the world.¹³
- *Curbing the power of the World Bank, the IMF and the WTO:* Much of the current debate among governments involves enhancing the roles of the Bretton Woods institutions. But the WTO, for example, continues to press for further deregulation and privatization of the financial sector, principally through its General Agreement on Trade in Services. Not only should the WTO's current Doha Round be suspended, but also existing WTO rules constraining regulation of financial services should be rolled back. Likewise, efforts by the IMF and World Bank to expand their influence as a result of the financial, climate, energy and food crises should be rejected. We must rethink the failed system that got us into this mess, not increase our reliance on it.¹⁴

On the restoration of regulation and supervision of the financial services industry.

- *Social license to operate:* Society must regain the means to control and correct financial institutions, and redefine their primary role as investing in the real economy and advancing environmental sustainability. Banks and other financial institutions need to earn their social licenses to operate and provide products and services which serve, rather than harm, the public interest.¹⁵
- *Get banks out of politics:* Decreasing the political influence of financial institutions (and all corporations) is critical.¹⁶ Testifying before the U.S. Congress in 2008, Nobel Prize-winning economist Joseph Stiglitz asserted, "Much of the inadequacy of current regulations and regulatory structures is the result of financial markets' political influence, in many countries through campaign contributions. These deeper political reforms, including campaign finance reform, are an essential part of any successful regulatory reform."¹⁷
- *Eliminate the shadow banking system:* Decades of deregulation have allowed the financial services industry to "innovate" new financial products, structures, and vehicles at an astonishing rate without monitoring and supervision. This has prompted the creation of a shadow banking system which has grown as a result of inadequate regulation, or attempts to circumvent existing rules.

- *No SIVs and SPEs:* It does not make sense to establish regulatory frameworks and reporting standards, while at the same time allowing financiers to evade them through off-the-book transactions. Financiers should not be allowed to create any structured investment vehicles and/or special purpose entities which allow them to avoid regulations.¹⁸
- *Regulate alternative investors,* such as hedge funds and private equity funds, which have for so long successfully evaded regulation, by introducing significant new transparency, reporting, and financial requirements.¹⁹
- *Eliminate tax havens:* Tightening up accounting standards and eliminating offshore tax havens is key to ending the shadow banking system.²⁰ Secrecy jurisdictions are established not only to allow companies, financiers and individuals to evade taxes, but to avoid regulations as well. No jurisdiction should be allowed to continue with its tax haven status. As part of the effort to eliminate such havens, banks should be explicitly prohibited from establishing or conducting transactions with entities based in these jurisdictions.²¹
- *Derivatives:* Only legitimate hedging instruments should be allowed, and they should be standardized and traded in regulated exchanges. The need to curb speculative derivatives trading is particularly critical in food- and energy-related commodities markets.²² Friends of the Earth supports requiring tradable instruments, such as credit default swaps, to be standardized and traded on exchanges, which would subject them to regulation and transparency.²³
- *Restoration of the Glass-Steagall Act:* The Glass-Steagall Act, which regulated the banking and investment industries after the Great Depression, should be reinstated. The repeal of the act in 1999 paved the way for the creation of “too big to fail” financial institutions, massive overleveraging among financial institutions, increased the risk of conflicts of interest, and put consumers’ real savings at risk.²⁴

On reorienting finance from the speculative to the real economy.

- *Reorient finance from speculation to long-term investment:* The rules and institutions of global finance should discourage speculation and encourage long-term investment in the real economy in a form that supports local economic activity, sustainability, equity, and reduces poverty.²⁵ For example, tax benefits could be given for longer-term equity investments.
- *Tax on international financial transactions.* The governments of the world's major currencies should levy a tax on certain international transactions so as to discourage speculative and herd behavior in international capital flows.²⁶ As Friends of the Earth has proposed since 1995, a Tobin-style tax (for example, 0.25 percent tax on stock trading, and 0.02 percent tax on options, futures, swaps, and currency trading) should be introduced to curb excessive speculation and promote longer-term investing that serves the real economy. Tobin-style tax revenue could be used to help pay for the bailout and address critical social and environmental needs.²⁷

On nationalized financial institutions and corporate accountability.

- *Government-owned financial institutions have the ability and responsibility to foster an environmentally sound future:* The National Environmental Policy Act should apply to such entities; this may be required under existing law.
 - o For example, insurance companies such as AIG should cease underwriting all kinds of insurance for fossil fuel energy projects and focus on facilitating a clean energy transformation.
 - o In the future, Fannie Mae and Freddie Mac should institute a policy to require an increasing percentage of the mortgages they purchase to be “green” (location efficient, energy efficient, and/or sustainably designed). It should phase out purchasing mortgages for development in flood plains and coastal hazard zones.²⁸
- *Accountability.* Failing to hold executives accountable for the disastrous consequences of their actions is unconscionable; those who were responsible should be persecuted to the full extent of the law. In the future, fines and penalties for financial and corporate malfeasance must be increased. Executives who mismanaged companies, forcing taxpayers to bail out their firms, should be removed.²⁹
- *Executive compensation:* Executive compensation must be reigned in at all companies that are being bailed out.³⁰ Executive compensation at banks in general should be limited, and the role of bonuses in remuneration systems should be changed so as to reward long-term financial success and the implementation of environmental and social policies and programs. Banks’ perverse incentive structures, like stock-options and short-term, volume oriented bonuses, stimulated excessive risk taking and effectively led to greed-oriented decision-making at banks.³¹

On bailout packages.

- In general, Friends of the Earth opposes the privatization of benefits and the socialization of losses, whether those losses be financial, environmental or social in nature. Taxpayers should not absorb the losses caused by private actors' bad decisions.³²
- Financial institutions should bear the brunt of the losses from this crisis. Taxpayer monies should be used to only cover the bare minimum necessary to keep our banking system and economic system functional. The government should acquire an ownership stake in the institutions that are bailed out, and require deep reforms in the companies and sectors that are rescued.³³
- Bailing out Wall Street banks without making proportionate efforts to keep American families in their homes is unfair. Friends of the Earth supports Chapter 13 judicial modification relief to keep homeowners from losing their homes.³⁴

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- ¹ “Bank to the Future: El Escorial Statement on Banks and the Financial Crisis,” Nov 2008 at http://www.banktrack.org/download/bank_to_the_future/escorial_declaration_final.pdf. Hereafter cited as “Escorial 2008”
- ² Escorial 2008
- ³ Escorial 2008
- ⁴ Escorial 2008
- ⁵ Sustainability and Accountability in the Financial Services Sector: Regulatory and public policy recommendations, 2001 at <http://www.foe.org/camps/intl/financialregs.html>. Hereafter cited as “FOE 2001”
- ⁶ FOE 2001 and Michelle Chan-Fishel, New Economy, Old Accounting: Expanding SEC Disclosure Rules for Investor Protection & Corporate Responsibility, Reporting to the Environmental Regulators: Environmental and Financial Consequences, American Bar Association Section of Environment, Energy, and Resources, 30th Annual Conference on Environmental Law, Keystone, Colorado (Mar. 2001)
- ⁷ FOE 2001
- ⁸ See upcoming report, “The Green Evolution: Environmental Policies and Practice in China’s Banking Sector,” Friends of the Earth, forthcoming, Nov 2008.
- ⁹ FOE 2001
- ¹⁰ FOE 2001
- ¹¹ FOE 2001
- ¹² “A Call to Action: Citizens’ Agenda for Reform of the Global Economic System,” Friends of the Earth, Institute for Policy Studies, International Forum on Globalization, 1999. Hereafter cited as “1999”
- ¹³ Statement on the proposed “Global Summit” to reform the international financial system, 2008 at <http://www.eurodad.org/whatsnew/events.aspx?id=2948>
- ¹⁴ New Principles and Rules To Build an Economic System that Works for People and the Planet, at
- ¹⁵ Escorial 2008
- ¹⁶ Escorial 2008
- ¹⁷ Joseph Stiglitz, Professor, Columbia University, Testimony to House Financial Services Committee, October 21, 2008 at http://www.house.gov/apps/list/hearing/financialsvcs_dem/stiglitz102108.pdf
- ¹⁸ Escorial 2008
- ¹⁹ Escorial 2008 and “Friends of the Earth Opposes Bush’s Blank-Check Bailout” 22 Sept 2008, at http://action.foe.org/t/928/pressRelease.jsp?press_release_KEY=418. Hereafter cited as “Sept 08”
- ²⁰ Sept 2008
- ²¹ Escorial 2008
- ²² Escorial 2008
- ²³ Sept 2008
- ²⁴ Sept 2008
- ²⁵ 1999
- ²⁶ 1999
- ²⁷ Sept 2008
- ²⁸ Sept 2008
- ²⁹ Sept 2008
- ³⁰ Sept 2008
- ³¹ Escorial 2008
- ³² 1999
- ³³ Sept 2008
- ³⁴ 28 Sept 08