EUROPEAN PARLIAMENTARY FINANCIAL SERVICES FORUM

EPFSF Briefing

"The Social and Economic Role of the Financial Sector: using finance to deliver sustainable and environmental development"

Summary

Since 2008, the financial sector has been under a higher scrutiny from policy-makers and society in general. The image of the financial industry has been tarnished and many challenges are still underway. The financial industry's ability to meet society's needs and deliver solutions to outstanding problems has been put into question and the sector is only slowly earning back society's trust through the combined actions and decisions of all actors involved in the financial system.

The financial industry plays a critical role for society at large: serving individuals, families, businesses, governments, civic institutions and other stakeholders. The sector performs indispensable functions such as enabling financial inclusion, facilitating saving and investment, providing protection from risks and supporting the creation of new jobs and enterprises. It is critical that the sector operates to provide these functions for society in a stable, sustainable way, and increases awareness of its activities in this area.

The financial industry can address one of the main societal needs by providing a broad access to financial products and services. In particular, the sector should on the one hand find ways to provide access to financial services to populations across EU Member States, including disadvantaged and low income segments and on the other hand find ways to help educate the public on financial management (of personal finances). Finally, it is important that the sector takes due account of the importance of delivering sustainable and environmentally sound development, in the context of its commercial activities and Corporate Social Responsibility policies.

Social and Financial Inclusion

True financial inclusion means that households and businesses have access and can effectively use appropriate financial services. Such services must be provided responsibly and sustainably, in a well regulated environment.[1] Financial Inclusion is often the key to achieve a better social inclusion; this explains the important role that the financial industry plays in this area.

Improving financial inclusion means that the financial sector should continuously consider to : i) provide appropriate and affordable savings credit and investment products, payment and money transfer services and insurance for low-income segments; ii) expand distribution networks to reach underbanked/underinsured areas especially where the savings gap means individuals are not saving enough for the long term (e.g. physical and other technology-enabled networks) and iii) collaborate with global bodies, local governments and policy-makers to develop a mutually supported strategy for inclusive finance and appropriate standards.

In cases where financial institutions are not able to provide risk-based services, for prudential reasons, they may usefully collaborate with other institutions - such as Microfinance Institutions and public bodies - to find solutions.

To achieve sustainable financial inclusion, the financial sector needs to serve, not only sell to, potential customers at the bottom of the pyramid and earn their loyalty by helping them grow their savings. Moreover, the industry should serve as a vital link between emerging technologies and those who rely on cash. It should also anticipate the emerging needs of underserved audiences, putting them at the heart of financial products and services when they are designed and providing them with financial dignity. Finally the industry should develop cross-sector partnerships whenever possible.

[1] CGAP (Consultative Group to Assist the Poor) definition: http://www.cgap.org/about/faq.

Many solutions and several programs have already been implemented which show that the financial sector is very active in delivering more inclusion of those customers at the bottom of the pyramid.

Financial Literacy

Financial literacy also known as financial education is primarily concerned with the knowledge of how to best manage one's finances. It endeavors to impart information and cultivate understanding while also affecting behavior.[2]

Current models of financial education – including classroom sessions and group instruction for new customers – are time-consuming and not very attractive to the customer. New approaches are nevertheless necessary, since this is a complex and costly issue. New approaches to financial literacy could include online games, mobile apps and "just in time" text messages.

The industry also needs to tailor financial literacy programs to new financial products available to low-income customers and others who are under-served by the traditional financial services industry. For instance, several providers in the sector are pioneering new products such as mobile money, government-to-person payments, and microinsurance. Furthermore, new types of financial capability programs that address the realities of the products that are available today and coming tomorrow should be developed.

To create new financial literacy tools will require coordination and alignment across a range of stakeholders including financial services providers, foundations, non-governmental organizations, other philanthropic funders, regulators and policymakers.

Different partnerships with NGOs are starting to help bring together key organizations across sectors to create a shared agenda with the aim to deliver real capability and empowerment to low-income consumers.

In parallel, steps are being taken by financial institutions to improve the financial knowledge of Small and Medium-sized Enterprises (SMEs), through brochures and training. Such support, combined with improved communication, can facilitate access to finance, and produce better outcomes for lenders and borrowers alike.

Delivering more sustainable environmental outcomes

By virtue of their central role in financing economic activity, financial institutions can play a role in delivering sustainable environmental outcomes through sustainability informed and driven decision-making. In the case of larger, longer term investments such as renewable energy projects, which may require significant sums of financing over many years, the industry has played a key role, often in partnership with public authorities.

The crisis, subsequent market turbulence and the introduction of new banking regulation generated a more difficult climate for EU commercial and savings banks in funding such projects. Nevertheless public programmes and targeted initiatives, such as the EU Project Bond, continue to expand the areas in which private financing (both bank and increasingly non-bank finance) can work with public support, in pursuit of developmental objectives.

Financing more sustainable environmental outcomes in general and in particular the energy transition to sustainable energy techniques and sources is an important topic for banks and investors at regional and national levels. As recognized in the EU Commission's Green Paper on long-term financing, public development banks in addition to the private sector play an important role to meet the targets of the EU 2020 strategy in terms of resource-efficiency and low-carbon economy in order to achieve sustainable growth.

[2] World Bank definition: http://wbi.worldbank.org/wbi/content/africa-regional-dialogue-financial-literacy-and-capability.

Public development banks with their business models designed to meet public-interest objectives have different instruments at their disposal, including indirect financing mechanisms via commercial banks. These public financing models allow incentivizing private funding by sharing the associated risks. They can further provide credits with preferential interest rates e.g. in order to support green renovation of buildings. Development banks as well as local funding agencies can also often mobilize funds from capital markets and use them to satisfy long-term funding needs for example for local sustainable infrastructure. Risks can also be shared with the support of European Institutions and the European Investment Bank Group. And capital markets finance can help us to achieve broader social goals, for example by providing long term funding for health programs.

Delivering sustainable growth

It is understood that excessive leverage within parts of the banking sector was a significant contributing factor to the financial crisis amongst other factors. Questions have come up whether the sudden drop of bank lending could be replaced by financial instruments and whether should be supported by public policies.

Indeed, there is very little correlation between business size and growth and high-growth SMEs such as start-ups need specific funding arrangements. Policy support designed for their specific challenges, such as cash flow finance and commercial skills support, could be helpful. However financial instruments are not adapted to the best part of SMEs: bank lending remains the favourite way of financing for European's SMEs today and will remain in the future. Supporting the expansion of high quality SME securitisation could be a further option to increase funding and capital capacity for bank lending.

It is recognised that favouring one type of instrument over another could have the result that the vast majority of European SMEs may not be able to access their preferred source of finance and could also jeopardise the economic success of the EU 2020 Strategy.

Achieving sustainable economic growth is a particular challenge in which banks have a role to play as a distribution mechanism for the European economy alongside other sources of capital as much as innovative financial instruments will have its role.

Conclusion

- High standards of financial inclusion and financial education constitute an important deliverable for the EU financial sector to help social inclusion and at the same time fulfil its societal role.
- Emerging technologies (e.g. mobile and online) and cross-sector partnerships should be used to foster financial inclusion and financial education and to deliver these in an efficient way.
- A regulatory environment that position both business and society for growth should be fostered. European legislation shall appropriately take into account well-functioning existing initiatives and partnerships in order to prevent adverse selection.
- Public development banks in addition to commercial banking play an important role to facilitate the necessary transition to sustainable energy techniques and sources in order to achieve sustainable growth.
- A sustainable economic policy for growth will require the availability of all means to finance the real economy, such as conventional bank-based lending and capital-market financing in the perspective of the entire sector and, especially for the purposes of SMEs.
- The role of ethical and socially responsible financial institutions must be promoted[3].

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[3] See European Economic and Social Committee „The Ethical and social dimension of European financial institutions" (Opinion), (2009/C 100/14) para. 1.8.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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