The Financial CRISIS

There are several defining features of the current financial crisis that I would like to highlight at the start of my presentation, that make this crisis unique. First is its scope, which is global in nature. Second, is its scale and the fact that trillions of dollars of capital has been wiped away. The third aspect involves its genesis in that the crisis started at the center of the system and not at the periphery. And finally, it is important to note the nature of the state’s response, namely bailouts and stimulus packages.

Investors across the board have felt the impact of the crisis and millions are being forced to reconsider their retirement plans, their home ownership, their employment security and the adequacy of their savings to support their families and educate their children. Paul Krugman in the NY Times Magazine Sunday September 7th, pointed to the fragile state we are left with after the meltdown of the financial system: “Now that the undiagnosed bubble has burst, the true riskiness of supposedly safe assets has been revealed and the financial system has demonstrated its fragility, U.S. households have seen $13 trillion in wealth evaporate. More than six million jobs have been lost, and the unemployment rate appears headed for its highest level since 1940.” In addition governments around the world have committed up to $5 trillion dollars in an effort to end the crisis and stimulate growth.

The collapse of the credit market, which was caused by the wholesale failure of policies designed to manage risk in these same markets, has stirred many institutions and individuals to examine their participation in the financial and equity markets and to review their investment policies, principles and strategies. This, I would argue, is a very good thing and something many in the faith community have been crying for, albeit in something of a wilderness, for many years.

This review obviously includes an analysis of what happened, some assignment of responsibility, an attempt to recapture what has been lost through negligence or liability and a consideration of what to do going forward in order avoid such crises in the future and create a more stable system. It also includes a much broader set of questions like an examination and analysis of what is called “systemic risk” that has been definitively exposed in the current crisis. Systemic risk is a commonly used phrase that means the risk that affects the entire financial system rather than a single institution or region. Risk is a
key aspect of a well functioning market. Indeed, it’s a key aspect of a well-functioning life. However, any review should equally inquire about how such systemic risk can be mitigated, contained or prevented in the future and must include a consideration of the role of the state (s) and its agencies for the guarantee of the system.

Many investors from the faith community have been addressing major banks on their off balance sheet liabilities and the potential systemic risk involved and have called in stockholder resolutions filed in 2004 and 2005 for greater disclosure and transparency about the collateral to support such risk taking. They had previously addressed these same banks on both the cancellation of debt the adoption of criteria for lending to developing countries that made a positive contribution to development and poverty alleviation. Of special concern in these engagements are the consequences of this financial crisis on the poor and marginalized who are at the periphery of the system. Attention has also been focused on the environment which is the common inheritance of all

**Faith Traditions in the midst of the Crisis**

Faith traditions, their institutions and their followers have not been immune to the impacts of the current crisis. Many religious orders have been forced to significantly rescale their ministry commitments, laying off scores of lay staff and re-evaluating the long-term impact of the crisis. Such reflection should continue to surface a close examination of the principles, policies and practices, informed by their respective traditions that they may have been pursuing. As participants in the financial system, capital markets and the economy, the faiths have always been challenged to reconcile the ethics of business and the market with the ethical and moral principles flowing from their respective traditions. The issues of profit taking, interest, usury, debt repayment, gambling, speculation and risk come immediately to mind and have been subject to theological reflection for many centuries.

This reflection needs to be continued as the financial system evolves and expands and the footprint of faith traditions changes. The extensive network of faith-based institutions and activities that are maintained throughout the world is at once a snapshot of our active presence in service and ministry but is at the same time a snapshot of financial activity within society. The extent and diversity of this activity and operations is immense depending on the organizational structure and the reach of their operations. The establishment and maintenance of all of these services and centers of operation demand an extensive operational and financial administration. They have important implications for us in terms of our use and reliance on the financial system. Unless we all mirror the life of the Buddhist monks who begin the day walking around with their begging bowls, we must disabuse ourselves of the notion that we can engage the global economy on our own terms.
A Growing Acceptance of Religion and the Market

Going back a few hundred years we discover two key ideas that spread rapidly across Europe and that presented faith communities with a unique set of challenges in this area. By the 17th century, there was growing acceptance of the idea that reasonable interest on a monetary loan does not amount to usury. This shift in mentality was seen as making the banking system possible and magnified the debates about interest and usury for all the Abrahamic faith traditions. The second key step was the creation and establishment of the limited liability corporation (LLC) as a separate person, a move that raised surfaced challenges to the obligation of individuals to repay their debts. When we consider that the practice of usury was prohibited for hundreds of years by the three Abrahamic faiths, they did become comfortable over time operating within the emerging capitalist framework that had profit and the corporation at its core. This engagement has evolved through a journey of legal semantics and ethical reasoning to the current practice.

Biblical teaching, however, continues to pose questions about these developments. The Book of Deuteronomy in the Judeo-Christian tradition says clearly: "At the end of every seven-year period you shall have a relaxation of debts, which shall be observed as follows. Every creditor shall relax his claim on what he has loaned his neighbor; he must not press his neighbor, his kinsman, because a relaxation in honor of the LORD has been proclaimed." (Deut:1-3) It was this phrase that served, in large part, to ground the great Debt Relief initiative that revolved around the celebration of the recent Millennium.

In the new testament of the Christian tradition, Jesus is seen casting out the money lenders; “Jesus entered the temple area and drove out all those engaged in selling and buying there. He overturned the tables of the money changers and the seats of those who were selling doves. And he said to them, "It is written: 'My house shall be a house of prayer,' but you are making it a den of thieves." (Mt. 21: 10-11)

To sustain their extensive operations religious communities and institutions have not only flirted with the market, they have embraced it. They have done this through the lens of principles consistent with their faith traditions and more proactively through coalitions that coordinate active ownership of assets invested in the market. It should be widely accepted today that such activity flows from the notion of responsible stewardship of the resources they have been given and the tasks they are committed to. Without concomitant obligations in this regard, the activity of faith-based entities in the market will fail to demonstrate coherence with founding ideals and will not yield the necessary witness to the tenets of particular faith tradition.

Faith Consistent Investment

So how have or can the faiths respond to these competing demands on their activities? The fallout from the current financial crisis affords them another opportunity to review those practices and examine how their traditions might shed light on what changes are
needed in both the regulation of the financial system and in the business model of the banking and financial services sector.

A quick review of what the faith traditions have in place reveals the following:

1. Many religious groups have looked to the teaching of their traditions and generated investment principles and policies that, I would argue, have been faithful to those teachings and relied on a fairly conservative approach to investing. High risk strategies and untested instrument instruments are rarely part of their portfolios.
2. Many of these principles and policies are focused primarily on securing the resources needed to support their respective missions and fulfill any fiduciary responsibilities.
3. The integration and infusion of their beliefs into their practices and policies has been accomplished through the use of both positive and negative screens. This practice will exclude corporations and activities that are not consistent with their beliefs and values and may include some companies or activities that are so inclined.
4. Some also engage in activities that flow from their commitment to be active owners of the assets in their portfolios. This includes but is not limited to engaging the board and management of corporations and or banks that they invest in. Voting proxies each year and filing resolutions for consideration at the annual meeting are all form a part of that commitment.
5. Alternative investing, (taking greater risk or accepting a lower return: micro finance, affordable housing trust, etc) has also been an important part of their investment practices and many continue this work in their mission

These are all good developments. I’d like to now examine and suggest how the faiths can help reshape the global financial system to create a sustainable future and respond more effectively to the needs of those living in poverty worldwide

**Addressing the Financial Services Sector**

Faith traditions have a unique global reach with significant potential impact. It is a reach that matched the span and penetration of trans-national corporations. Many are aware that the recent period of global integration has been roundly criticized for the benefits that it has brought to multinational and global corporations at the expense of workers, local communities, the environment and the power of individual states to fulfill their role of governance.

The financial services sector has been in the forefront of this globalization process and has reaped enormous profits in the process. Major banks, insurance companies and credit card companies have created an enormous integrated global footprint. This allows them to provide a variety of services to clients in both the public and private sector around the globe and to participate in capital markets throughout the world. Many groups are part of this system and through what has come to be called “Faith-consistent investing” we have struggled to be faithful to our beliefs and values in the process.
Through the Interfaith Center on Corporate Responsibility\textsuperscript{2} and the International Interfaith Investment Group\textsuperscript{3} faith institutions have come together to support each other’s efforts in this work. They have also been joined by “socially responsible” asset-management funds as well as foundations and pension funds with whom they share common values and priorities.

Working together these institutions have actively engaged the financial crisis and the major institutions involved in the crisis on at least three different fronts: as citizens and members of civil society in their respective countries and in international forums; as clients and shareholders in these corporations and in their own institutions, initiatives and projects.

1. As Citizens

The foundation for the operation of the financial system is trust and that same trust is built and sustained by a framework and process that involves a number of different actors and judgments. In the collapse of that foundational trust, the list of issues and concerns that are being raised is quite extensive. A key priority is the responsibility of states to make sure that its citizens are well served by the financial system, that the economy is well organized and that there is a meaningful regulatory framework. This of course necessarily includes in some quarters a debate about the extent of government regulation needed to ensure stability (tight or loose) over against the preference of some for voluntary codes and standards policed by the sector itself.

In the Catholic tradition there is, for instance, a consistent body of teaching about the role of the state to promote the common good. One of the key texts on the Church’s role in the world states “The complex circumstances of our day make it necessary for public authority to intervene more often in social, economic and cultural matters in order to bring about favorable conditions which will give more effective help to citizens and groups in their free pursuit of man's total well-being”\textsuperscript{4}.

Elsewhere, In Pacem in Terris, John XXIII states that “For experience has taught us that, unless these authorities take suitable action with regard to economic, political and cultural matters, inequalities between the citizens tend to become more and more widespread, especially in the modern world, and as a result human rights are rendered totally ineffective and the fulfillment of duties is compromised.”\textsuperscript{5}

Pope John Paul summarizes clearly this teaching in the encyclical Centesimus Annus as follows; “It is the task of the State to provide for the defence and preservation of common goods such as the natural and human environments, which cannot be safeguarded simply by market forces. Just as in the time of primitive capitalism the State had the duty of defending the basic rights of workers, so now, with the new capitalism, the State and all of society have the duty of defending those collective goods which, among others, constitute the essential framework for the legitimate pursuit of personal goals on the part of each individual.
Here we find a new limit on the market: there are collective and qualitative needs which cannot be satisfied by market mechanisms. There are important human needs which escape its logic. There are goods which by their very nature cannot and must not be bought or sold. Certainly the mechanisms of the market offer secure advantages: they help to utilize resources better; they promote the exchange of products; above all they give central place to the person's desires and preferences, which, in a contract, meet the desires and preferences of another person. Nevertheless, these mechanisms carry the risk of an "idolatry" of the market, an idolatry which ignores the existence of goods which by their nature are not and cannot be mere commodities."

Only last month, the current Pope, Benedict XVI who was certainly part of this great debate in the 1960s as a young professor, reminded us that while the economic activity does not exist in a vacuum and does have moral consequences, the power of individual states has been circumscribed by events. He addresses the current crisis directly, a reason some reported that the documented was delayed so much: “In our own day, the State finds itself having to address the limitations to its sovereignty imposed by the new context of international trade and finance, which is characterized by increasing mobility both of financial capital and means of production, material and immaterial. This new context has altered the political power of States.

Today, as we take to heart the lessons of the current economic crisis, which sees the State's public authorities directly involved in correcting errors and malfunctions, it seems more realistic to re-evaluate their role and their powers, which need to be prudently reviewed and remodelled so as to enable them, perhaps through new forms of engagement, to address the challenges of today's world”

Working together with numerous partners in the investment world and with non-governmental organization institutional faith based investors have called for renewed engagement by the state and the states working together in an examination of the principles of the financial system and the regulatory reform of its operations. This includes reform of the governance of institutions like the World Bank and the International Monetary Fund and the re-examination of many of their long standing policies and practices that promoted a one size fits all economic theories and policies to promote financial stability and to alleviate poverty.

Specifically this includes key issues such as systemic risk management, moral hazard that presupposes state intervention to avert collapse of certain institutions and the systemic flaw that facilitates the privatization of profits while socializing the risks that are assumed. Faith communities have also called for the inclusion of such core principles as transparency, accountability and oversight that are essential in a financial system like ours and the absolute necessity of enhanced collaboration between nation-states if a global economy is to serve the needs of people and communities and safeguard the earth for future generations..

2. As Clients & Shareholders,
Faith consistent investors have engaged major banks since the first Latin America debt crisis of 1970’s. Many of these banks were flush with dollars from the oil boom and loaned it to dictators; military juntas, unscrupulous borrowers and corrupt governments without following basic financial lending criteria about ability to repay or any monitoring protocol regarding what the money was to be used for in such loaning practices. The citizens of these countries were left with the repayment responsibilities after these leaders left the scene with little to show by way of development for the people. Since then it has been a series of engagements about the dangers of capital flight; use and promotion of tax havens; use of capital controls by sovereign governments; financing projects harmful to the environment and violating the rights of indigenous and local communities; discrimination against the poor and minorities in lending and insurance services—a practice known as “redlining”—; community reinvestment act compliance— meaning that banks comply with their legal responsibility to invest some of their assets in the communities where they are doing business--; excessive fees for the repatriation of remittances; credit card and predatory lending abuses; reasonable disclosure of off balance sheet liabilities and derivatives; clear accounting for counter party risk assumed through multiple transactions and compensation structure that awards excessive risk taking.

In response to these efforts and in combination with the passage of legislation such as the Community Reinvestment Act, the Foreign Corrupt Practices Act, The Patriot Act and Credit Card Accountability, Responsibility and Disclosure Act, numerous changes have been introduced by the companies in this sector. The adoption and implementation of improved codes of conduct on human rights and the environment such as the Equator Principles and principles of practice on lending by many banks and financial services companies have decreased the number of abuses and provided mechanism for addressing grievances.

3. As Practitioners

Faith traditions at various levels have been historically active in the creation and promotion of funds and institutions that support local economies and community development such as community development loans funds, credit unions, cooperatives, funds Leviticus and Partners for the Common Good. These funds support microfinance, affordable housing, small business and social entrepreneurship. Faith communities have also participated with other investors in building institutions like South Shore Bank in Chicago and Fonkoze, Haiti's Alternative Bank for the Organized Poor. These efforts, in many instances, were started and supported through below market rate investments, where risk has been deemed too great or the loan processing too labor intensive. In many instances these efforts were started to fill the gap which conventional lending institutions had shunned though in the case of microfinance they are now entering. The Isaiah Funds, an interfaith collaborative in response to the natural disaster in New Orleans is a recent example of this work.

**Positive Social Impact Investing**
More recently faith traditions have joined with other socially responsible investors to create funds that offer market rate returns but with a positive social impact mission. These can be either focused on a specific priority or a geographic region and are intended to contribute to the development strategy in a particular region or area.

For example, the Global Solidarity Forest Fund\textsuperscript{10} is creating sustainable forestry in Mozambique and hopes to extend the focus of the fund to other countries in southern Africa. Other areas of focus for these efforts include Green technology, Community development, Sustainable Real Assets, Sustainable Consumer products.

Most recently the establishment of an Interfaith Stock Exchange has ben proposed and is under consideration. Sound good? Of course, that discounts the fact that all exchange contains an element of good faith. The Interfaith Stock Exchange would be a virtual but non-operating stock exchange that enables faith institutions to chose stocks that comply with their values. It will include funds that are specifically created for each of the eleven world religions as well as funds that may be applicable to several of the faiths. It is hoped that this will allow institutions and individuals access to an information database from a computer that would facilitate integration of faith based principles into investment decisions such as one’s 401k account.

**Conclusion**

In the public sector debate, the legislative process and in the exercise of active ownership of invested assets, faith consistent investors have and will continue to work with their colleagues to raise the following issues about the activities and practices of the banks and financial service sector corporations and on the regulation of the financial system.

**Responsible Financial Institutions**

1. Are the activities and projects financed both productive and sustainable?
2. Is the risk profile of the company or activity a danger to the entire system and therefore especially potentially harmful to the poor and those at the periphery?
3. Are their policies about responsible lending, human rights and the environment, risk management and disclosure available to stakeholders and implemented?
4. Is the compensation structure fair and adequate? Are the criteria for the compensation of top executives transparent and in the long term interest of all the stakeholders?
5. Are there clear lines of accountability and monitoring for decisions about products and services especially those that are relatively new and pose a systemic risk?
6. Does the board of directors have the best interest of all stakeholders in kind?

**Reshaping the Global Financial System**

Our principles remain fairly predictable:
1. Putting people especially the poor in developing countries and the environment first as priorities of the financial system.
2. More robust global regulatory reform that clearly establish sustainability as a priority and therefore includes the all the externalities on the balance sheet.
3. Eliminate the use of speculative financial tools on necessities like food and fuel.
4. Suppresses the culture of Tax Havens in the system that rob governments of the resources that are needed to adequately fund budget priorities.

Faith traditions have been pioneers in relief and development. The moment is asking for a more comprehensive view of social justice aimed at true development. The motivation for this vision comes from our belief in what is greater than the individual or the whole. It is, as Pope Benedict recently said our “openness towards the transcendent” that compels us to integrate such principles into an ever expanding network of relationships that for too long a time have been focused on the logic of economic integration. The tradition of the faiths as an ethical compass to this system of integration is a long one; it is a platform for our preaching and our teaching and one which the faiths have an obligation to set before the world as it sets a new course for its financial dealings.

There are examples where the faiths have done this. The integration into their investment priorities of the vision of mission and ministry that flows from their traditions and is consistent with their relief and development work is already underway. Through partnerships with other like minded investors and by inviting their members to see these opportunities and tools as a means of reshaping the financial system and to actively provide opportunities to the poor across the world as a new moment for bringing their faith to life in the world, these same faith traditions can make a very important contribution to a new and more just financial system and the alleviation of the suffering that poverty causes.

1 NY Times Magazine; Sept 6th; p.41
2 www.iccr.org
3 www.3ignet.org
4 Church in the Modern World #75
5 Pacem in Terris #63
6 Centesimus Annus #40
7 Caritas in Veritate #24
8 http://www.equator-principles.com/principles.shtml
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