

Global Alliance for Banking on Values

Strong, Straightforward and Sustainable Banking

Financial Capital and Impact Metrics
of Values Based Banking

Summary

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**GLOBAL
ALLIANCE
FOR BANKING
ON VALUES**

Over the past year, intense and wide-ranging debate has arisen on the heels of the global financial crisis. In recent months, the critique has turned to capitalism itself, with media headlines posing questions such as “Crisis in Capitalism?” and “What’s wrong with capitalism?” Criticism has targeted the international financial system, questioning the role and activities of banks in particular.

Questions have focused on how banks have generated their returns and, even more closely, on how they have shared their returns with various stakeholders including customers, investors, employees (especially senior management), and wider society more generally. While the debate continues to draw attention, a group of banks has for some time been answering many of these challenges by delivering strong, straightforward and sustainable banking services.

Sustainable banks have consistently delivered products, services and social, environmental and financial returns to support the real economy¹. These banks demonstrate decades of responsible banking and a consistent commitment to productive economic activity. They have increased their activity during the present recession, expanding their lending to small and growing businesses in particular. Committed to providing a broad range of banking services to the real economy over the long-term, they highlight the powerful role of sustainable banks as stewards of successful, equitable capitalism.

The evidence of their success suggests a renewed emphasis in public policy, and by investors, on sustainable banks, could provide the long-term path for responsible banking necessary to support a more just, environmentally sound, and sustainable economy.

Starting in May 2011, the Global Alliance for Banking on Values (GABV)², a network of front-running sustainable banks, undertook a project to examine the financial capital dynamics and impact metrics systems of sustainable banks. This project, although focused on GABV members, also included non-members with similar business models to GABV members. The project compared the financial profiles of these sustainable banks with Global Systemically Important Financial Institutions (GSIFIs) as defined by the Financial Stability Board³.

In addition to gathering substantial information and conducting in-depth interviews with the sustainable banks, the project surveyed potential sources of financial capital to support the growth of these institutions. The project reviewed current and emerging approaches to impact metrics reporting.

The project provides a framework for further work on developing new sources of patient capital for sustainable banks whose performance can be measured on the basis of development, environmental, and financial metrics.

Key Findings

Key conclusions with relevance for both investors and public policy include:

- A clear statement of the Principles of Sustainable Banking was needed, and has been developed, to highlight characteristics distinguishing sustainable banks from other financial institutions
- The historic and prospective financial performance and support to the real economy of sustainable banks compares favourably with GSIFIs
- Measuring non-financial returns of banks in a meaningful way presents a major challenge and will require significant multi-stakeholder efforts to resolve
- Sustainable banks will need to raise capital externally if growth trends continue
- There may be potential innovative approaches for finding new sources of patient financial capital for sustainable banks.

1. Economic activities that generate goods and services as opposed to a financial economy concerned exclusively with activities in the financial markets.

2. For more information: www.gabv.org/

3. For more information: www.financialstabilityboard.org/

The project highlighted the need for a concise definition of sustainable banking. The GABV has endorsed the following Principles of Sustainable Banking:

Principles of Sustainable Banking

1. Triple bottom line approach at the heart of the business model;
2. Grounded in communities, serving the real economy and enabling new business models to meet the needs of both;
3. Long-term relationships with clients and a direct understanding of their economic activities and the risks involved;
4. Long-term, self-sustaining, and resilient to outside disruptions;
5. Transparent and inclusive governance;
6. All of these principles embedded in the culture of the bank.

The financial profiles of sustainable banks and GSIFs, from 2007 to 2010, illustrated clear differences between the two groups (see Appendix 1).

These differences include:

- Sustainable banks had a significantly greater exposure to customers in both deposits and loans
- Sustainable banks had relatively higher and better quality capital although the differentiation declined over time
- Sustainable banks had better Returns on Assets with comparable Returns on Equity
- Sustainable banks had significantly higher levels of growth in loans and deposits.

The research from this project has consequences for both public policy and investors. The focus of sustainable banks on customer lending and deposit taking is directly relevant to public policy makers and regulators given their implicit and explicit support to maintain the critical functioning of the banking system to support the general economy throughout the world.

From an investor perspective the historic assumption that sustainable banks have not provided financial returns comparable with other banks is not supported by the data in the years reviewed. Furthermore, the comparative financial and social value proposition of sustainable banks is expected to be even more compelling on a forward-looking basis, especially given the context of developments within financial services industry regulation.

This analysis needs to extend beyond the years most impacted by the financial crisis as well as include explicit consideration of volatility of returns. In addition, the analysis would benefit from further expansion of the number of banks covered in both groups. It needs to be extended to provide a forward-looking perspective on returns, especially given the changing regulatory and business model environment. Further research is needed to examine financial profile and return differences resulting from geographic and business model variations within both the sustainable bank and the GSIFI universes. Nevertheless, the initial analysis provides constructive guidance for assessing the performance of sustainable banks.

Standardized and robust non-financial and financial metrics, to demonstrate the impact of these banks on people and the environment, need further development to inform investment decisions and review the performance of sustainable banks. A priority is improving the metrics framework, building on industry developments to date including IRIS⁴. Specifically, efforts to address measuring real impact on improving society and the environment will need to develop across three dimensions:

4. See <http://iris.thegiin.org/>

- Substantial improvement in the current state of measurement and public disclosure by banks;
- Shifting the focus of investors and others from historic Triple Bottom Line metrics to deeper and more meaningful measures of impact;
- Developing a practical approach for measuring sustainability driven by multi-stakeholder perspectives.

There is clear evidence in reviewing the financial performance, position, and future prospects of sustainable banks that capital in excess of resources generated internally will be required to support the autonomous growth of these institutions. This growth is especially strong compared to the GSIFs as it appears that the GSIFs have been reducing their balance sheets to improve their capital levels. It may be possible to develop sources of capital for providing efficient and patient financial capital to support the growth of sustainable banks. These potential sources should receive:

- An attractive value proposition to investors interested in supporting a return to sustainable finance
- Stable and adequate financial returns
- Measurable non-financial returns linked to the Principles of Sustainable Banking, while
- Protecting and enhancing the mission of the investees.

As a result of this effort, the following next steps have been identified:

- Further analysis on the financial and non-financial returns and profiles of sustainable banks, GSIFs and other financial institutions
- Further development of a robust and stakeholder driven metrics framework
- Further work on development of potential sources and structures of patient capital for investing in sustainable banks.

Given the GABV commitment to extending the reach of sustainable banking to meet the needs of the real economy, it is anticipated that the GABV will move forward on addressing these issues in the near future.

Who are the values-based banks?

While public discussion continues about how to address the challenge of 'too-big-to-fail' banks and cajole or regulate them into expanding the amount of capital they make available to the real economy, a subset of banks have been pursuing business models with sustainable, community-focused finance at their core.

Many of these sustainable banks have been in business for a few decades, others for far longer. Their models of providing long-term, patient but sustainably profitable banking services have been at the heart of some of the world's most successful economies, especially in the small and growing business sectors. The vital role that these banks play in true economic development is increasingly recognised in the debate over how to restructure local and global finance.

The GABV is committed to supporting the growth of straightforward, strong and sustainable banking to address the challenges facing the economy, people and the environment.

Appendix 1

Summary of Financial Profile Research

Sustainable banks have a significantly higher proportion of their assets invested in lending than GSIFIs.

Total Loans / Total Assets					
	2010	2009	2008	2007	Average
Sustainable Bank Average	69.61%	67.58%	71.00%	69.79%	69.50%
Sustainable Bank Weighted Average	72.71%	71.46%	69.50%	70.42%	71.02%
GSIFIs Banks Average	37.25%	37.59%	36.45%	38.61%	37.80%

Sustainable banks fund a much larger portion of their total balance sheet with customer deposits than GSIFIs.

Total Deposits / Total Assets					
	2010	2009	2008	2007	Average
Sustainable Bank Average	70.66%	69.83%	67.36%	67.80%	68.91%
Sustainable Bank Weighted Average	72.53%	70.12%	65.76%	65.967%	68.59%
GSIFIs Average	40.73%	40.35%	38.12%	41.24%	40.43%

Sustainable banks have much higher levels of equity to total assets with slightly higher levels of BIS 1 capital ratios (especially in recent years) than GSIFIs.

Equity / Assets					
	2010	2009	2008	2007	Average
Sustainable Bank Average	8.92%	9.45%	9.21%	9.63%	9.30%
Sustainable Bank Weighted Average	8.89%	8.90%	8.38%	7.75%	8.48%
GSIFIs Banks Average	5.72%	5.35%	4.52%	4.94%	5.11%

BIS 1 Ratio					
	2010	2009	2008	2007	Average
Sustainable Bank Average	15.80%	16.42%	12.78%	12.07%	14.27%
Sustainable Bank Weighted Average	13.61%	13.82%	13.45%	12.35%	13.31%
GSIFIs Banks Average	12.41%	11.17%	8.16%	6.88%	9.65%

Sustainable banks have generally better or comparable Return on Assets and Returns on Equity over the time period covered. The returns of sustainable banks are also less volatile than those of GSIFIs.

Return on Assets					
	2010	2009	2008	2007	Average
Sustainable Bank Average	0.61%	0.21%	0.49%	n/a	0.44%
Sustainable Bank Weighted Average	0.69%	0.45%	0.59%	n/a	0.58%
GSIFIs Banks Average	0.46%	0.14%	0.08%	0.65%	0.33%

Return on Equity					
	2010	2009	2008	2007	Average
Sustainable Bank Average	7.75%	5.86%	7.18%	n/a	7.26%
Sustainable Bank Weighted Average	8.20%	5.85%	7.17%	n/a	7.07%
GSIFIs Banks Average	9.68%	2.17%	-1.53%	13.91%	6.06%

Sustainable banks have significantly higher growth in loans and deposits leading to higher growth in assets and income than GSIFIs.

2007-2010 Growth Rates (local currency)				
	Loan Growth	Deposit Growth	Asset Growth	Net Income Growth
Sustainable Bank Average	80.52%	87.74%	77.60%	64.62%
Sustainable Bank Weighted Average	50.06%	51.12%	40.79%	64.37%
GSIFIs Banks Average	21.38%	27.28%	23.14%	-6.72%

Additional Sources of Information on Banking Financial Performance

1. A McKinsey historic review of Returns on Equity can be found in Figure 1 in a February 2010 publication: The next normal: Banking after the crisis⁵
2. Longer term Return on Assets for US banks can be found in Figures 9 and 10 in a study published by the Federal Deposit Insurance Corporation⁶
3. Investor returns from financial companies over a five year period can be found on p. 53 of the JPMorganChase 2010 Annual Report⁷

5. <http://www.efinancialnews.com/share/media/downloads/2010/03/4058465789.pdf>

6. <http://www.fdic.gov/bank/analytical/banking/2006jan/article2/>

7. <http://investor.shareholder.com/jpmorganchase/annual.cfm>

Appendix 2

Banks Included in Sustainable Bank Research

The following banks were identified as having business models fundamentally consistent with the Principles of Sustainable Banking. There were 14 GABV members, as of 31 December 2011, were included, plus three other banks in this study.

GABV Members

ABS Bank, Switzerland
Banca Etica, Italy
BancoSol, Bolivia
Bank Integral, El Salvador
BRAC Bank, Bangladesh
Cultura Bank, Norway
GLS Bank, Germany
Merkur Bank, Denmark
Mibanco, Peru

New Resource Bank, California, USA
One Pacific Coast Bank, California, USA
Triodos Bank, The Netherlands
Vancity, British Columbia, Canada
Xac Bank, Mongolia

Other Sustainable Banks

Credit Cooperatif, France
Ecobank, Togo
Sunrise Community Banks, Minnesota, USA

Global Systemically Important Financial Institutions (GSIFs)

There were 29 banks classified as Global Systemically Important Financial Institutions by the Financial Stability Board.

Bank of America
Bank of China
Bank of New York Mellon
Banque Populaire CdE
Barclays
BNP Paribas
Citigroup
Commerzbank
Credit Suisse
Deutsche Bank
Dexia
Goldman Sachs
Group Credit Agricole
HSBC
ING Bank

JP Morgan Chase
Lloyds Banking Group
Mitsubishi UFJFG
Mizuho
Morgan Stanley
Nordea
Royal Bank of Scotland
Santander
Société Générale
State Street
Sumitomo Mitsui FG
UBS
Unicredit
Wells Fargo

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