

Global Alliance for Banking on Values

Real Economy
– Real Returns:
The Business Case
for Sustainability
Focused Banking

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**GLOBAL
ALLIANCE
FOR BANKING
ON VALUES**

Real Economy – Real Returns: The Business Case for Sustainability Focused Banking

In 2013 banks with business models based on the Principles of Sustainable Banking have once again demonstrated higher financial returns than the largest banks in the world. These sustainability focused banks, with a social, environmental and economic triple bottom line at the core of their business models, deliver these results while continuing to be focused on meeting the needs of their clients through lending and deposit products.

Executive Summary

A sustainable real economy¹ requires enterprises that deliver economic resiliency, environmental preservation and social empowerment to the communities in which they operate. These enterprises need not only direct investment capital but also access to financial services including lending, deposit and cash management products typically delivered by banking institutions. Without these banking services these enterprises will not be successful. Banking institutions that focus on meeting the banking services needs of these enterprises must in turn deliver adequate financial returns to attract the capital required from investors to support their growth.

Since the financial crisis that became evident with the collapse of Lehman Brothers in 2008, a group of sustainability focused banks, all members of the Global Alliance for Banking on Values (GABV)², have demonstrated through their focus on the real economy, their strong capital positions, and their steady financial returns that banking models based on the Principles of Sustainable Banking³ provide viable and needed alternatives adding strength to a diverse financial ecosystem.

In 2013 these banks continue to show that lending to the real economy delivers better financial returns when compared with the largest banks in the world. This conclusion is supported by recent research on returns delivered by banks focusing on shared value⁴. Furthermore these banks address a very real need of enterprises for banking services, especially credit, as identified through independent research⁵.

Research Outline

In 2012 the GABV published the results of research comparing sustainability focused banks (SFBs) and Global Systemically Important Financial Institutions (GSIFIs)^{6,7} focused on the following key questions:

- What support does a bank provide to the real economy?
- How resilient is a bank in the face of economic challenges?
- What returns does a bank provide to society, clients and investors?
- What growth does a bank achieve to expand its impact?

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1. The real economy relates to economic activities that generate goods and services as opposed to a financial economy that is concerned exclusively with activities in the financial markets.
 2. More information on the GABV can be found at www.gabv.org.
 3. Full description of the Principles of Sustainable Banking is found in Appendix 1.
 4. Banking on Shared Value: How Banks Profit by Rethinking Their Business published by FSG. Full report available at: <http://www.fsg.org/tabid/191/ArticleId/1138/Default.aspx?srpush=true>.
 5. Growth for Good or Good for Growth: How Sustainable and Inclusive Activities are Changing Business and Why Companies Aren't Changing Enough produced by CitiFoundation, The Fletcher School, and the Monitor Institute. Full report available at: http://www.citifoundation.com/citi/foundation/pdf/1221365_Citi_Foundation_Sustainable_Inclusive_Business_Study_Web.pdf.
 6. More information available at www.financialstabilityboard.org.
 7. Listing of sustainability focused banks and GSIFI Peer Groups can be found in Appendix 2.

This research used publicly available financial results through the year-end 2011 and was updated in October 2013. This research has now been updated to include financial information for fiscal year 2013. This updated research continues to support the business case for investing in banks that serve the real economy with the additional sustainability focus of the Principles of Sustainable Banking.

Results—Financial Perspective

Publicly available financial information does not currently provide a clear distinction between bank activities in the real, as contrasted with the financial, economy. Furthermore there is limited disclosure of non-balance sheet activities that could also be relevant. Therefore this research uses lending to and deposits from clients as a proxy for the distinction between the real and the financial economy activities of a bank.

The degree to which a bank finances the real economy is evident from the portion of assets on its balance sheet that is devoted to lending. The difference between sustainability focused banks and the GSIFIs in the research is striking. For sustainability focused banks the level of lending is nearly double that of the GSIFIs. And it remains core to their activity with just over 76% of their balance sheets devoted to lending compared to just over 40% of the balance sheet of GSIFIs.

Loans to Total Assets			
	2013	2008	2003
SFBs	76,2%	76,0%	77,1%
GSIFIs	40,5%	38,8%	43,4%

In addition to the focus on lending, sustainability focused banks rely much more on client deposits to fund their balance sheets in comparison with GSIFIs. This focus on deposit taking is not only another example of their focus on clients and the real economy. Furthermore this reliance on customer deposits reduces the liquidity risk of their funding strategies.

Deposits to Total Assets			
	2013	2008	2003
SFBs	80,4%	71,5%	71,4%
GSIFIs	48,8%	42,0%	47,3%

The sustainability focused banks also maintained strong capital positions, relative to the GSIFIs, especially as measured by comparing Equity/Total Assets ratios. At the same time high levels of capital did not reduce their appetite to lend, challenging claims by some larger financial institutions that higher capital requirements lead to less lending.

The sustainability focused banks did not show higher levels of capital than the GSIFIs relative to risk based capital measures⁸. However, the ratios for the GSIFIs were significantly impacted by the relatively low level of Risk Weighted Assets (RWA) compared to Total Assets, as calculated by their risk models. There is ongoing discussion as to whether these calculated levels of RWAs fully capture the risks for which capital is required⁹.

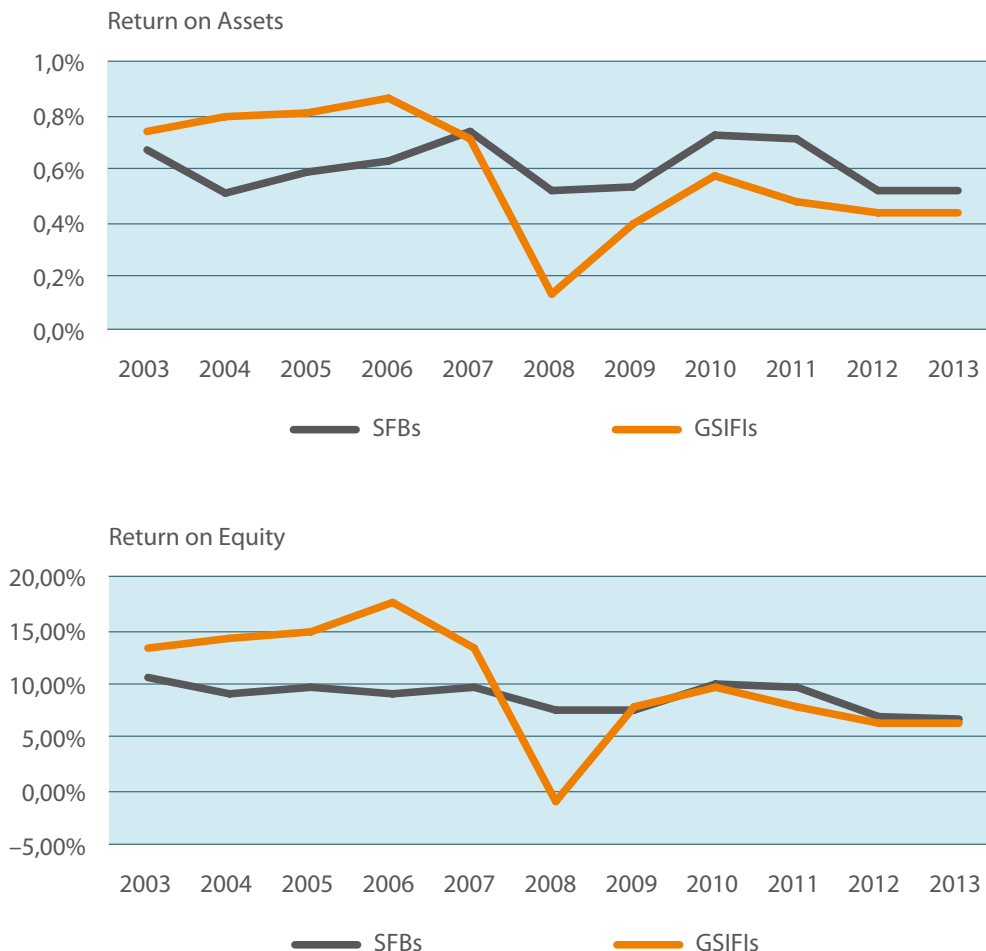
8. Due to changes in capital regulation over the full time period, Tier 1 Ratios and RWAs/Total Assets Ratios are not meaningful for the full cycle and in the pre-crisis period.

9. The Dog and the Frisbee; Andrew Haldane, Executive Director Financial Stability, Bank of England, delivered to the Federal Reserve Bank of Kansas City Economic Policy Symposium; Jackson Hole, Wyoming, 31 August 2012. Back to Basics: A Better Alternative to Basel Capital Rules; Thomas M. Hoenig, Director, Federal Deposit Insurance Corporation, delivered to The American Banker Regulatory Symposium; Washington, D.C., 14 September 2012.

Capital Comparisons			
Equity / Total Assets	2013	2008	2003
SFBs	7,7%	7,3%	6,2%
GSIFs	6,6%	5,0%	5,2%
Tier 1 Ratio			
SFBs	12,4%	11,6%	n/m
GSIFs	13,3%	10,1%	n/m
RWA / Total Assets			
SFBs	60,9%	60,5%	n/m
GSIFs	39,8%	41,0%	n/m

Comparing the financial returns for sustainability focused banks with GSIFs provides a more complex picture. The sustainability focused banks have historically stable Returns on Assets although at levels below those reported by GSIFs prior to the crisis. However, the sustainability focused banks provided resilient financial returns better than GSIFs over the entire cycle with lower levels of volatility. As noted in earlier reports this result challenges the prevailing assumptions of many investors that sustainability focused banks would deliver lower returns than larger banks that have a focus on maximising financial returns.

Relative to Returns on Equity the GSIFs perform better, on average, over the cycle albeit with more volatility. However post-crisis returns for sustainability focused banks are higher than those of GSIFs and with less volatility. In addition, a lower level of Equity/Assets for GSIFs means that a portion of the GSIFs' returns is due to greater leverage, implying greater risk. Investors and others assessing the Return on Equity should expect higher returns for GSIFs given both the higher degree of leverage and the greater volatility of the returns.



	2009–2013		2003–2013	
	SFBs	GSIFIs	SFBs	GSIFIs
Financial Returns and Volatility				
Return on Assets	0,66%	0,46%	0,68%	0,58%
Return on Assets – Standard Deviation	0,16%	0,20%	0,30%	0,35%
Return on Equity	8,6%	7,6%	9,2%	10,3%
Return on Equity – Standard Deviation	2,4%	3,8%	3,7%	7,9%

The issue of growth demonstrates further marked differences between the two groups. The sustainability focused banks had much higher growth in Loans, Deposits and Assets compared to the GSIFIs over time especially since the crisis began. Total Income has also grown faster over both time periods for sustainability focused banks although the difference in growth rates for Total Income is less between the two groups.

Growth (Compound Annual Growth Rates)		
	2009–2013	2003–2013
Loans		
SFBs	13,2%	9,3%
GSIFIs	3,8%	8,3%
Deposits		
SFBs	15,3%	10,4%
GSIFIs	4,9%	9,4%
Assets		
SFBs	12,9%	9,0%
GSIFIs	0,7%	8,5%
Equity		
SFBs	13,8%	10,8%
GSIFIs	8,6%	11,0%
Total Income		
SFBs	8,5%	6,4%
GSIFIs	6,5%	6,4%

European Challenges

The research has been extended to specifically make a comparison in the European market¹⁰. There are eight sustainability focused banks and 14 GSIFIs based in Europe¹¹. Comparing these two groups of banks operating with similar market conditions further highlights the strength of the sustainable banking model. As shown in the global comparison, sustainability focused banks in Europe show significantly higher levels of finance for the real economy, stronger levels of equity capital, and better levels of Return on Assets. They also delivered significantly stronger levels of growth over the cycle, especially post-2008 when the crisis became evident.

10. An analysis of the performance of six sustainability focused banks in developing markets provides useful insight into the strength of this banking model for those markets. This analysis can be found in Appendix 3.

11. Full comparison details of European sustainability focused banks and European and US GSIFIs can be found in Appendix 3.

The challenges facing the European GSIFs and their ability to meet the needs of the European real economy are further illustrated by comparison with US GSIFs. Although some comparisons are complicated by differences in accounting rules, especially as related to derivative portfolios, the relative strength and improvement in the capital position of the US GSIFs as well as their higher levels of profitability provide the US GSIFs with a better basis for addressing the economic challenges facing the US through support of the real economy.

Conclusions

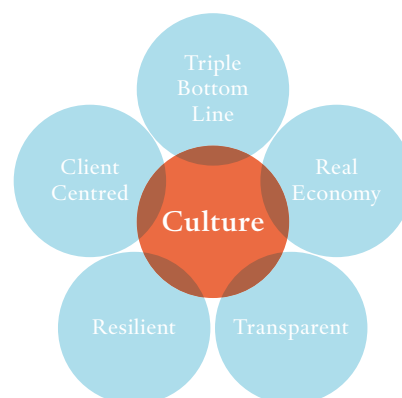
Banking institutions that focus on meeting the financial services needs of enterprises that deliver economic resiliency, environmental preservation and social empowerment to the communities in which they operate have consistently delivered acceptable risk adjusted financial returns over the last several years as shown by this research. Strengthening the diversity of the banking ecosystem through the growth of banks with business models based on the Principles of Sustainable Banking should provide shared value not only to society but also to the banks and their investors choosing that model.

Appendix 1

Principles of Sustainable Banking

Principle 1. Triple bottom line approach at the heart of the business model.

Sustainable banks integrate this approach by focusing simultaneously on people, planet and prosperity. Products and services are designed and developed to meet the needs of people and safeguard the environment; generating reasonable profit is recognized as an essential requirement of sustainable banking but is not a stand-alone objective. Importantly, sustainable banks embrace an intentional approach to triple-bottom-line business – they don't just avoid doing harm, they actively use finance to do good.



Principle 2. Grounded in communities, serving the real economy and enabling new business models to meet the needs of both.

Sustainable banks serve the communities in which they work. They meet the financial needs of these geographic and sector-based communities by financing sustainable enterprise in productive economies.

Principle 3. Long-term relationships with clients and a direct understanding of their economic activities and the risks involved.

Sustainable banks establish strong relationships with their clients and are directly involved in understanding and analysing their economic activities and assisting them to become more sustainable themselves. Proper risk analysis is used at product origination so that indirect risk management tools are neither adopted as a substitute for fundamental analysis nor traded for their own sake.

Principle 4. Long-term, self-sustaining, and resilient to outside disruptions.

Sustainable banks adopt a long-term perspective to make sure they can maintain their operations and be resilient in the face of external disruptions. At the same time they recognize that no bank, or its clients, is entirely immune to such disruptions.

Principle 5. Transparent and inclusive governance.

Sustainable banks maintain a high degree of transparency and inclusiveness in governance and reporting. In this context, inclusiveness means an active relationship with a bank's extended stakeholder community, and not only its shareholders or management.

Principle 6. All of these principles embedded in the culture of the bank.

Sustainable banks seek to embed these principles in the culture of their institutions so that they are routinely used in decision-making at all levels. Recognizing that the process of embedding these values requires deliberate effort, these banks develop human resources policies that reflect their values-based approach (including innovative incentive and evaluation systems for staff), and develop stakeholder-oriented practices to encourage sustainable business models. These banks also have specific reporting frameworks to demonstrate their financial and non-financial impact.

Appendix 2

Listing of Peer Groups

Global Systemically Important Financial Institutions as of 31 December 2013¹²

1. Bank of America
2. Bank of China
3. Bank of New York Mellon
4. Banque Populaire CdE
5. Barclays
6. BBVA
7. BNP Paribas
8. Citigroup
9. Credit Suisse
10. Deutsche Bank
11. Goldman Sachs
12. Group Crédit Agricole
13. HSBC
14. Industrial and Commercial Bank of China
15. ING Bank
16. JP Morgan Chase
17. Mitsubishi UFJ FG
18. Mizuho FG
19. Morgan Stanley
20. Nordea
21. Royal Bank of Scotland
22. Santander
23. Société Générale
24. Standard Chartered
25. State Street
26. Sumitomo Mitsui FG
27. UBS
28. Unicredit Group
29. Wells Fargo

Sustainability Focused Banks¹³

1. Affinity Credit Union
2. Alternative Bank Schweiz
3. Assiniboine Credit Union
4. Banca Popolare Etica
5. BancoFie
6. BancoSol
7. bankmecu
8. Beneficial State Bank**
9. BRAC Bank
10. Centenary Bank**
11. Clean Energy Development Bank**
12. Group Crédit Coopératif
13. Cultura Bank
14. Ecological Building Society
15. First Green Bank**
16. GLS Bank
17. Merkur Cooperative Bank
18. Mibanco
19. New Resource Bank**
20. SAC Apoyo Integral
21. Sunrise Community Banks
22. Triodos Bank
23. Vancity
24. Vision Banco**
25. XacBank

** These banks did not have financial history for the full time period covered, primarily due to the fact that they were de novo institutions. They were included in the returns analysis after four years of operations and for all years for other ratios.

12. This list is defined and published by the Financial Stability Board (www.financialstabilityboard.org). Banks in orange were included in the European comparison.

13. SFBs were defined to include all banks that were members of the Global Alliance for Banking on Values as of 31 March 2013. Banks in orange were included in the European comparison. Banks in blue were included in the developing markets analysis. Given the variation in size of these banks all ratios are collected as a weighted average based on the US Dollar assets as of year end for each year of the analysis.

Financial Comparisons Summaries

All Banks

	2013	
	SFBs	GSIFIs
Real Economy		
Loans/Assets	76,2%	40,5%
Deposits/Assets	80,4%	48,8%
Capital Strength		
Equity/Assets	7,7%	6,6%
Tier 1 Ratio	12,4%	13,3%
RWAs/Total Assets	60,9%	39,8%

	2008	
	SFBs	GSIFIs
Loans/Assets	76,0%	38,8%
Deposits/Assets	71,5%	42,0%
Capital Strength		
Equity/Assets	7,3%	5,0%
Tier 1 Ratio	11,6%	10,1%
RWAs/Total Assets	60,5%	41,0%

	2003	
	SFBs	GSIFIs
Loans/Assets	77,1%	43,4%
Deposits/Assets	71,4%	47,3%
Capital Strength		
Equity/Assets	6,2%	5,2%
Tier 1 Ratio	n/m	n/m
RWAs/Total Assets	n/m	n/m

	2009–2013	
	SFBs	GSIFIs
Return on Assets	0,66%	0,46%
Return on Assets – Standard Deviation	0,16%	0,20%
Return on Equity	8,6%	7,6%
Return on Equity – Standard Deviation	2,4%	3,8%

	2003–2013	
	SFBs	GSIFIs
Return on Assets	0,68%	0,58%
Return on Assets – Standard Deviation	0,30%	0,35%
Return on Equity	9,2%	10,3%
Return on Equity – Standard Deviation	3,7%	7,9%

	2003	
	SFBs	GSIFIs
Return on Assets		
Return on Assets – Standard Deviation		
Return on Equity		
Return on Equity – Standard Deviation		

	2009–2013	
	SFBs	GSIFIs
Loans	13,2%	3,8%
Deposits	15,3%	4,9%
Assets	12,9%	0,7%
Equity	13,8%	8,6%
Total Income	8,5%	6,5%

	2003–2013	
	SFBs	GSIFIs
Loans	9,3%	8,3%
Deposits	10,4%	9,4%
Assets	9,0%	8,5%
Equity	10,8%	11,0%
Total Income	6,4%	6,4%

	2003	
	SFBs	GSIFIs
Loans		
Deposits		
Assets		
Equity		
Total Income		

Developing Market SFBs

	2013	2008	2003
Real Economy			
Loans/Assets	67,1%	74,8%	74,3%
Deposits/Assets	64,9%	67,9%	56,1%
Capital Strength			
Equity/Assets	9,0%	9,1%	16,7%
Tier 1 Ratio	10,6%	7,7%	9,6%
RWAs/Total Assets	73,2%	77,3%	77,2%

	2009–2013	2003–2013
Financial Returns and Volatility		
Return on Assets	1,9%	2,48%
Return on Assets – Standard Deviation	0,5%	1,09%
Return on Equity	20,4%	22,5%
Return on Equity – Standard Deviation	6,0%	8,2%

	2009–2013	2003–2013
Compound Annual Growth Rates		
Loans	23,8%	30,8%
Deposits	26,3%	32,1%
Assets	26,7%	31,3%
Equity	25,0%	24,8%
Total Income	22,3%	28,0%

Acknowledgements

This study was undertaken by the Global Alliance for Banking on Values (GABV). This research builds on a March 2012 report supported by the GABV with additional financial support from The Rockefeller Foundation. These studies were conducted with the assistance of and input from Enclude (www.encludesolutions.com) (previously doing business as ShoreBank International and Triodos Facet), an advisory firm dedicated to building an inclusive and prosperous global economy. The primary author of this study is David Korslund, Senior Advisor to the GABV (David.Korslund@gabv.org). Extensive analytical and other support was provided by Radek Halamka and Diederik van Meenen, GABV Interns. This effort was supported by input and support from GABV members for which the author is very grateful.

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