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for banking
on values



***Real Economy – Real Returns:
A Continuing Business Case for Sustainability-
focused Banking***

2016 Research Report

Real Economy – Real Returns: A Continuing Business Case for Sustainability- focused Banking

A sustainable real economy¹ requires enterprises and individuals that put people before profit, focusing their resources on activities that deliver economic resiliency, environmental regeneration and social empowerment for the communities and people they serve. Banking and financial institutions are uniquely positioned to provide critical financial products and services needed to support enterprises and individuals in these initiatives.

Following the 2008 financial crisis, banks that put people before profit have gained recognition and are growing in strength and number. Whether called regenerative banking, ethical banking, values-based banking or sustainable banking; a growing number of banking institutions are reassessing their role in supporting the delivery of social, economic and environmental impact. We call these banking institutions sustainability-focused banks.

This banking approach is much more than corporate social responsibility or charitable giving. It is banks embracing a viable model that strategically take a longer term view of profit and prosperity. For sustainability-focused banks, profit is a result of sustaining and growing value in the real economy and healthy communities, not an end goal.

Sustainability-focused banks are growing in strength and number because they focus on serving real human needs in the real economy. They do this by providing investment capital, safe depositories for monetary assets, and cash payment services required by enterprises and individuals living and operating in the real economy.

Since the financial crisis seven years ago, a group of sustainability-focused banks (all members of the [Global Alliance for Banking on Values \(GABV\)](#)²), have demonstrated that a focus on the real economy with a dedication to supporting economic, social and environmental impact delivers steady financial returns. These banks operate in numerous markets, serve diverse needs, use distinct business models but share a common strategic foundation; the [Principles of Sustainable Banking](#)³. They are growing because they provide economically viable banking alternatives focused on the needs of society thereby creating a more diverse financial ecosystem.

Since 2012 the GABV has published research comparing the results of sustainability-focused banks with the largest banks in the world. This research originally looked at financial results through year-end 2010 and is now updated through yearend 2015. Initial results were impacted by the results of the 2008 financial crisis. It is striking that with the crisis now several years behind us, the conclusions remain fundamentally the same.

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 its [website](http://www.gabv.org): www.gabv.org

³ [Principles of Sustainable Banking](#) (Appendix 1). www.gabv.org/about-us/our-principles

Sustainability-focused banks have constantly shown that serving the real economy delivers better and more stable financial returns than those shown by the largest banks in the world. These sustainability-focused banks address the very real needs of enterprises and individuals within their communities for banking services, especially credit. The success of their banking approach is verified by independent research⁴. There is also increased evidence of the support for sustainability-focused banking from regulation in developing markets such as Peru, Malaysia, Nigeria and elsewhere.⁵ This awareness is also increasing in developed markets as well over the last year. Finally the overall positive returns of sustainability focused enterprises is now also being demonstrated.⁶

Why isn't all banking done this way?

The data is clear: making the business case for sustainability-focused banking compelling. So why aren't all banks adopting this model? The reasons are many, ranging from: inertia and the power of the status quo, including existing personal incentive structures; a lack of courage and innovation by banking executives and shareholders in changing course; and limited awareness of the data that reports like this provide.

However, there is growing recognition of the need for a change in how banks behave and operate⁷ that over time should result in the growth of sustainability-focused banks within the overall financial ecosystem. There are early signs that investors are beginning to seek a more stable return from their investments in banks where they can also verify that their capital is being used to support real economy activity.

Research Outline

The GABV research comparing the results of sustainability-focused banks (SFBs) with Global Systemically Important Financial Institutions (GSIFIs)^{8,9}, focuses 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?**

⁴ [Growth for Good or Good for Growth: How Sustainable and Inclusive Activities are Changing Business and Why Companies Aren't Changing Enough](http://www.citifoundation.com/citi/foundation/pdf/1221365_Citi_Foundation_Sustainable_Inclusive_Business_Study_Web.pdf) produced by CitiFoundation, The Fletcher School, and the Monitor Institute (http://www.citifoundation.com/citi/foundation/pdf/1221365_Citi_Foundation_Sustainable_Inclusive_Business_Study_Web.pdf), [Banking on Shared Value: How Banks Profit by Rethinking Their Business](http://www.fsg.org/publications/banking-shared-value?srpush=true) published by FSG (<http://www.fsg.org/publications/banking-shared-value?srpush=true>). [The Effect of Ethics on Banks' Financial Results, Radek Halamka and Petr Teplý](https://www.vse.cz/pep/609) (<https://www.vse.cz/pep/609>).

⁵ International Finance Corporation [Sustainable Banking Guidance](http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Partnerships/Sustainable+Banking+Network/SB+Guidance+from+SBN+Members/) (http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Partnerships/Sustainable+Banking+Network/SB+Guidance+from+SBN+Members/). Central Bank of Nigeria [Principles of Sustainable Banking](http://www.cenbank.org/out/2012/ccd/circular-nsbp.pdf) (www.cenbank.org/out/2012/ccd/circular-nsbp.pdf)

⁶ [Corporate Sustainability: First Evidence on Materiality](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2575912) written by Mozaffar Khan, George Serafeim, and Aaron Yoon (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2575912).

⁷ John Gapper, *Other Peoples Money*; Luigi Zingales, [Does Finance Benefit Society](http://faculty.chicagobooth.edu/luigi.zingales/papers/research/Finance.pdf) (faculty.chicagobooth.edu/luigi.zingales/papers/research/Finance.pdf)

⁸ Learn more at the Financial Stability [website](http://www.financialstabilityboard.org) (www.financialstabilityboard.org)

⁹ Listing of Sustainability Focused Banks and GSIFI Peer Groups can be found in Appendix 2.

This report provides a sixth update of that research and incorporates financial results through the end of 2015. The GABV research is based on publicly available financial information. Initial research released in March 2012 was based on financial information through the end of 2010.

What is most striking is the data consistency over the years proving the business case for investing in SFBs that serve the real economy, and the business case for banking institutions that operate in accordance with 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 economy, in contrast to the financial economy. Furthermore, there is limited disclosure of non-balance sheet activities that could be relevant. Therefore, this research uses lending and deposit information as a proxy for the distinction between the real and the financial economy activities of banking institutions.

The degree to which a banking institution finances the real economy is evident from the portion of assets on its balance sheet devoted to lending. As a group, the difference between SFBs and GSIFIs in the research is striking. For SFBs the level of lending is nearly double that of GSIFIs. And it remains core to their activity with over 75% of their balance sheets devoted to lending compared to just over 40% of the balance sheets of GSIFIs in 2015.

CHART 1 – Loans to Total Assets

Loans / Total Assets	2015	2010	2005
SFBs	76.8%	78.1%	72.9%
GSIFIs	41.6%	39.9%	41.4%

In addition to the focus on lending, SFBs rely much more on client deposits to fund their balance sheets in comparison with GSIFIs. This focus on deposit taking is another example of their focus on real needs of individuals and enterprises and the real economy. Furthermore, this reliance on customer deposits reduces the liquidity risk of their funding strategies while returning to the roots of banking that intermediated between clients with excess capital and those in need of capital for productive investments.

CHART 2 – Deposits to Total Assets

Deposits/Assets	2015	2010	2005
SFBs	81.7%	77.0%	73.9%
GSIFIs	52.2%	47.0%	46.5%

SFBs also maintained strong capital positions, relative to GSIFIs, especially when measured as a comparison of Equity/Total Assets ratios. At the same time, high levels of capital did not reduce their appetite to lend, challenging claims by some larger banking institutions that higher capital requirements lead to less lending.

SFBs did not show higher levels of capital than GSIFIs relative to risk-based capital measures¹⁰. This increase appears to be primarily driven by pressure from regulators and governments seeking to avoid future bailouts for larger financial institutions as occurred after the 2008 financial crisis. This contrasts with the capital ratios of SFBs which have been historically strong as part of their strategy of being resilient.

The ratios for GSIFIs were significantly impacted by the relatively low level of Risk Weighted Assets (RWA) compared to total assets, as calculated by their internal risk models. There is an ongoing discussion, led by regulators and supported by regulatory research, as to whether these calculated levels of RWAs fully capture the risks for which capital is required¹¹. Therefore, the strength of the Equity/Total Assets ratios of SFBs positions them well for challenging economic conditions in contrast to GSIFIs with lower levels of equity to total assets.

In reviewing the ratio of RWAs to Total Assets, the GSIFIs have decreased this ratio over the periods reviewed suggesting their view that their assets are less risky. In contrast this ratio for SFBs has increased suggesting a more conservative approach.

CHART 3 – Capital Comparisons

Equity / Total Assets	2015	2010	2005
SFBs	8.1%	8.1%	6.3%
GSIFIs	7.3%	6.3%	4.9%
Tier 1 Ratio			
SFBs	12.8%	12.4%	11.6%
GSIFIs	14.0%	12.4%	8.4%
RWA / Total Assets			
SFBs	61.6%	61.9%	53.0%
GSIFIs	44.2%	41.5%	49.3%

SFBs have historically stable Returns on Assets (ROA), although prior to the crisis at levels below those reported by GSIFIs. However, the SFBs provided resilient financial returns better than GSIFIs over the last ten years, with lower levels of volatility. As noted in earlier reports this result challenges the prevailing assumptions of many

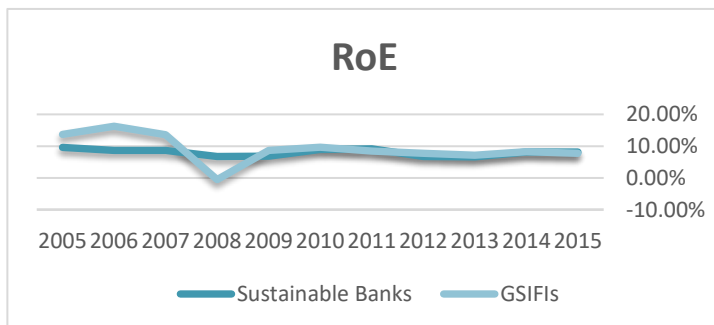
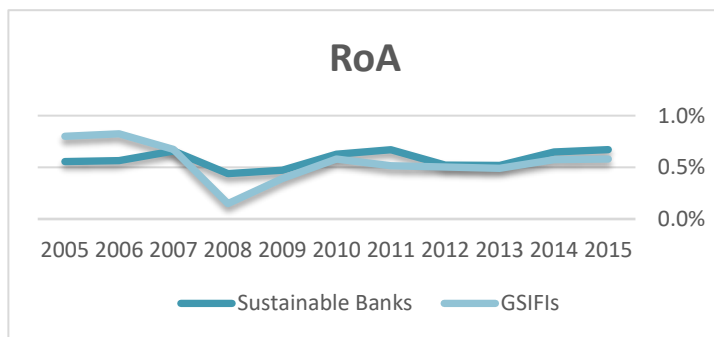
¹⁰ Due to changes in capital regulation over the full time period, Tier 1 Ratios and RWAs/Total Assets Ratios are not meaningful for the full cycle and in the pre-crisis period.

¹¹ *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 (<http://www.bankofengland.co.uk/publications/Pages/speeches/2012/596.aspx>). *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 (https://www.fdic.gov/news/news/speeches/chairman/spsep1412_2.html).

investors that SFBs would deliver lower returns than larger banks that have a focus on maximising financial returns.

Relative to Returns on Equity (ROE) GSIFIs performed better, on average, over the last ten years albeit with more volatility. However, post-crisis returns for SFBs are higher than those of GSIFIs, and with less volatility. In addition, a lower level of Equity/Assets for GSIFIs means that a portion of GSIFIs' returns is due to greater leverage; implying greater risk. Investors and others assessing the Return on Equity should expect higher returns for GSIFIs given both the higher degree of leverage and the greater volatility of the returns.

CHART 4 – ROA and ROE Comparisons



	Return on Assets	
	5y (2011-2015)	
	Average	St. Dev.
SFBs	0.64%	0.19%
GSIFIs	0.53%	0.19%

	10y (2006-2015)	
	Average	St. Dev.
SFBs	0.65%	0.26%
GSIFIs	0.53%	0.35%

	Return on Equity	
	5y (2011-2015)	
	Average	St. Dev.
SFBs	8.0%	2.3%
GSIFIs	7.8%	3.3%

	10y (2006-2015)	
	Average	St. Dev.
SFBs	8.3%	4.9%
GSIFIs	8.7%	7.7%

It is of interest that there are new sources of stress on the financial returns for GSIFIs and other large global financial institutions. The costs related to legal and compliance issues leading to fines that have consistently grown over several years. The CCP Research Foundation estimates that these costs exceed GBP 205 billion for the period between 2010 and 2014.¹² The vast majority of these costs were incurred by GSIFIs.

¹² Learn more from [CCP Research Foundation \(conductcosts.ccpresearchfoundation.com/conduct-costs-results\)](http://conductcosts.ccpresearchfoundation.com/conduct-costs-results)

For SFBs the impact of these costs resulting from fines and sanctions are minimal to non-existent. The SFBs have borne the increased costs of internal compliance teams to meet more complex requirements placed on all banks, regardless of the SFB history of minimal compliance issues impacting clients and society. While incurring these additional costs, driven by regulators addressing the misdeeds of others, SFBs have maintained their profitability.

The issue of growth further demonstrates marked differences between the two groups. SFBs had much higher growth in Loans, Deposits, Assets, Equity and Total Income compared to GSIFIs over time especially since the crisis began.

CHART 5 – Growth

	5y (2011-2015)	10y (2006-2015)
Loans		
SFBs	11.3%	13.9%
GSIFIs	4.9%	6.2%
Deposits		
SFBs	12.4%	14.2%
GSIFIs	5.1%	7.5%
Assets		
SFBs	8.9%	12.9%
GSIFIs	1.9%	5.2%
Equity		
SFBs	9.3%	14.5%
GSIFIs	5.7%	9.8%
Total Income		
SFBs	7.6%	10.4%
GSIFIs	0.5%	4.9%

European Challenges

The research has again been extended to specifically make a comparison in the European market. There are nine SFBs and 13 GSIFIs based in Europe¹³. Comparing these two groups operating with similar market conditions further highlights the strength of the sustainability-focused banking model. As shown in the comparison, SFBs in Europe show significantly higher levels of finance for the real economy, stronger levels of

¹³ Full comparison details of European SFBs and European and US GSIFIs (Appendix 3).

equity capital, and better levels of Return on Assets with lower volatility. They also delivered significantly stronger levels of growth over the cycle, especially post-2008 when the crisis became evident.

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

Conclusions

Sustainability-focused banks continue to demonstrate the ability to deliver steady risk-adjusted financial returns by focusing on the real economy, and acting as financial intermediaries dedicated to supporting economic, social and environmental impact while anchored by strong capital positions. These banking institutions operate in numerous markets, serving diverse needs, using distinct business models but they are united by a set of common guidelines, the [Principles of Sustainable Banking](#). These banks are growing in size and number because they are meeting the needs of individuals and enterprises in the communities where they live and operate.

The banking ecosystem will be strengthened as a result of the growth of financial institutions operating in accordance with the [Principles of Sustainable Banking](#). Systemic strength and lower risk to depositors and deposit guaranty programs will come from the resilient and positive performance of these banks. These banks deliver shared economic, social and environmental value to multiple stakeholders including society, clients, co-workers and investors.

[Why isn't all banking done this way?](#)



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 as of 31 December 2014

Global Systemically Important Financial Institutions¹⁴

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

Sustainability Focused Banks¹⁵

1. Affinity Credit Union
2. Alternative Bank Schweiz
3. Assiniboine Credit Union
4. Banca Popolare Etica
5. Banco Ademi
6. Bank Australia
7. BancoFie
8. BancoSol
9. Beneficial State Bank**
10. BRAC Bank
11. Centenary Bank**
12. City First Bank
13. Cultura Bank
14. Ecology Building Society
15. Ekobanken
16. First Green Bank**
17. GLS Bank
18. Group Crédit Coopératif
19. Merkur Cooperative Bank
20. New Resource Bank**
21. NMB Bank Limited
22. SAC Apoyo Integral
23. Southern Bancorp
24. Sunrise Community Banks
25. Triodos Bank
26. Vancity
27. Vision Banco**
28. XacBank

**** These banks did not have financial history for the full 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.**

¹⁴ This list is defined and published by the [Financial Stability Board](http://www.financialstabilityboard.org) (www.financialstabilityboard.org). Banks in orange were included in the European comparison.

¹⁵ SFBs were defined to include all banks that were members of the Global Alliance for Banking on Values as of 31 December 2015. Banks in orange were included in the European comparison. 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.

Appendix 3 Financial Comparisons

All Banks

	2015		2010		2005	
	SFBs	GSIFIs	SFBs	GSIFIs	SFBs	GSIFIs
Real Economy						
Loans/Assets	76.8%	41.6%	78.1%	39.9%	72.9%	41.4%
Deposits/Assets	81.7%	52.2%	77.0%	47.0%	73.9%	46.5%
Capital Strength						
Equity/Assets	8.1%	7.3%	8.1%	6.3%	6.3%	4.9%
Tier 1 Ratio	12.8%	14.0%	12.4%	12.4%	11.6%	8.4%
RWAs/Total Assets	61.6%	44.2%	61.9%	41.5%	53.0%	49.3%
Financial Returns and Volatility						
			5y (2011-2015)		10y (2006-2015)	
			SFBs	GSIFIs	SFBs	GSIFIs
Return on Assets			0.64%	0.53%	0.65%	0.53%
Return on Assets - Standard Deviation			0.19%	0.19%	0.26%	0.35%
Return on Equity			8.0%	7.8%	8.3%	8.7%
Return on Equity - Standard Deviation			2.3%	3.3%	4.9%	7.7%
Compound Annual Growth Rates						
			5y (2011-2015)		10y (2006-2015)	
			SFBs	GSIFIs	SFBs	GSIFIs
Loans			11.3%	4.9%	13.9%	6.2%
Deposits			12.4%	5.1%	14.2%	7.5%
Assets			8.9%	1.9%	12.9%	5.2%
Equity			9.3%	5.7%	14.5%	9.8%
Total Income			7.6%	0.5%	10.4%	4.9%

European Banks Comparison

	2015			2010			2005		
	European SFBs	European GSIFIs	US GSIFIs	European SFBs	European GSIFIs	US GSIFIs	European SFBs	European GSIFIs	US GSIFIs
Real Economy									
Loans/Assets	75.9%	47.6%	28.6%	76.2%	45.2%	27.6%	65.0%	44.0%	32.0%
Deposits/Assets	81.5%	44.9%	54.4%	69.6%	38.5%	45.8%	61.5%	38.0%	44.2%
Capital Strength									
Equity/Assets	8.6%	6.1%	10.2%	9.6%	4.9%	9.5%	7.1%	4.1%	6.9%
Tier 1 Ratio	13.1%	14.6%	14.2%	12.2%	12.2%	13.9%	10.0%	8.0%	6.9%
RWAs/Total Assets	64.6%	35.3%	56.4%	71.7%	34.0%	51.7%	67.7%	38.5%	51.3%
Financial Returns and Volatility									
	5y (2011-2015)			10y (2006-2015)					
	European SFBs	European GSIFIs	US GSIFIs	European SFBs	European GSIFIs	US GSIFIs			
Return on Assets		0.35%	0.21%	0.72%		0.36%	0.28%	0.71%	
Return on Assets - Standard Deviation		0.12%	0.24%	0.21%		0.17%	0.33%	0.44%	
Return on Equity		4.0%	4.2%	7.7%		4.1%	6.1%	8.6%	
Return on Equity - Standard Deviation		1.5%	4.6%	2.1%		2.1%	8.6%	6.1%	
Compound Annual Growth Rates									
	5y (2011-2015)			10y (2006-2015)					
	European SFBs	European GSIFIs	US GSIFIs	European SFBs	European GSIFIs	US GSIFIs			
Loans	11.4%	-0.6%	10.0%	15.2%	3.8%	7.5%			
Deposits	13.7%	1.8%	8.4%	15.9%	4.5%	11.2%			
Assets	8.0%	-2.2%	3.1%	13.5%	2.0%	6.7%			
Equity	7.4%	2.3%	4.5%	15.9%	6.2%	11.4%			
Total Income	7.4%	-2.9%	-0.7%	11.8%	1.8%	4.9%			

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