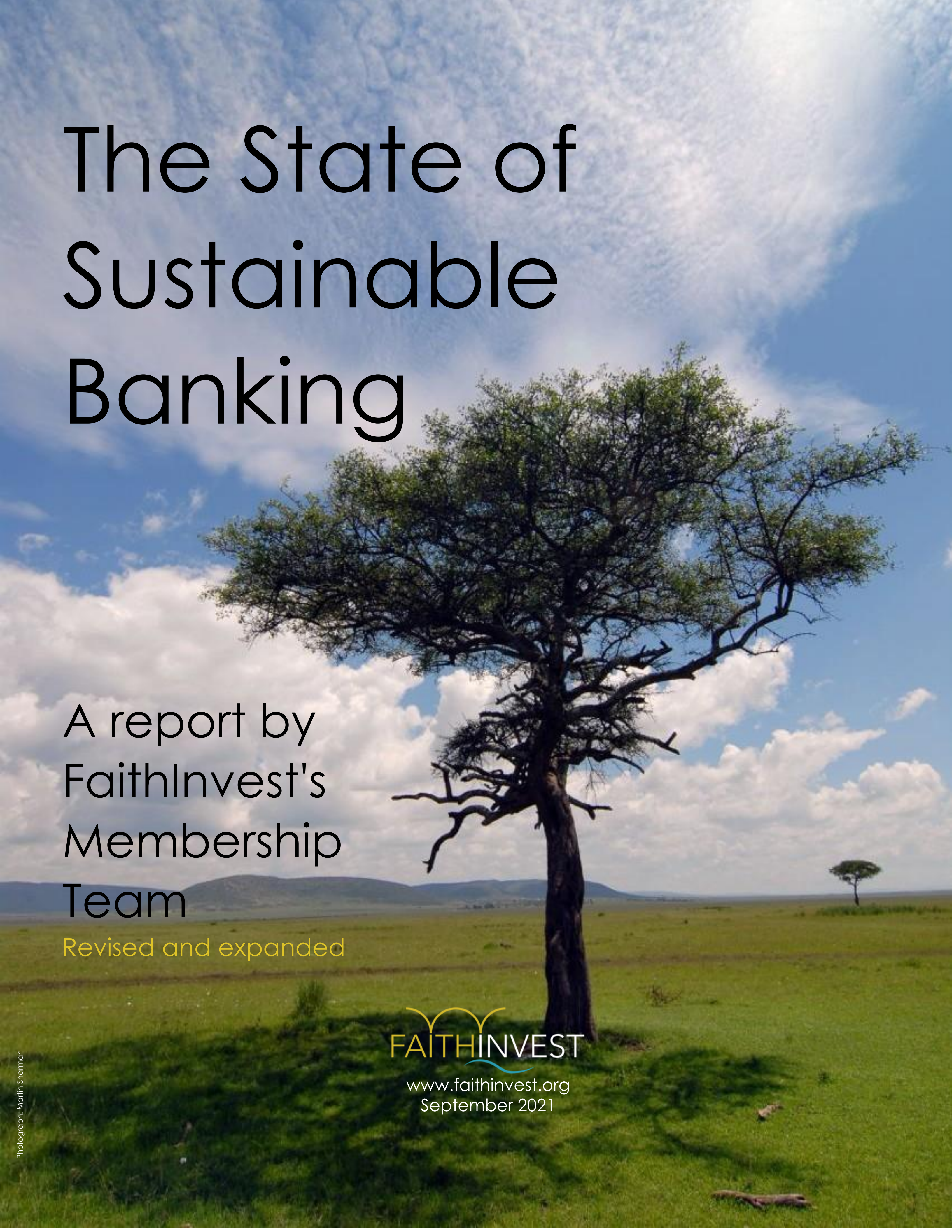

The State of Sustainable Banking

A report by FaithInvest's Membership Team

Revised and expanded

FAITHINVEST

www.faithinvest.org

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Photograph: Martin Sharman

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Introduction

Global banks' $750bn in fossil fuels finance conflicts with green pledges

Financial Times
March 24, 2021

Financial Times
March 27, 2021

'Dirty Dozen' reduce financing but still hold more than $2tn in fossil fuel loans

Recent headlines in the financial press made grim reading for environmentally conscious investors. As the above headlines show, the world's biggest banks are still funding fossil fuels, including a number of signatories to the UN Principles for Responsible Banking. This is a growing concern for faith groups, an increasing number of which are adopting values-driven positions on climate change, including divesting from fossil fuels.

So how can a values-driven faith asset owner find a bank that shares its values, whether on climate or other issues? And what are the tradeoffs, if any, in working with such a bank? FaithInvest's Membership Team takes a look at these questions in its updated State of Sustainable Banking Report. We use the term 'sustainable banking'; others may use various terms such as 'ethical banking'.

Paul Goldwhite and Mathew Jensen
FaithInvest, September 2021

Sustainable banking – A commercial perspective

There are few ways a values-driven asset owner can have greater impact, dollar for dollar, than through their choice of banking partner. Religious organizations, broadly defined, are major customers of the world's banks. How big?

As with most information relating to religions and money, this is highly confidential data, and very difficult to quantify, but we can get a sense of the magnitude through reports like *Giving USA 2020* which found "Giving to religion increased 2.3% between 2018 and 2019, with an estimated $128.2 billion in contributions"[1]. This represents one year of cash

[1] *Giving USA 2020*: Charitable giving showed solid growth, climbing to $449.64 billion

contributions in just one country, the United States. Expand this number to all countries across years and the amount of money passing through, or on deposit in banks hired by faith organizations is meaningful. Some of this cash on deposit by faith asset owners is held safely in reserves by the bank, much of it is loaned out – typically on over 70%[2] on average, in part to individuals, or "consumers" in the parlance, in the form of mortgages or other consumer loans, and also to "non-consumers" such as governments, other financial institutions, and commercial and industrial borrowers to fund their business and investment activities. Depending on the bank, non-consumer lending can be a significant part of their loan portfolio.[3] While non-consumer lending activity can fund projects like affordable housing, as recent research has highlighted[4] many of the world's largest banks have provided significant loans and underwriting support to fund fossil fuel commercial and government activities.

Simply, if the bank shares the depositor's values in how they lend, every dollar on deposit can be values-aligned. If the bank does not share the depositor's values, deposits may be used to fund activities that conflict with the depositor's values.

In addition to deposits, faith organizations as bank customers pay fees to banks, directly or indirectly, through securities brokerage, treasury services, custody and securities lending, and other commercial bank activities. In short, customers are a major source of profits for banks, which should give them significant influence over banks. Customers may exercise influence by expressing their views to bank management ("customer advocacy") or through their choice of banking partners.

Recently launched "sustainable banking" efforts, like the Net-Zero Banking Alliance[5] and growth in groups like the Global Alliance for Banking on Values[6], suggests there may more options, actions and alternatives for faith asset owners seeking values-aligned banking.

What is sustainable banking?

There are *many* names in the market today for banks and banking that pursue or adhere to non-financial values-aligned objectives or parameters as part of their business – Ethical, Social, Alternative, or Just Banking, to name a few. For this paper, we'll use *Sustainable Banking* as an umbrella term for these various names. As the varied names suggest, what constitutes sustainable banking is, to a degree, in the eye of the beholder.

Banks have widely varying sustainability. The aforementioned 'Dirty Dozen' banks are among

[2] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/loan-to-deposit-ratios-keep-sliding-at-us-banks-64816545

[3] Gross loan activity for a bank can be difficult to find. For one example, see page 32 of this Credit Suisse Investor Presentation: https://www.slideshare.net/creditsuisse/equity-investor-presentation

[4] http://priceofoil.org/content/uploads/2020/03/Banking_on_Climate_Change_2020.pdf

[5] https://www.unepfi.org/net-zero-banking/

[6] https://www.gabv.org/

the least sustainable, as they finance large amount of fossil fuel production. At the other end of the spectrum are highly sustainable banks with very low or negative carbon intensity of their loan portfolios.

Sustainability can be about many things, not just impact on climate. Parts of the philanthropic community and academia have developed a definition of 'sustainable banking' that is distinct from traditional banking. An oversimplification of sustainable banking, but a useful one, is *banking with impact*.

Below, we list key criteria used to judge a bank's sustainability:

- *Values-profitability.* This refers to several types of behaviour. Crucially, it means the bank should fund activities with social and environmental added value (impact). It also means avoiding financing proscribed enterprises, and often covers themes related to human rights[7]. Social profitability also involves financial inclusion: a sustainable bank should ensure its services are available to traditionally underserved communities. A growing number of banks are setting aside a portion of their assets for socially beneficial activities. Because some of these banks are very large, they can commit substantial resources to this effort[8]. At the same time, studies[9] show that many of these banks continue to fund activities that some socially responsible investors find objectionable.

- *Transparency.* Sustainable banks are expected to be transparent in their operations, particularly as regards their loan portfolio. Transparency allows clients to ensure that their bank is providing funding consistent with their values and any stated sustainable guidelines. Further, some sustainable banks allow depositors to guide and restrict the uses of their funds on deposit.

- *Faith-specific considerations.* Some banks serve specific faiths. For example, Islamic banks offer services that comply with the tenets of Islam including the prohibition on paying interest. The Vatican's bank, The Institute of Religious Works, provides banking services for some Catholic organisations.

Of course, dedicated sustainable banks must be economically viable, but we find today that they generally do not distribute large profits to shareholders, and they tend to limit executive pay and employee pay differentials, among other differences in their operating practices. More traditional commercial or retail banks may offer sustainable products, like ESG money market funds or impact-oriented investment services, or they may dedicate a

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[7] For a recent example, see As Major U.S. Banks Stop Funding Private Prisons, Companies Seek Money Abroad (eji.org)

[8] For a recent example, see JPMorgan pledges $2.5 trillion over 10 years toward climate change (cnbc.com)

[9] For example, see Banking on Climate Chaos - Rainforest Action Network (ran.org)

certain portion of their loan or underwriting activity to ESG related borrowers, as components of their overall business. In general, we find today that fully commercial banks, at one end of the spectrum, tend to emphasize financial profitability while meeting various regulatory regimes, and the larger commercial banks may additionally be classified as "systematically important" by groups such as the Financial Stability Board[10], with additional reporting and regulatory requirements. At the other end of the spectrum, Sustainable Banks, identified by membership in standard setting organizations like Global Alliance for Banking on Values[11], tend to emphasize "values profitability" and more traditional impact investing metrics, with additional related transparency and reporting on their operations and loan portfolios.[12] Further, sustainable banks may be faith aligned or sponsored, with dedicated banks today serving Christian, Hindu, Islamic, Jewish and other faith organizations and communities around the world.

[10] [Financial Stability Board (fsb.org)]

[11] [Global Alliance For Banking on Values ~ Independent banks delivering sustainable development for unserved people (gabv.org)]

[12] For a good example see Triodos: [Key figures - Integrated Annual Report 2020 (annual-report-triodos.com)]

Do dedicated sustainable banks provide the services needed by Faith Asset Owners?

Faith-oriented needs for banking services depend on which activities they undertake in-house:

- Deposits and checking – *almost all faith organizations need this*
- Corporate treasury and employer services
- Loans, credit or financing
- Safe keeping of securities
- Securities brokerage services
- Securities lending

Sustainable banks generally provide deposits, checking and credit. Another consideration is whether an investor needs a bank with a network of global offices. Most sustainable banks lack the geographic reach of traditional large global banks, and we have not identified sustainable banks that offer other commercial services like custody, brokerage or securities lending. Asset owners requiring such services could use a sustainable bank for "local" deposits and checking, and work with a traditional bank for other banking needs.

Sustainable banking – the role of advocacy

Because sustainable banks may not offer all the services some asset owners need, many will continue to do business with traditional banks. Even in traditional banking relationships, however, asset owners can still promote and cultivate sustainability - through advocacy.

Asset owners have two forms of advocacy: as customers and as shareholders. Shareholder advocacy is a well-established way to promote sustainable banking practices, with its roots in the South African anti-apartheid shareholder resolutions fifty years ago, through to major shareholder efforts today to eliminate banking activities in coal production[13], as an example.

Shareholder advocacy is the idea that the owners, or shareholders, of a company can influence its behavior in many ways, including *how* it generates profits as well as sustainability, among other things. Shareholder advocacy can take the form of direct engagement with the bank's leadership, submitting shareholder proposals for a company to take a specific course of action, or voting on shareholder proxies all in a manner consistent with the shareholder's values. The path to success in shareholder advocacy, as with

[13] https://www.nasdaq.com/articles/hsbc-toughens-stance-on-fossil-fuel-funding-after-shareholder-heat-2021-03-10

customer advocacy, is strength in numbers. There are organizations whose purpose is to influence the behavior of companies in which their members are shareholders. While each member of the organization may hold only a small number of shares, collectively they may represent a fraction of the company that is large enough to get the attention of management. An example of one such organization that is highly relevant to faith asset owners is the Interfaith Center on Corporate Responsibility, ICCR. ICCR provides a forum for its members to share views and, if desired, coordinate interactions with companies with the goal of changing corporate behavior so that it more closely aligns with their values.

Advocacy from a customer perspective is a more recent phenomenon. Customer advocacy means raising issues of prime importance to the attention of senior managers at the bank from the position as a customer of the bank. Unlike shareholders, customers have no legal or formal say in the governance of the bank, rather, they are able to influence the bank through their impact on the bank's business, profitability and reputation. When enough customers start asking for the same thing, the bank may be compelled to respond.

A relevant related example is that customer advocacy has been the main driver of the ongoing surge in ESG investing: asset owners pressured investment managers for many years. It is plausible that if a critical mass of bank customers advocates for, say, net-zero carbon intensity of the loan portfolio, banks will feel pressure to comply, as those customers can take their business to banks that are more responsive. Some traditional banks have already said they would meet this goal by 2050, encouraged in part by recent shareholder engagement efforts, but additional pressure from customers might help bring this date forward.

There are organizations, such as BankFWD, that can help customers focus their advocacy efforts with banks and generate critical mass. Faith-based organizations can multiply their advocacy efforts by encouraging business leaders within their congregations who share their values to make similar requests of their banks.

Identifying sustainable banks

There are several networks of dedicated likeminded sustainable banks that support common principles. Examples include:

- Global Alliance for Banking on Values, GABV – 65 banks, $200 billion in assets
- European Federation of Ethical and Alternative Banks and Financiers, FEBEA – 30 banks

Further examples of networks that may include sustainable banks are:

- Cooperative banks – owned by their customers

- Credit unions – members required to share a common bond such as locality, employer, religion or profession

- Community development banks – provide access to financially underserved communities

Member banks in these organisations typically agree to a set of terms, principles, and standards[14] that essentially define sustainable banking, usually in the form of pledges, along with meeting certain other criteria around business lines offered, balance sheet size and location.

While these organisations collect information on the bank's '…functioning, the collection of savings and the use of resources'[15], it is unclear if these organisations in any way independently monitor member bank's compliance with their terms, principles and standards.

Potential concerns with sustainable banks

There is anecdotal evidence suggesting that sustainable banks may be somewhat less risky than otherwise similar traditional banks. As noted, self-identified sustainable banks tend to be smaller, often regionally focused, and perhaps less diversified than their traditional bank counterparts.

On the other hand, sustainable banks may be less complex businesses, and know their customers better from a more focused client-base. Also, sustainable banks, by the nature of their missions, tend to avoid highly controversial industries such as those that are widely recognised to aggravate climate change. While fossil fuel industries, for instance, may offer potentially lucrative investment opportunities, at least in the short term, they are potentially subject to heightened legal, regulatory and commercial risks. A sustainable bank that avoids those industries is protecting itself from those risks.

Another possible concern is that some sustainable banks offer below-market interest rates on deposits. This may not matter much at a time when interest rates are quite low, but that will not always be the case.

Few sustainable banks are household names. They can be identified through sustainable banking networks, two of which are mentioned above. Even within the same network of sustainable banks, individual banks vary in how they implement and act on sustainable banking (for example, how they seek to have impact on their communities). Sustainable banks also tend to be privately owned, versus publicly listed, and therefore have more limited disclosures, and would not have ESG ratings and analysis from a recognised

[14] The FEBEA Charter for example, OUR CHARTER - Febea

[15] JOIN US - Febea

organisation. It therefore would take some effort to ascertain that a bank's values are aligned with the faith-based organisation, reliably delivers the requisite services, and is suitably 'safe' and highly solvent.

Key questions and challenges

While this segment of the banking universe continues to develop, and organisations such as those noted earlier provide better means and standards for identifying banks that seek to pursue sustainable practices, there are a number of key questions and challenges today for asset owners to adopt a sustainable banking partner:

- *Suitability*: How to identify, monitor and compare suitable sustainable banks to ensure values-alignment, while securing required banking services at competitive rates and costs?
- *Measurement*: How to think about the impact of moving to sustainable banking; how to measure it and how to compare it to other ESG or impact investing possibilities?
- *Indirect Relationships*: How to manage 'indirect' banking relationships, for example, a commingled fund investment where the asset manager is responsible for selecting the fund's bank (for custody, cash management, etc)?
- *Supporting Sustainable Banking*: Are there actions faith asset owners can take today that would provide support to identified sustainable banks? This may include using a sustainable bank for some deposit or investment activity.

Sustainable banking offers the opportunity for values-based asset owners to more fully align their financial activities with their values. Making sustainable banking a viable option for a broad array of values-based asset owners will require additional developments in at least the areas of Suitability and Measurement. With the spate of recent reports and press announcements related to sustainable banking issues, it may be time to engage the question: should my organisation consider a sustainable bank?

FaithInvest supports faith-based asset-owning institutions that want to engage with – and act on – key topics such as sustainable banking. More information: www.faithinvest.org