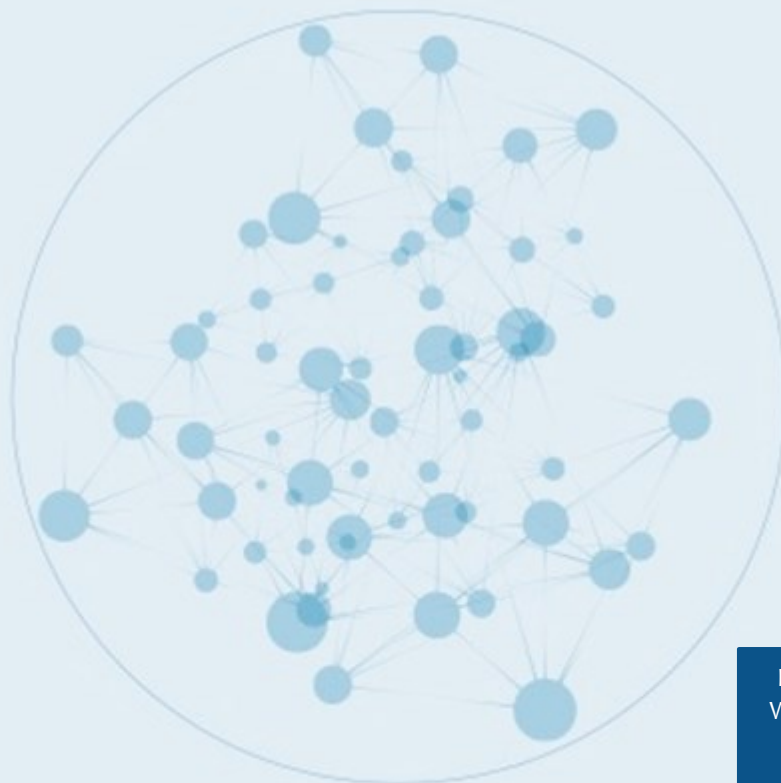




VALUES BASED BANKING

Bringing the voice of the
citizen into finance



INQUIRY
WORKING
PAPER

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The UNEP Inquiry

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to improve the financial system's effectiveness in mobilizing capital towards a green and inclusive economy—in other words, sustainable development. Established in January 2014, it will publish its final report in October 2015.

More information on the Inquiry is at: www.unep.org/inquiry or from: Ms. Mahenau Agha, Director of Outreach mahenau.gha@unep.org.

About this report

This Working Paper has been developed as a contribution to the UNEP Inquiry by a working group 'The Vienna Group of Citizens' that came together through the Institute for Social Banking (ISB) international summer school on the role of the citizen in banking in July 2014.

The working group includes participants from seven European countries working in social banking, civil society, business and academia. They also drew on their global networks including meeting with the Board of the International Association of Investors in the Social Economy (INAISE), the Secretariat of the Federation of European Ethical and Alternative Banks (FEBEA), and co-hosting a workshop with the Global Alliance for Banking on Values (GABV).

The paper is intended to stimulate discussion. The views expressed in this paper represent those of the authors and do not necessarily represent those of the host institutions or funders.

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Foreword – by the Vienna Group of Citizens

The initiators of this report came together at the 2014 Institute for Social Banking (ISB) International Summer School which had as its core theme the role of citizens in banking. We realised that the majority, if not all of the responses to the UNEP Inquiry on the Design of a Sustainable Financial System would come from institutions rather than from those at the very heart of any financial system: the citizen.

It can be argued that recent evidence of mis-selling, market-rigging and other bad-faith activities in the banking sector as well as its failure to provide financial services for all are evidence that the voice of the citizen is rarely heard either within banks or by those who regulate them.

We believe it is essential that citizens' voices are heard. We are confronting profound challenges caused at least in part by the way large parts of the financial system have served their own short term self-interest at the expense of the real economy and everyman and woman. A sustainable financial system must be shaped with citizens at its heart.

Grameen Bank founder Muhammad Yunus urges us to consider whether our bank is worthy of our custom, not the other way round. Only by rebuilding trust will banking earn the recognition by citizens of the enormous societal value it can generate. Today the world remains unconvinced while many senior bankers remain in denial. Yet there are values based banks already designing financial products and services to address social and environmental needs, invest in the real economy and find ways to bank the unbankable. These banks are also operating profitably and growing their market share.

The question we set out to explore with others was *“How does values based banking support a green economy?”*

However, before addressing the ‘greening’ of the financial system we need to state what we mean by sustainability. We believe it goes beyond ensuring that we are able to maintain the status quo with our energy intensive, consumer driven needs. Sustainability refers to the whole ecosystem, an interconnected web with a vast and rich diversity of species, of which humanity is only one part, and a high degree of inter connectedness. New economic and financial models are required which respect and support the ecosystem of which we are a part and which include care of the soul as a part of care of the planet.

In order to gather collective intelligence we carried out interviews, surveys, workshops and one-to-one meetings. We have engaged with some of the most respected influencers working to develop a more responsible, democratic and fair financial system. The process of inclusive action research has been important not only in gathering information but in building a movement for change. It is self-evident that we cannot represent citizens as a whole but we see this report as a prototype for further citizens' engagement in similar discussions about the financial system.

This report argues that values based banking has the potential to be a powerful channel for citizens' voices in finance, enabling people to make more active and informed decisions about their financial needs and their choices of their financial services providers. It highlights diverse examples and new thinking, shares knowledge on approaches and solutions outside of the mainstream of banking and finance, and explores the case for policy change.

Values based banking demonstrates a different way of operating, which to date has been at a small scale, compared to the giants of banking. Bolder leadership from both political and business leaders is necessary to scale up its impacts, but active citizen engagement is also of crucial importance.

Values based banking, which includes customers in its governance and operating system is the pivotal actor around which new socio-economic institutional arrangements can be built. Values based banking is purposively oriented towards the development of a values based economy which embraces the image of sustainability outlined above.

We welcome UNEP's intention in holding this Inquiry and trust that its Directors will recognise that the old paradigm lies in pieces having failed to make the world more inclusive or sustainable. It is time for a new paradigm: establishing a clear link between profit and social purpose, having the ability to measure it, and putting the citizen at the heart of the financial system. We believe that values based banking is the pivotal actor in the development of a values based economy.

We acknowledge that our simple vision is challenging and that there needs to be a transition period but we believe that only a financial system built upon values of sustainability, transparency, diversity/fairness and inclusion can deliver a step change in the financial system's effectiveness in mobilising capital towards a green and inclusive economy.

We hope that the UNEP Inquiry, as well as our own networks and communities will adopt, respect and champion the recommendations and, that the UNEP Inquiry will include the voice of the citizen in their final report.

| | |
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Summary

Today's financial system is in many ways too large, too complex, and too removed from the real economy. It has become focused on short-term profit maximisation, it does not pay enough attention to social and environmental risks, and it leaves 2.5 billion people without access to adequate or any financial services.

Banks play an important role in the economy intermediating between savers and borrowers. As such the role banks can play in contributing to or undermining sustainable development is profound. Values based banking is purposively oriented towards the development of a sustainable economy. It is a diverse movement drawing in community banks, ethical, green and socially oriented banks and including cooperatives, credit unions, privately owned banks, B Corporations and public companies. Values based banking is not determined by organizational form but is characterised by a culture and performance model based on:

- **Economic, social and environmental performance** as a 'triple bottom line'.
- **Serving communities and the real economy** and enabling new business models.
- **Long term relationships** with clients and a direct understanding of their economic activities.
- **Long term, self-sustaining resilience** to outside disruptions
- **Transparent and inclusive** governance

Values based banks have understood something that is missing in mainstream banking: that banking is a combination of responsibility for society and making reasonable profit to generate fair livelihoods. They have demonstrated that this approach can be well-governed and profitable, achieving success on both narrow financial measures as well as broader social, economic and environmental impacts.

We identify four values that need to be at the heart of a sustainable, or values based financial system: sustainability, transparency, diversity/fairness and inclusion.

To achieve its potential, values based banking has to broaden its outreach and diversify its portfolio by catering to stakeholders of both a values based economy and a market-oriented one. The paper highlights key channels for scaling up the impact of values based banking:

1. Growing the values based banking sector
2. Influencing mainstream banks to adopt sustainable strategies
3. Building capacity of civil society to catalyse change and hold the system accountable
4. Educating and engaging consumers
5. Accounting for environmental and social impacts
6. Creating policies and regulations aligned to sustainable finance

1 Challenges to Today's Financial System

The financial system provides three key services that support the real economy. These may be summarized as:

- **Payment, settlement and transaction services.** These include the provision of deposit and custody accounts, as well as services to support the settlement of payments between households and companies.
- **Intermediation.** Household savings are typically pooled in deposit accounts, pension funds or mutual funds. They are then transformed into funding for households, companies or government.
- **Risk transfer and insurance.** Deposit accounts allow households and companies to insure themselves against liquidity shocks, while some derivatives and other insurance contracts facilitate the dispersion of other financial risks within the economy.

“The purpose of the financial system is the role of a mediator between abundance and demand for money”

These services support the allocation of capital, and the production and exchange of goods and services, which are all essential to a well-functioning economy.¹ The basic services provided by the financial system are relatively timeless but the structure of the system that provides them continues to evolve.

Banks and capital markets channel savings into investment in quite different ways.² Banks perform intermediation mostly on their balance sheets. They take in savings typically as deposits and provide funding primarily in the form of loans, often through close relationships with borrowers. Markets tend to keep savers and investors at arm's length by serving as a forum where debt and equity securities are issued and traded. Banks can overcome problems arising from asymmetric information and contract enforcement using the knowledge they accumulate through relationships; markets do so by means of contract covenants and the courts.

This report is mainly focused on the role of banks. Banking is one of the oldest parts of the system, generally regarded as beginning with the first prototype banks of merchants in Assyria and Babylonia around 2000 BC, developing through the northern cities of medieval and early Renaissance Italy, to our modern banking system.

Throughout the history of banking there have been banks whose sole purpose was to serve the human needs of the real economy. For much of that time this was viewed as banking as normal: it was the mainstream. It is tempting to look back for a golden age of banking and finance. However, only 50-60 years ago just a small proportion of people in Europe had access to banks and those that did were almost exclusively from the higher socio-economic groupings.

¹ R. Davies, P. Richardson, V. Katinaite, and M. J. Manning (2010). Evolution of the UK banking system. Bank of England Quarterly Bulletin, Q4.

² L. Gambacorta, J. Yang and K. Tsatsaronis (2014). Financial structure and growth. BIS Quarterly Review, March 2014.

The current perception of the financial system, including banking is that the system as such is selfish, driven by short-term profit maximization and subverted by greedy managers. This might be true in part but it would be short sighted not to look at the overall role of the financial system in supporting the needs of the real economy. Although banks today are not seen as great innovators, significant innovations over time have undoubtedly enhanced the common good. These include the development of insurance, mortgage loans, microfinance, pensions, invoice discounting and the ability to hedge genuine currency and commodity risks.

“The opportunity for a new financial system at this point in time is the ongoing dissatisfaction with the financial system”

In this section we examine the current challenges facing the financial system (and banking in particular) which set the scene for needed innovations and responses from both within and outside of the mainstream of financial institutions.

1.1 Who does banking and the financial system serve?

The first challenge in developing a financial system that is aligned with the needs of sustainable development is to ensure it is truly inclusive. An economy is not sustainable in the long term if it excludes people or communities.

In 2009, more than half of the world’s adult population were unbanked.³ The World Bank reports that 75% of the world’s poor are unbanked not only because of poverty, but also because of the cost, travel distance and amount of paper work involved. More than 2.5 billion people do not have access to a bank account.⁴ Even in rich countries, 10% do not have a bank account, either by choice or lack of access, and according to a FDIC report in the US only two thirds of households are fully banked, with access to more than basic services.⁵ Financial tools for savings, insurance, payments and credit are vital for all, and can help communities lift themselves out of poverty. Lacking a bank account can force savers to take risks and make it harder to build up savings, let alone use credit or other financial tools. New technologies such as mobile money and online services are helping to bridge the gap, but savings, loans and insurance are still not available to all those who need these services.⁶ In addition, the World Bank estimates a US\$3-4 trillion funding gap for micro, small and medium enterprises in the post 2008 world.

1.2 Does the financial system support the real economy?

Well-functioning financial systems (including both banks and capital markets) provide information and reduce transaction costs, which in turn improve resource allocation and boost economic growth. In poorer countries commercial banks tend to predominate, while in more advanced economies stock markets tend to become more active and efficient relative to domestic banks.⁷

The recent global financial crisis has made us rethink the contribution of the broader financial sector to the real economy. In an address to the European Central Bank Conference in September 2014⁸ Benoit Cœuré, Executive Board Member, noted the empirical literature on finance and growth built up a substantial body of evidence that financial sector deepening is a key component of the economic

³ A. Chaia, A. Dalal, T. Goland, M.J. Gonzales, J. Morduch, R. Schiff (2009). *Half the World is Unbanked*. Financial Access Initiative Framing Note.

⁴ www.data.worldbank.org

⁵ Federal Deposit Insurance Corporation (2014). *2013 FDIC National Survey of Unbanked and Underbanked Households*. October 2014.

⁶ GSMA (2014). *State of the Industry 2013: Mobile Financial Services for the Unbanked*.

⁷ R. Levine (2005). *Finance and Growth: Theory and evidence*.

⁸ www.ecb.europa.eu/press/key/date/2014/html.sp140902.en.html

development process. This seemed true in both emerging markets and industrialized economies.⁹ Yet, it has been shown that economies with large, dynamic and complex financial sectors are not immune to severe macroeconomic contractions. The analysis has now been refined to show that, beyond a threshold size, the effect of finance on long term economic growth can weaken and become negative.¹⁰

Five possible explanations are put forward for the negative impact of too much financial activity in an economy:

- **Shift away from the traditional activity of intermediating between savers and borrowers.**
- The evidence suggests that banking strategies that are heavily geared towards generating non-interest income, such as through trading are riskier.¹¹ Some central bankers argue that it is not the creation of fee income per se but some of the activities that give rise to the income that are the problem.
- **Attracting talent away from the real economy.** In 1945 the financial sector accounted for less than 2.5% of total labour income. By 2006 this share was 8.3%.¹² Too many bankers and too few engineers can harm the overall productivity of the real economy.
- **Misallocation of credit to less productive economic activities.** Much of the spike in financial intermediation before the crisis was associated with household mortgages, accounting for more than 80% of overall banking lending in some countries. While owning one's own home can be a galvanising feature for personal as well as economic development, generally an additional euro of mortgage lending contributes less to overall economic growth than an additional euro to a young, innovative company.
- **The moral hazard of being 'too big to fail'.** An accommodative monetary policy increases the probability of a systemic meltdown and so can harm long-term growth. There is a tension between the utility function of banks as intermediators of capital and their role as profit maximising entrepreneurs, particularly where the latter does not feel fettered by values or regulation.
- **The challenge of regulating complexity and inter-connectedness.** It is more difficult for regulators to understand what is going on in large and complex financial systems while policy makers have allowed the financial system to balloon without availing themselves of appropriate measurement and mitigation tools to ensure that finance is channelled in an economically effective way.

1.3 Does the financial system externalise too much risk to society?

All financial systems combine bank-based and market-based intermediation but the particular blend of the two varies across countries.

Following the annulment of the US Glass-Steagall Act bank holding companies began to intermingle these two quite different activities, yet in both cases they were doing so with other people's money, unlike the original merchant banks that also risked their own capital. This trend was also seen in other countries.

⁹ R.G. Rajan and L. Zingales (1998). *Financial Dependence and Growth*. *American Economic Review*, Vol. 88, No. 3.

¹⁰ J-L. Arcand, E. Berkes and U. Panizza (2012). *Too much finance?* IMF Working Paper, 12/161.

¹¹ O. De Jonghe (2010). *Back to the basics in banking? A micro-analysis of banking system stability*. *Journal of Financial Intermediation* Vol 19 No 3

¹² T. Philippon (2010). *Financiers versus Engineers: Should the Financial Sector Be Taxed or Subsidized?* *American Economic Journal: Macroeconomics* Vol 2 No 3

As banks grew and broadened their scope post-deregulation, they increasingly become ‘too important to fail’. Bank of England research suggests that this may have also altered these banks’ private incentives in a fundamental way. Once a bank is perceived to be too important to fail, a wedge is driven between private and social returns to scale and scope, since the bank does not internalize the potential economic costs of its failure. Their subsequent actions may make them more highly interconnected and leveraged. In the period 1969-2009 retail deposits became a smaller and smaller element of total liabilities as wholesale interbank funding grew.

1.4 Does the financial system adequately respond to environmental risks?

The banking sector has been slow to respond to the challenges of environmental sustainability. Banking is thought of as an industry with low direct impacts, but given their exposure to risk, bankers have been relatively slow to examine the environmental and social responsibilities of their clients. It has been argued that closer enquiry into the behaviour of businesses they lend to or invest in would require unacceptable interference in the activities of clients or even be deemed to be acting as a shadow director.¹³ This seems to overlook the due diligence banks ought to be performing to assess the risks involved in any credit proposal.

However, more recently the pressure from NGOs, civil society and in some cases, governments, has revealed the effects that banks can have through their lending and investment policies.

A broader example is the current fossil fuel divestment campaign which is generally regarded as moving faster than either the anti-apartheid or tobacco movements. Banktrack has produced a coal finance report card which found that despite the financial distress faced by the global coal industry in 2014, global financing for coal mining and coal-fired power companies stood at US\$141 billion.¹⁴ In the UK alone, Royal Bank of Scotland (currently owned 80% by the UK Government) underwrote loans to coal companies valued at US\$1.61 billion.

Banco Santander and the rainforest

In 2015 Greenpeace launched a YouTube campaign video depicting swathes of rainforest being destroyed by a logging company for the sake of paper and packaging which threatened the habitats of orang-utans and tigers. Greenpeace noted that Banco Santander had arranged £400 m of loans for the company to expand its logging operations in Indonesia. Within two days the video had been viewed over 3 million times and activists launched protests against the banks. Within 48 hours the bank announced it would cease lending to the company and any future funding would be conditional on new sustainability measures being implemented.¹⁵

The potential influence of the banks is recognized explicitly in the remarks by the Executive Director of UNEP that if we are to transition to a green economy we need to better align the financial system with the needs of sustainable development. However, we need to see transparency and consistency of values across a whole organization. Crédit Suisse has made much in PR terms of signing up as a Climate Bonds Partner.¹⁶ However it is leading a US\$400 million bond issue on behalf of Golden Agri-Resources, the key

¹³ M. Jeucken (2002). *Banking and sustainability: Slow starters are gaining pace*. *Ethical Corporation Magazine* No. 11, pp. 44-48.

¹⁴ www.banktrack.org

¹⁵ Greenpeace (2015). *Santander stops financing forest destroyer* APRIL. <http://www.greenpeace.org.uk/blog/forests/result-santander-stops-financing-forest-destroyer-april-20150226>

¹⁶ www.climatebonds.net

backer of a palm oil developer accused through the Roundtable on Sustainable Palm Oil of ‘compounding poverty and food insecurity by taking land without community consent and making hollow promises of development benefits.’ Campaign group Global Witness has drawn attention to how European banks and pension funds financed Wilmar, the world’s biggest palm oil company to grab land in Uganda. Global Witness has also connected Crédit Suisse to land grabbing by rubber companies in Cambodia and Laos.¹⁷

1.5 Have financial institutions lost their moral compass?

The roots of the banking system are in societies where religion was central to human thought, both in Europe and the Islamic world, although the role of religion has declined in the Western world.¹⁸ In the Western world many banks became viewed increasingly and saw themselves solely as financial institutions concerned only with matters financial.

Financial institutions and professions have codes of ethics. However applying these principles in practice is difficult. Speaking in London in 2014 at the Conference on Inclusive Capitalism, Christine Lagarde, Managing Director of the IMF, said that “some prominent firms have been mired in scandals that violate the most basic ethical norms”, while Mark Carney, Governor of the Bank of England, told the same audience that in the face of damage to social capital, “integrity can neither be bought nor regulated. Even with the best possible framework of codes, principles, compensation schemes and market discipline, financiers must constantly challenge themselves to the standards they uphold.” Yet while business leaders such as Jamie Dimon, head of JP Morgan considers global financial regulation “un-American”, and banks continue to be implicated in mis-selling and manipulation yet no banks or bankers go to jail, it is clear that the standards they uphold fall well below the minimum acceptable.

In 2013 a study by Jaroslav Belas of the Tomas Bata University in Zlin looked at the impact of the financial crisis on business ethics in the Slovak banking sector.¹⁹ Although banks in Slovakia have their own ethical code in which they undertake to offer only services that meet customer needs,²⁰ a 2012 survey by Deloitte found strong and growing dissatisfaction amongst Slovak consumers.²¹ Employment uncertainty amongst Slovak bank workers was translating into deteriorating even cynical customer service. A wider, international study by EY in the same year across 35 countries found that 56% of bank customers believe banks do not recognise their real needs and do not adjust their products to meet these needs.²²

“Ethical behaviour cannot be forced by rules and regulations. It needs a cultural change.”

A study in May 2015 by the University of Notre Dame on behalf of law firm Labaton Sucharow found that despite the very public campaign by the US Government to root out bad behaviour in finance, it remains a problem in need of attention on both sides of the Atlantic.²³ William Dudley of the New York Federal Reserve remarked that the degree of risk taking reflects the prevailing incentives in the industry. Nearly a third of those questioned in the study ‘believe compensation structures or bonus plans in place at their

¹⁷ A. Simms (2013) *Banks and pension funds continue to bankroll deforestation*. www.theguardian.com/sustainable-business/2015/apr/30/deforestation-land-grabs-banks-pension-funds-palm-oil-credit-suisse-mitsubishi and <https://www.globalwitness.org/archive/credit-suisse-ignored-human-rights-commitments-and-became-major-shareholder-vietnamese/>

¹⁸ A. Zaman (2008). *Islamic Economics: A Survey of the Literature*, Munich Personal RePEc Archive

¹⁹ <http://nho.econ.muni.cz>

²⁰ www.sbaonline.sk/sk/o-nas/eticky-kodex

²¹ www.deloitte.com/view/sk_SK/sk/press/sk-press-releases/0b5e168d47e08310VgnVCM2000001b56fo0aRCRD.htm

²² www.ey.com/CZ/.cs/Newsroom/News-releases/2012_Nova-era-bankovnictvi

²³ www.secwhistlebloweradvocate.com/LiteratureRetrieve.aspx?ID=224757

company could incentivise employees to compromise ethics or violate the law'. The report's authors also noted that 'respondents from the UK are either more willing to commit a crime they could get away with or are more frank about it'. Few admitted to being willing to blow the whistle and a number reported that they now had employment terms that prohibited them from reporting illegal or unethical behaviour.

The core function of the financial system to support the real economy has given way to a focus on speculation; making money out of money. The disconnection of money both from the real economy and values leads to challenges that have been manifested in various ways over the last decades.²⁴

Banks found they could earn more from money than from providing services for the real economy. Fees replaced interest income as the core component of revenue. This trend is exacerbated when unprecedented levels of liquidity are injected into the system by central banks. In addition, the regulatory focus has been on holding higher levels of capital for interest income related assets. The 'income to capital' ratio is higher for non-interest income and this will be an influencer of bank behaviour when capital is scarce or costly. In a basic bank fee income can be less risky than lending. We also acknowledge that interest income may be problematic if it is connected with high, unsustainable levels of debt whether personal, corporate or public. Nonetheless the trend towards greater fee income reflects a more complex financial system.

“There is a growing resentment against profit maximization”

1.6 Are our overall expectations unsustainable?

While many agree with the need for sustainability in economies, this can mean very different things. Does it mean finding a way to sustain our energy intensive, consumer driven needs? Or, does sustainability refer to the whole ecosystem, an interconnected web with a vast and rich diversity of species and high degree of interconnectedness?

Writing in the Guardian in May 2013, Dr. Llewellyn Vaughan-Lee saw the first image as one presenting economic models of growth and energy efficiency, often with accompanying 'green' ideas, such as green technologies or, in the case of finance, green bonds, to help our civilisation develop.²⁵ This is the corporate image of sustainability with pictures of material progress that the environment is seen as supporting and which provide new market opportunities.

The second image considers the ecosystem as a living whole of which humanity is only one part. In this complex web of interrelationships all species are dependent upon each other and it is the organic pattern that needs to be sustained. No one part can be considered as separate from the whole. Even with new technologies and innovation, the idea of endless economic growth is unsustainable and new economic and financial models are required which respect and support the ecosystem of which we are a part. Satish Kumar goes further by also highlighting a spiritual dimension: “We need to include care of the soul as a part of care of the planet”.²⁶

In recent years it has not just been institutions that earned money from money. In the late twentieth century and first years of the 21st century, people became accustomed to relatively high real rates of interest on their savings which helped to condition their lifestyle expectations. They became used to

²⁴ A. Baranes (2009). *Towards Sustainable and Ethical Finance*, *Development* 52(3) 416-420

²⁵ www.theguardian.com/sustainable-business/eco-spirituality-values-based-economic-structure

²⁶ Various, including <http://tedxexeter.com/2012/04/20/satish-kumar-talk/>

making money out of money without necessarily considering the risk profile of that money. This is reflected in one of our survey findings that showed that not all customers are willing to accept lower interest rates to support 'nature and society' or other social goods. However, a 2012 study by management consultancy Zeb found that German residents stated that they would forgo 1.3% in remuneration to invest their money ethically.²⁷ Irrespective of the questionable reliability of survey answers, it is clear that savers with values based banks make a conscious choice to place their money there and are willing to forgo some part of their remuneration.

In its 84th Annual Report the Bank for International Settlements noted that the global economy continues to face serious challenges and has not shaken off its dependence on monetary stimulus.²⁸ There is little appetite for taking the long-term view. Few are ready to curb financial booms that make everyone feel illusively richer. So there exists a vast disconnect between the performance of markets and what is happening in the real economy.

1.7 How will disruptive technologies change the possibilities for finance?

The internet is changing the possibilities for financial products and institutions. Many of the disruptive innovations are covered in the new economics foundation paper for this Inquiry ²⁹so we do not seek to repeat them here. Mobile money is a key disruptor, with emerging markets such as Kenya leading the way. Approximately 1.2 billion people will use mobile money accounts in 2015 up from a negligible number in 2010 according to Ovum research. But disruptive technologies offer a way forward to a new financial system through the democratisation of finance, the avoidance of entrenched conflicts of interest and the promotion of responsible investment behaviour. For the first time everyman and woman, wherever they are provided they have access to the internet, can go online and invest in companies whose values they believe in. "If Americans shifted 1% of the US\$30 trillion they hold in long-term investments to small businesses, it would amount to more than 10 times the venture capital invested in the whole of 2011".³⁰

While many technology players are only in it for the money, the key appeals to the user are that it is individual or personal and that it is social, two essential ingredients to the wider development of values based banking.

Nevertheless today's mainstream bankers believe that branches will continue to be important. Brad Jones, a specialist in mobile financial services in Southeast Asia who has worked with IFC, Visa and mobile payments providers, for example says "There will always be a need for the customer to be able to have some connection with the provider. Maybe it happens at the level of an agent who visits homes and offices and is himself supported by an office [Values based Banca Etica has pioneered the role of itinerant bankers]. Maybe it's the ability to contact a call centre to address questions [Values based GLS Bank has invested a lot in developing its call centres within Germany]. The human channel engenders trust."³¹ For many bankers brought up in a branch banking system, there remains scepticism about whether mobile technology will affect customer loyalty. One group (39% in the EIU Report) believe mobile will increase customer churn because it will increase commoditisation, reduce barriers to entry and make switching easier. A diminished human connection will hurt interaction and engagement. A second group (33%)

²⁷ Social Banking Study Management summary, www.zeb.de/de/aktuelles/zeb-social-banking-study-2012.html

²⁸ Bank for International Settlements (2014). Annual Report

²⁹ <http://www.neweconomics.org/publications/entry/financial-system-impact-of-disruptive-innovation>

³⁰ A. Cortese (2011). www.locavesting.com and www.fastcompany.com/1771064/locavesting-investing-main-street-instead-wall-street

³¹ The Economist Intelligence Unit (2014). How mobile is transforming retail banking Redefining banking to survive and thrive in a digital world

believe that an easier, faster, lower cost banking service will mean customers will not want to leave, while a third group (28%) were undecided. There was greater agreement (61%) on personalisation and innovation as important retention tools.

Simple was established in the US in 2009 to create a new kind of digitally native bank which users interact with mainly through an iPhone app. It created an easy, customer-friendly banking experience, which allows customers to easily and intuitively keep track of where they are spending money, and lets them set and save for goals. It was recently bought by Spanish banking giant BBVA

In France a start-up called **Compte Nickel** is operating through 'tabacs' (tobacconist shops) to provide an easy to open, simple bank account designed for people who may be unable to open a more traditional bank account. Although the innovators are struggling against strong regulation, since the launch in February 2014 they have gained more than 100,000 clients from 740 authorised 'bureaux'.³²

Although **Bitcoin** continues to disappoint operationally with only 8 million accounts opened globally, decentralised crypto currencies are gaining the attention of global businesses and banks. At present the global norm is to keep banks and bitcoins separate. However plans to open a Bitcoin bank in Switzerland have recently been announced.³³

30% of retail bank executives surveyed saw virtual banks as potential partners while 50% saw them as threats. Virtual banks are seen as a greater threat in Europe, the Middle East and Africa than in the Americas.

In *The End of Banking*³⁴ the authors argue that the digital revolution has left banking beyond repair. In the current era of unconstrained banking there are no market-driven incentives for banks to upgrade their business models or for regulators to compel them to do so. In the short term, fee generation from the financial economy remains attractive despite its concentration producing negative effects on the real economy.

³² www.liberation.fr/economie/2015/04/29/le-compte-nickel-fait-sauter-les-banques_1277345 and www.compte-nickel.fr

³³ www.coinbuzz.com/2015/05/30/switzerland-bitcoin-bank/

³⁴ www.endofbanking.org

2 Values based banking: innovation beyond the mainstream

Often we think of banking as a homogeneous sector. In reality it is not. There are global banks, investment banks, retail banks, community banks, social banks, church banks, local banks, green banks, development banks and even public banks. There are formal banks and informal banking organizations as well as a shadow banking system. Mutual saving banks, rural banks, credit unions and revolving savings and loan funds were institutions set up on the basis of mutual help amongst working people.³⁵ There are banks that operate in a ‘western’ financial system and those that operate according to Sharia law.

In this report we focus on what we call **values based banks**. This includes social, ethical, green and community banking. It is not defined by a particular governance model and includes public limited companies, mutuals, and private banks. However, many who may consider themselves as values based may not adhere to the deeper green form of sustainability that we recognise or freely adopt their values. Nor are all sustainable.

Peter Blom, Chair of the Board of the Global Alliance for Banking on Values (and CEO of Triodos Bank) refers to values based banking as undertaking “positive financial innovation focused on meeting human needs in the real economy”.³⁶ GABV research has identified some 2,000 banks with this focus, having assets of US\$600 billion equivalent and equity of US\$65 billion equivalent. GABV believes that it can reach a billion people with sustainable banking by 2020.

Values Based Banking Principles

The Global Alliance for Banking on Values has developed a set of principles of sustainable finance and sustainable banking that are intended to describe the fundamental pillars of sustainable banking.

Economic, social and environmental performance as a ‘triple bottom line’ at the heart of the business model

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

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

Long term, self-sustaining, and resilient to outside disruptions

Transparent and inclusive governance

Culture of the bank which embeds these principles

A key feature of values based banking is also the social mission to educate and empower customers and other stakeholders to be part of a values based economy.

³⁵ S. Remer and O. Weber (2011). *Social banks and the future of sustainable finance*. O Routledge

³⁶ SFRE Press Release. www.gabv.org/our-news/sustainability-finance-real-economies

2.1 Banks that serve the unserved

A growing number of financial institutions seek to serve people and communities that are not reached by existing financial networks (the so called ‘bottom of the pyramid’ market) through microcredit, microloans, microinsurance and other financial products. The GABV’s members include credit unions and microfinance banks. The International Association of Investors in the Social Economy (INAISE) has a majority of members from the South, some of them representing localised networks of revolving savings and loan funds, bancos comunales, microfinance funds and credit unions, and charitable organizations.

In many cases local small scale institutions are growing, some to become formalised financial institutions in order to meet growing customer need. An example of growth over the last 10 years is provided by the Banco Communal, La Chanchita, in Peru.

La Chanchita, Banco Communal, Peru

This financial cooperative was set up in 1994 to provide microcredit and promote savings. As the ‘bank’ grew to know the needs of its stakeholders it also developed education, micro insurance, healthcare and environmental support. Today, it is also providing IT and electronic media support, financing for climate change adaptation and the effective development of business value chains. At a grass roots level it is providing more than finance and finds strength beyond its immediate size by being part of a much larger apex network FORTALECER.

New intermediaries are emerging to serve those that still live outside the formal system. For example, in Mexico 85% of the population keep most of their savings under the mattress.³⁷ KIWI is a new company enabling these savers to access services

KIWI (www.usekiwi.com) is a start-up providing personalised pre-payment plans to help Mexican families pay for big-ticket items such as medical operations, school textbooks, building materials and home appliances. The company has developed a technology platform through which merchants, clinics and retailers can sign up to offer their customers the option to pre-pay in instalments. The service is free for users who sign up and agree a payment schedule, making payments through local convenience stores. The commission is paid by the merchant.

Another innovative approach is ‘value chain financing’ by microfinance institutions to support farmers to market their produce more effectively.

Taytay Sa Kauswagan Inc (TSKI) (www.tski.com.ph/) is a microfinance institution in the Philippines. It has introduced a warehouse receipt financing mechanism for farmers and offers loan of up to 80 per cent of the market value of the produce stored at a certified warehouse. While prices drop at harvest time, the rice is stored in a warehouse rented by TSKI. When the price of milled rice rises, TSKI facilitates the milling and helps market the produce to institutional buyers such as hospitals, schools as well as wholesalers and retailers. Integration of agricultural value chains has resulted in lower transaction costs which in turn enabled TSKI to reduce the interest rates on loans to farmers.

In Viet Nam financial reforms in 1991 led to the revamping of co-operative finance and the creation of the People’s Credit Fund (PCF). The PCF is a network comprising local credit funds as primary societies, a

³⁷ <http://unreasonable.is/mexico-series-kiwi/>

central fund, and an association of local funds. Self-financed and self-managed, the PCF is a co-operative in nature and has been an engine of growth and resilience in times of crisis.

In Bolivia Banco Solidario provides an interesting case study.³⁸

BancoSol is a private commercial bank chartered in 1992 with strong values based roots. 75% of the shares were held by NGOs and donor organizations with the balance held by prominent, successful and influential Bolivian business people. It built on the success of an NGO microfinance loan fund, PRODEM which had begun in 1987, but which had found that its reliance on donor funds was constraining its ability to grow and serve its market. As a regulated bank, BancoSol could pursue its values based mission through a profit-making strategy.

By 2013 the bank had grown to a balance sheet of over US\$1 billion with 233,000 active borrowers and 628,000 depositors. While the bank has grown successfully, one of its founding shareholders the Bolivian foundation, SEMBRAR felt that the needs of rural agriculture required a different level of support to the bank's predominantly urban business. It began a programme of education, capacity and marketing support for small farmers. However, like PRODEM it has found that donor funds are a constraint on ability to grow. So, it is intended that the loan business will be spun off in a new chartered bank while the support services will continue to be provided by the Foundation.

In recent natural disasters the role of these intermediaries has developed in a new way. While large mainstream banks act as a conduit to receive donations from the public, microfinance funds have been found to be fleet of foot, knowledgeable about local conditions and needs and capable in the delivery of disaster relief, for example in Nepal in 2015.

As with any market there are also participants with purely commercial motives seeking to maximise profits from the bottom of the pyramid markets without committing themselves to reinvest in those communities. Cases have been reported where predatory microloans can push families into poverty rather than helping them out of it, and where microlenders exploit rather than help the community they operate in.^{39, 40} Such organizations are not part of a values based economy but feed off it.

There is also a burgeoning movement of **community development finance institutions** (CDFIs). They developed in the US in response to the issues of bank redlining (banks denying loans to businesses and households in certain, often racially determined neighbourhoods). In 2011 alone they originated more than US\$30 billion in financing in urban, rural, and Native communities with cumulative net charge off rates of less than 1.7%. They have demonstrated an ability to lend prudently and productively in unconventional markets often overlooked by the regulated finance system. In the UK too CDFIs have grown, some set up by communities, others owned by local public bodies.

The former CEO of Pan American Bank, California's oldest Latino Bank, Jesse Torres, has coined the term *Banktivism*, calling on banks and bankers to use their influence among their stakeholders to make a difference in the communities they serve by supporting activities aimed at promoting and directing social, political, economic or environmental change.

³⁸ C. Gonzalez-Vega, M. Schreiner, R. L. Meyer, J. Rodriguez, S. Navajas (1996). *BancoSol, the challenge of growth for microfinance organisations*. Ohio State University, Economics and Sociology Occasional Paper 2332

³⁹ J. C. Lewis (2008). *Microloan Sharks*. *Stanford Social Innovation Review*. Summer 2008.

⁴⁰ *The Wall Street Journal* (2009). *A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum*. <http://www.wsj.com/articles/SB125012112518027581>

They are all examples of organizational response to market failure or asymmetries within the financial system. As many do not take deposits they could be considered to be part of the **shadow banking system**. This is a term for the collection of non-bank financial intermediaries that facilitate the creation of credit across the global financial system but who are not subject to regulatory oversight. According to the IMF, the largest shadow banking systems are found in advanced economies although growth has been fastest in emerging markets, outstripping the growth of the traditional banking system. In the US, the assets of the shadow system exceed those of the conventional system. Shadow banking can complement traditional banking by expanding access to credit or by supporting market liquidity, maturity transformation and risk sharing. However, without adequate regulation, shadow banking can put the stability of the financial system at risk and is often associated with ways of circumventing regulation. The total size of the market is expected to reach US\$100 trillion before the end of this decade. A large part of the growth has come about, for example with the expansion of the Chinese online merchant Alibaba into consumer finance.

Of course much of the shadow banking system is driven by profit maximising motives and are not values based organizations as we would describe them. However, as the example of CDFIs above as well as some microfinance organizations, providers like KIWI and even some crowd funding platforms attest there are institutions in the shadow banking market working to build a values based economy.

2.2 Diverse governance and stewardship

Values based banking is defined by principles and culture, not the ownership structure or legal form, and values based banks can be found in many forms. Not every cooperative or credit union is a values based bank, nor does being publicly traded preclude a bank from pursuing a mission of social, environmental and economic sustainability.

Governance and ownership

Cooperatives: Affinity Credit Union, Assiniboine Credit Union, Vancity Credit Union, GLS Bank, Banca Etica, Merkur Cooperative Bank, Crédit Coopératif, La Nef, bankmecu, Self Help Credit Union, Ecology Building Society

Shareholder banks with controlling shareholders: Triodos Bank, BRAC Bank, Beneficial State Bank, Charity Bank

Private banks: Sunrise Banks, New Resource Bank, Visión Banco

Cooperatives are popular throughout the world, except with bank regulators. They work predominantly under a rule of one member-one vote but they differ in structure – in how many people sit on the board and how they are elected. Cooperatives can create stronger bank-client relationships as by their nature, clients of cooperatives are also members and so they are more likely to take an interest in the bank's operations and judge it against responsibility criteria. Another advantage of this form is that it can contribute to the cooperative economy as a whole.

Cooperative banking also plays a major role in many countries. A report for the Policy Network in June 2012⁴¹ found that cooperative banks serve about 180 million customers, mainly households, SMEs and local communities and have a market share of about 20% in Europe. They employ 750,000 people, have more than 50 million members and one in three of all European SMEs is serviced by a cooperative bank. Some credit unions are as large as banks, for example Vancity Credit Union, Canada or Self-Help Credit Union in North Carolina.

In some cases cooperative banks are independent organizations, and in others have been initiated and nurtured through public intervention and links with other institutions. In France, government involvement has been extensive. The Finnish cooperative banking sector was set up in a top down process with government support while Portuguese agricultural credit cooperatives owe their growth since the revolution in part to government support. In several countries the social catholic movement supported the development of cooperative banks while many were also set up by or with the support of trades unions.

Vancity is Canada's largest community credit union, serving more than 500,000 members. In 1946 it was the first financial institution to provide mortgages to people living east of Cambie in Vancouver's working-class east end. It measures financial and also social return and has continued to innovate financial products, for example launching a Fair & Fast alternative to payday loans which reduces costs for borrowers and helps them break the cycle of debt. Vancity Investment Management also offers members an investment fund that is free of fossil fuels.

JAK Bank is a Swedish cooperative bank owned by its members, of which there are about 38,000. The primary objective of the JAK Members' Bank in Sweden is to provide its members with interest free loans. To accomplish this it requires borrowers to first save and lend through the bank, accumulating savings points which roughly balance out the borrowing costs over time.⁴² Other countries have expressed interest in the JAK model, notably in Ireland, but without success because of the lack of spare resources within JAK to 'export' the model.

Most continental European cooperative banks were established on the basis of the ideas of Hermann Schulze and Friedrich Raiffeisen who found the urban and rural poor excluded from access to credit other than on usurious terms. From Germany the concept spread across continental Europe and the Nordic countries. In Britain cooperative banking had different roots. **Building societies** predate the coops and were associated with a revivalist Christian movement that became popular among working and lower middle class people. **Credit unions** appeared only in the last 60 years or so and were based on US

Why isn't Triodos Bank stock-market listed?

“Because if we were primarily accountable for delivering profit to external shareholders, we could not pursue our mission to use money exclusively for positive social, environmental and cultural change. And also, we want to avoid a system of pricing that does not reflect the reality of the business of the bank.”

Triodos Website

⁴¹ E. Bevilacqua (2012). Co-operative banks as key players. http://www.policy-network.net/pno_detail.aspx?ID=4189&title=Co-operative-banks-as-key-players

⁴² A. Hyder (2013) Interest-free banking in Sweden: How much is it Islamic?. University of Gavle

credit unions, which themselves were inspired by Canadian adaptations of the German cooperative banking concept.

Banking regulators in Europe argue that at a time of need, cooperative members are less likely to be able to meet calls for capital. This remains unproven.

In the UK a number of building societies chose to demutualise, becoming Plcs. This had negative consequences not just terminally for Northern Rock and Bradford & Bingley but also for customer choice. A shift from reliance on close member relationships to dependence on the wholesale market in financing (subprime) mortgages in the end caused their meltdown.^{43,44} A mutual ownership structure and governance can help to underpin the culture and values of a bank.

When the **Airdrie Savings Bank** had the opportunity to merge with other savings banks in the UK to form the Trustee Savings Bank which would, itself be privatised, it chose to remain independent arguing that it was in the best interests of neither customers nor staff to merge. Today the TSB has demerged out of Lloyds Bank, itself a Plc, and is being sold to Banco Sabadell, Spain while Airdrie remains independent serving its Scottish community.

Somewhere between cooperatives and privately held shares are the **Special Controlling Shareholders**. These are often represented by a foundation or golden share holder whose function is to keep the organization mission aligned and focused. To preserve mission alignment between founders and new shareholders, values based share company banks rarely have their shares listed.⁴⁵ However, BRAC Bank is an exception where one half of the shares are publicly traded and one half remain in ownership of BRAC NGO and the IFC.⁴⁶

Privately held banks within GABV benefit from alignment with mission-driven shareholders, as is the case of US members, or microfinance investors in Latin America.

Values based banks stress their long-term goals as opposed to quarterly earnings, public listing is therefore an exception. It can be argued, as some regulators do, that not having a wide market in the shares limits the potential for them to raise capital at scale. However, this has not proved to be the case to date.

The US defines **community banks** as organizations with assets of US\$10 billion or less. In the US they have combined being a major source of credit for the real economy with also being a stable one. They rely largely on long-term relationships and time tested judgment. They focus on business lending. In the run up to the crisis they held overall business loans equal to 30% of assets, compared to 14% by the largest banks. In June 2012 it was at a similar level although the largest banks were down to 12%.⁴⁷ As at June 2012 community banks only accounted for 17% of industry wide (US) banking assets but were responsible for more than 50% of all lending to small businesses. Using their judgment skills they have been more successful than the big banks in avoiding asset impairment, providing a relatively stable source of credit – a critical element of the financial landscape. One of the newest members of the GABV as of March 2015 is Sunrise Community Banks of Minneapolis.

⁴³ R.P. Klimecki & H. Willmott (2009). *From Demutualisation to Meltdown: A Tale of Two Wannabe Banks*. *Critical Perspectives on International Business*, Vol. 5, pp. 120-140.

⁴⁴ <http://www.bsa.org.uk/information/consumer-factsheets/general/list-of-demutualised-building-societies/>

⁴⁵ <https://www.triodos.com/en/about-triodos-bank/service/faq?faqId=82465> Accessed 25 February 2015

⁴⁶ <http://www.bracbank.com/Shareholding-Structure.php>

⁴⁷ Dallas Federal Reserve Bank (2015)

Sunrise Banks is a family owned, nationally chartered community bank. It is governed through an advisory board and board of directors comprised of local business owners, community representatives, and local ownership. It is certified as a Community Development Financial Institution (CDFI) and is also certified as B Corporation (see definition below); a certification granted to organizations that demonstrate a commitment to transparent corporate governance, solid environmental stewardship, and positive community impact. Sunrise Banks originate small business, commercial real estate, and community facility loans in the urban core of Minneapolis and Saint Paul. Over 60% of Sunrise’s loans are originated in low income communities.

Public banks play a prominent role in the banking systems of many countries, including Germany (where they hold 50% of the assets), Switzerland and India. In the US there is just one example of a public bank, the Bank of North Dakota.

The Bank of North Dakota was started 95 years ago by farmers tired of being price-exploited by grain monopolies and by private banks ready to foreclose at the first sign of crop trouble. The bank underwrites the expansion and creation of small and medium sized business within the state to help keep North Dakota economically sound.⁴⁸ According to the Wall Street Journal it is “more profitable than Goldman Sachs, has a better credit rating than JP Morgan Chase and has not seen a profit growth drop since 2003”.⁴⁹ It is solid rather than sensational, putting pooled assets to work for the good of the community and every year makes surpluses that are passed to the North Dakota general fund to help pay for public services. It does not speculate in derivatives or finance loans it does not understand. It does not pay bonuses or high salaries and self-insures its deposits rather than use the FDIC guarantee scheme.

Recently the citizens of Vermont wanted to create a new public bank but the private banks mobilized to prevent the legislation, although they could not stop an enactment of a law to dedicate 10% of the State treasury’s cash balances towards making loans and investments within Vermont.

A number of **new business structures** have emerged for social entrepreneurship; including community interest companies, community benefit societies, social enterprises (with or without asset lock), social businesses, new hybrid corporations (for profit businesses that are dedicated to a social purpose, and required to reinvest a portion of profits into that social purpose), B Corporations (the “B” stands for Benefit). At the start of 2015, Charity Bank in the UK became the first European bank to achieve certification as a **B Corporation**.⁵⁰ This means the bank meets rigorous standards of social and environmental performance, accountability and transparency as certified by US non-profit B Lab. B Corporations are spread across 121 industries in 37 countries. In May 2015 Triodos Bank and Community Sector Banking, Australia also joined the B Corporation movement.⁵¹

⁴⁸ A consequence of this is that the bank has long been a supporter of the shale oil business, which other values based banks would question on environmental grounds.

⁴⁹ Wall Street Journal (2014). Shale Boom Helps North Dakota Bank Earn Returns Goldman Would Envy. <http://www.wsj.com/articles/shale-boom-helps-north-dakota-bank-earn-returns-goldman-would-envy-1416180862>

⁵⁰ www.charitybank.org January 2015

⁵¹ <https://colour-of-money.co.uk/b-corp-europe>

2.3 Values based banking with religious roots

Religious foundations have played a key role in some streams of values based banking. There are many **banks whose origins lie in the church.**

Banco Caja Social was founded over 100 years ago by Jesuits in Colombia, to encourage workers to save. Today it is owned by a number of investors of which the Fundacion Social has 43% and has more than 5 million customers. It has grown organically and by acquisition and provides financial services, including microcredit to individuals, entrepreneurs, small and medium sized enterprises which contribute to social development.

In the UK, Reliance Bank is owned by the worldwide Salvation Army. Kingdom Bank is the 60 year old vision of a Pentecostal pastor whose mission statement includes “changing lives for good.” The Methodist and Baptist churches also have their own financial services companies. Faith-based investing uses screening, shareholder advocacy and community investing to express stewardship of investment resources.

Germany has a tradition of church banks such as the Catholic DKM Darlehnskasse Munster and Bank für Kirche und Caritas in Paderborn, as well as evangelical banks like KD Bank in Dortmund. These church banks have a proprietary distribution and ownership structure. They are exclusively organised as cooperative banks with regional churches and related institutions being members and clients at the same time. The largest eight church banks have a combined balance sheet of US\$45 billion. In 2003, the Franciscan order set up the Bank für Orden und Mission pledging to invest its own money according to ethical criteria based on evaluations of Oekom, a sustainable ratings agency. Many of the church banks now have sustainability filters as minimum criteria for investing. Churches and their supporter groups have also been active in seeding non-bank financial intermediaries such as Oikocredit, Netherlands, SIDI, France, and Shared Interest in the UK, each working internationally through local partners to provide livelihood finance and financial education.

The Desjardins Group, Quebec and Ontario is the largest association of credit unions in North America. It was founded as a caisse populaire in 1900 by Alphonse and Dorimene Desjardins to contribute to the well-being of individuals and communities and so relieve poverty. The Desjardins enlisted the support of the Roman Catholic Church to provide support for the loans they were willing to make to people who otherwise had no collateral and found themselves outside the market economy. By 2010 the Desjardins Group had expanded to 5.8 million members and C\$172.3 billion of assets, yet the original mission remains constant.

Islamic banking is a rapidly growing area. The Islamic view of humans is dynamic and complex. It is acknowledged that greed and other base motivations exist but the essence of humanity is the possibility of choosing a higher and more spiritual mode of existence instead. Profit motivated social responsibility is explicitly condemned in Islamic teachings. Virtue must not be subordinated to making a profit. A major area of difference between Islamic and conventional economics is the prohibition of interest since it does not reward any productive activity. The key concept in Islamic banking is that lenders must participate in the risks of the business in order to earn a reward. Islamic laws and institutions (including banks) are designed not to make profits but to promote moral and spiritual growth.

According to Islamic-banking.com, the assets of Islamic finance had grown to US\$1.3 trillion by 2013. While this includes conventional banks offering Sharia compliant products, it also includes banks based on religious roots that focus on a healthy society and a mindful management of resources.

However, there are many who say that because Islamic banking is a response to religious rules that are handed down, without explicit acknowledgement of the environment or society, it is not a freely adopted values based system. There is also a practical challenge in implementing an Islamic economic system: the development of alternatives to interest. There are many shades of grey here with some scholars arguing that Sharia compliant instruments that fulfil the functions of Western institutions are simply financial engineering. A more extreme view is that Islam is so radically different from existing capitalist structures that it will require a revolution to put such structures in place.

The Islamic banking system is based on trust and community. A common objection is that this is only possible in small communities capable of sustaining personal relationships. To underpin such a development Arshad Zaman⁵² argues that a Dar-ul-Amanah is needed to preserve the value of deposits which would then be used for socially profitable objects. The potential to use Islamic motivation to create new types of institutions that conform with the Islamic spirit is illustrated by the Tabung Haji in Malaysia which helps Muslims to perform the Hajj and mobilises savings for this purpose⁵³.

2.4 Social, ethical and green banks

In the last 40 years a 'new' type of **values based banking** has developed, known widely as social, ethical, green or alternative banking.

These banks have focused on human needs in the real economy. They have played a key role in investing in green and social innovation sectors which other banks had not yet investigated and understood. Triodos and GLS Bank, for example, were pioneers in the analysis, understanding and financing of solar and wind energy. Nowadays they and others are also incubators for many new housing models as well as companies and small entrepreneurs. Once these structures have been deemed to have been de-risked the traditional banks begin to enter the market too.

“... in an ethical bank the economic assessment of projects is accompanied by social and environmental assessments...”

By and large they have not been affected by the financial crisis in the same way as mainstream financial institutions in part because they have invested in long-term customer relationships and have not become dependent on the wholesale money markets. They are part of a values based rather than market oriented economy. The values based banks' way of doing business is perceived as responsible and sustainable and as a support for society. In the current low interest rate environment there is an even higher acceptance by their customers to see part of their returns being re-invested in sustainable projects.

A study in the *Journal of Business Ethics*⁵⁴ developed a *Radical Affinity Index* to assess the extent that 114 European banks were driven by an ethical ideology and principles in four key areas: information transparency, placement of assets, use of guarantees and participation. The clearest difference was in

⁵² A. Zaman (1989). *Why development fails*. *Pakistan Administration* XXIV (1)

⁵³ *Islamic Research and Training Institute* (1995)

⁵⁴ L. San-Jose, J. L. Retolaza, J. Gutierrez-Goiria (2011). *Are ethical banks different?* *Journal of Business Ethics*, April 2011 pp. 151-173

transparency of information and in the placement of assets. Except to the extent required by the regulators, values based banks are not active in the interbank or wholesale markets. They finance themselves with customer deposits and seek to invest in organizations with similar values, including taking proportionate investments in other values based banks. Mutual guarantee schemes or guarantor communities were found to be specific to values based banks.

Another feature of values based banks is the role of gift money. Many financial institutions have a foundation or charitable trust associated with them. Values based banks, however, see gift money as another important face of money which has as important a role as consumption or investment money. They work with their foundations to respond to the spectrum of needs of an applicant, complementing the work of the bank.

We could think these banks reconnected with and renewed some aspects of the mutual and cooperative movement of the 19th century referred to above; or that they foresaw the possibility of new ideals based on values more than on religious belief or tradition, based this time on a free consciousness of solidarity (brotherhood), mutual help, “social compassion” and concern for human rights, environmental and social justice.

2.5 Innovation in other parts of the financial system

Values based innovations are also taking place in other parts of the financial system such as stock exchanges and the payments system.

Social stock exchanges (SSEs) are exchanges that list only social businesses. Using SSEs, the intention is that investors can buy shares in a social business just as investors focused solely on profit would do in the traditional stock market. Currently, some operate only as directories or match-making services, with others moving closer to becoming fully fledged exchanges. Today there are social stock exchanges in Brazil, Canada, the UK, Singapore, South Africa and Kenya⁵⁵ but each in its own way struggles with structures, rules and regulations developed to serve a market oriented economy not a values based one, but the seed has given life to tools such as crowd funding and impact investing.

Here, there is also a role within a values based financial system for so called local alternative or complementary currencies which have developed in many places including Europe, Japan, and South America with good results for the local real economy. These can help deliver sustainable environmental actions (for example cities could be authorized, in certain conditions, to distribute such currencies as a reward for environmental work as seen in the examples in the slums in Brazil with removal of plastic).

⁵⁵ *The rise of social stock exchanges:* www.ssireview.org/blog/entry/the_rise_of_social_stock_exchanges

Who owns and should own the financial system?

Beyond the issues of ownership and governance of individual financial institutions lies a broader question which is about the ownership of the financial system itself.

“Why do we need to talk about ownership in the financial system? For me the question seems to be too limited. It is not likely that there could be one institution or authority that could anticipate, with the necessary accuracy, all influences and outcomes of the processes in the financial system.”

In some countries the principal banks also control the payments system(s) making it very difficult for new entrants to compete evenly. The payment system is an operational network, governed by laws, rules and standards that provide the functionality of the banking system. An efficient national payment system reduces the cost of exchanging goods and services and is indispensable to the functioning of the markets. A weak system can drag on the stability and developmental capacity of a national economy. Because of this many are run by governments or public agencies.

Since the stock exchanges have been privatised, trading volumes have exploded, enabled by technology and innovations such as high frequency trading. This may suit the private interests of the exchange if it gets paid on volume but the false liquidity and damaged resilience reduce its functionality for, or even relevance to the real economy that is left out of the governance of the private exchange. But can private interest or even government control or disallow such activities which fail to serve the common good? We may see the start of the IEX Group's stock exchange estimated to open in the third quarter of 2015. The IEX became famous in Michael Lewis' novel *Flash Boys* and seeks to establish a stock exchange owned by the buy-side of the market and to provide fair conditions.⁵⁶

The Committee on Transforming Finance co-convened by Hazel Henderson has issued a statement that calls for finance to be recognized as a global commons.⁵⁷ They argue that policy responses to the crisis to date have been tinkering rather than transformative. The Committee's objective is to construct a statement on the needs to transform the financial system into one that serves the economy rather than acts as its master, as we have today, and to one that is just and respects the imperative of ecological function.

⁵⁶ IEX Group: www.iextrading.com

⁵⁷ The Committee on Transforming Finance (2010). *Transforming Finance Group's Call Recognizes Finance as a Global Commons*
http://p2pfoundation.net/Transforming_Finance_Group%27s_Call_Recognizes_Finance_as_a_Global_Commons

3 Time for a new paradigm: learning from values based banking

The challenge of designing a sustainable financial system is to create one which is a servant of the real economy, not its master, and which enables the sustainable intergenerational increase of common welfare and environmental resilience. The ultimate purpose of the financial system and the banking sector should be to serve people's needs. Values might differ by geography and in time, but human welfare remains the primary value across different world cultures. However, before we can repurpose the financial system, we need to be sure that we understand the mindsets and values that underpin that system. As Donella Meadows says in her seminal piece, *12 Leverage Points for Change*, "Shared ideas in the minds of society, the great big unstated assumptions, constitute that society's paradigm or deepest set of beliefs about how the world works. From them, from shared value agreements about the nature of reality, come system goals and information flows, feedbacks, stocks and everything else about systems".

So, what are values? Values are the beliefs and motivations that shape behaviour and actions. Important research from Common Cause has shown that humanity shares a common set of values. These values can be organised into groupings and clusters – including those values that support extrinsic and intrinsic motivations. This research suggests that for a very long time our human systems – including our financial system- have been built with a disproportionate emphasis on extrinsic values that support the *individual* such as hedonism and competition. However, today's context is that we live in a truly interconnected world with ecological limits. We now need to bring the system into balance by putting more emphasis in designing our systems with intrinsic values, such as relationship, openness and kindness.

We have become accustomed to the axiom that price equals value and that free markets are able to self-regulate. Although the financial and economic crisis should have served to reveal this as myth, the behaviour of banking authorities in pumping liquidity into the financial economy suggests we have a lot of learning or unlearning to do. If we reject this hypothesis and seek a new paradigm which is not based on short-term profit maximisation, then values based finance points the way. In simple terms decisions should be based on societal value not simply price, and financial institutions and instruments must support economic resiliency, social empowerment and environmental regeneration through the real economy.⁵⁸

In 2014, the GABV published *Real Economy-Real Returns: the Business Case for Sustainability Focused Banking*. It finds that lending to the real economy delivers better financial returns. This conclusion is also supported by Banking on Shared Value by FSG.⁵⁹ This report argues that most banks are leaving value on the table and in so doing are missing an opportunity. In the increasingly combative relationship between banks and society two points have become obscured: banking is essential to solving many of today's challenges and addressing these is crucial to the growth of banking.

In 2015 Marlene Karl, of the German Institute for Economic Research (DIW), published a discussion paper *Are ethical and social banks less risky?*⁶⁰ The paper introduced a new and comprehensive dataset on these banks in EU and OECD countries. The author compared their riskiness with an adequately matched control group of conventional banks. The main finding was that values based banks are significantly

⁵⁸ *Real economy produces goods and services to the real need of people and planet. The return on investment which should be expected is not to be measured only in financial terms, but in terms of improving human lives and human society (Definition of INAISE)*

⁵⁹ www.fsg.org/tabid/191/ArticleId/1138/Default.aspx?srpush=true

⁶⁰ M. Karl (2015). *Are ethical banks less risky?* DIW Berlin http://www.diw.de/documents/publikationen/73/diw_01.c.508003.de/dp1484.pdf

more stable (in terms of z-score) than their conventional counterparts and that they have lower loan to asset ratios and higher customer deposit ratios than conventional banks.

We have an opportunity to redesign the financial system with an emphasis on different values, and using experience and models demonstrated by the values based banking sector.

“Banking institutions should operate in service of economy not in exploitation of the economy.”

In our survey we found that four key values were felt important to frame the new paradigm for finance:

- **Sustainability:** Responsible for enabling positive intergenerational impact for people and planet
- **Transparency:** Making transactions and activities understandable and evident to citizens
- **Diversity/Fairness:** Allowing diverse needs to be fulfilled, distributive justice to be enabled
- **Inclusion:** Being accessible and proactively engage diverse input from society

These values cannot dictate what is good and what is bad, rather, they should provide a different frame of reference through which to observe reality. In line with the condition of diversity, people are able to decide by themselves, within a particular context what suits them the best, but they can only do this effectively if they have access to transparent information on the consequences on the economic, social and environmental consequences of different choices and have a range of options. It is quite possible that the informed decision is to stay with the status quo: with financial institutions as they are at the moment.

“Fairness is a matter of standpoint”

Values based banks can be a role model in applying the new values frame because they already live by it. They show that the application of sustainability, transparency, diversity and inclusion to banking is possible and that the banks’ business models are sustainable.

3.1 Sustainability

Today we know much more about externalities caused by various types of economic activity. We also know that many resources are finite. We would be remiss not to incorporate the new knowledge in our thinking. We know there are global environmental consequences to our local economic activity and we also know that creating a job might be of higher social value than the immediate money invested in its creation. Extending the current decision-making paradigm to include all three dimensions⁶¹ – economic, social, and environmental – is of high importance for organizations to be able to respond to the challenges and demands of today. It also needs to be embraced by regulators and policy makers who, too often focus on immediate economic and financial risks.

At the 2015 Cumbre Mundial de Finanzas Solidarias in Lima, Peru, delegates cited the clash between government policies and short-term regulatory focus. In Brazil the banking superintendent has amended some actions to enable government programmes to be enacted and to recognise that in finance small can be beautiful but this is the exception. Given a lack of political will to internalise external costs of social and environmental impacts, banks must be required to consider explicit environmental and social criteria in their lending and risk management. The UK government-owned Green Investment Bank publishes the criteria it uses to assess, monitor and report the green impact of every investment it makes.⁶²

⁶¹ TBL, ESG, Common Good balance sheet are the same.

⁶² Green Investment Bank Handbook at www.greeninvestmentbank.com/green-impact/green-investment-handbook/

GLS Bank: Credit decisions based on social and environmental factors:

In values based banks, credit decisions are not based on financial criteria alone. Some use positive and negative screening criteria for credit decisions. For example GLS Bank, the oldest social and ecological bank in Germany has social and environmental criteria which include social and ecological business policies, social engagement, development goals, energy efficiency and renewable energies, energy efficient transport systems, resource efficiency, natural medicine and exclusions based on violation of human rights, basic rights and labour laws, child labour, animal testing, controversial environmental activities, controversial economical activities, nuclear power, biocide, organochlorine production, embryonic research, agricultural gene technology, pornography, armaments and addictive substances.

But often the most important factor is the overall assessment of the project by the promoter and its goals, and whether only financial profit is the motivator or is it satisfying social and/or environmental needs or the improvement of wellbeing.

<https://www.gls.de/privatkunden/ueber-die-gls-bank/arbeitsweisen/anlage-und-finanzierungsgrundsaeetze/> accessed 29 March 2015

3.2 Transparency

Throughout our survey with people, and reviews of the practices of values based banks the most mentioned value is transparency – knowing where your money is going and what it is doing. Transparency is about revealing understandable and unbiased information. The financial system and money are just a means towards meeting human needs. In the words of French social bank La Nef: “we simply want to make a bridge between savers and borrowers” but to do so there must be informed and responsible customer choice.

Although financial reports of many of the big banks are as long as 500 pages the amount of understandable and unbiased information is arguably low and the number of pages may be off putting to anyone other than a bank analyst, certainly to the customer who may want to learn more about what is happening in the institution. Some banks present more usable data and case studies as evidence of their social and environmental impact. It also allows customers, actual or potential to assess more effectively the risks associated with a bank or product alongside a straight comparison of interest rates. Transparency also enables independent research to be conducted.

GABV believes that transparency is the most important driver of change in finance, as it is crucial to informing customer choice.

Transparency also relates to how a bank is run. Despite the rhetoric and exhortations to higher standards, too little attention is paid by regulators or policy makers as to how banks or the infrastructure such as the payments systems are run and where responsibility and accountability lie. Given the pivotal role that banks and the financial system play in fuelling or constraining economic activity, greater diversity and transparency in the selection process of the composition of boards of banks and regulators can help change the culture and rebuild trust.

3.3 Diversity

Diverse challenges and stakeholders demand diverse solutions. Only by accepting such diversity is banking and the financial system able to serve the needs of all actors. The diversity of stakeholders; rich

and poor, urban and rural, young and old, local and international needs to be reflected and represented in governance and to be fair, representative of social and economic justice.

Assiniboine Credit Union: Diverse governance.

Assiniboine Credit Union is a socially responsible financial cooperative. It was formed in 1943 by Winnipeg Electric Company employees in Canada. It has a set of rules describing a desired board composition in which diversity plays an instrumental role. Skills and other competencies such as understanding of Assiniboine’s mission and triple bottom line commitment are only part of the mix. Diverse representation of members and the communities they serve complete the requirements. An annual gap analysis is undertaken to check whether gender, age, ethnic or cultural diversity is maintained with regard to those the credit union serves.

3.4 Inclusion

As far as possible inclusion should extend across all activities – stakeholders should be included in strategic decision-making, diverse groups should be included in the financial system. Civil society should hold the system to account. Inclusion, together with sustainability and transparency, also lead to the holistic employment of the paradigm to all activities. Financial institutions should present data on their impact, be it positive or negative.

If we take humanity as a central point of the financial system then all human beings are born stakeholders and as such all stakeholders should have the right of fair access to the financial system as well as access to air, water, soil or any other common good. And as such, everyone is to a certain extent affected by developments in the financial system. However, often citizens, as well as politicians and journalists build opinions on seemingly very flimsy understanding of the financial system. This is not a surprise as the system is complex and lacks transparency at all levels. Most of us do not know where our money goes and do not understand the processes behind it. This applies equally to front of office staff in many mainstream banks, unable to answer the question “What did my bank do with my money last night?”

“It is most essential to grow citizen’s awareness”

Inclusive governance

GLS Bank has 3 positions on the supervisory board for employee representatives. The bank also invites all clients to participate in the discussion and feedback process. This is not only evidenced by having a very active and open social media presence but also by inviting all members to the annual meetings and actively asking for their feedback.

Inclusive banking

In adherence with the principles of co-operativism, Banca Etica engages its co-operative members in the most essential decision making within the bank, namely credit decisions. After training in how to assess borrowers, groups of members participate in the credit appraisal process, often bringing a different, localised insight to the process. Their assessment is discussed with the credit analyst, both forming part of the credit submission but with the members holding a right of veto.

Many values based banks see financial education, to enable people to understand and engage in finance, as part of their mandate. On their websites, in their stakeholder communications and through social media, as well as in conversations with customers or as keynote speakers they speak about the financial system and the role of money. Strengthening the power of stakeholders, as well as creating awareness, is not only a top-down issue but can also come by connecting and exchange. A good example on how this can work is the Community Development Platform run by GLS which allows interested and like-minded people to get and give information, and explore opportunities to collaborate for positive change. Charity Bank runs an award winning programme of ‘Different Journeys’ days which brings savers and borrowers together through a day of visits to meet borrowers and their customers or beneficiaries.

3.5 Ethics in finance

Ethics and values need to be at the core of a future sustainable financial system. The financial system is a global system with institutions that act internationally, therefore any framework needs to be broadly accepted.

John R. Boatright introduces a framework characterising ethical issues in finance that is useful based on six principles of mitigating harm to people, fulfilling duties and obligations, enabling the fulfilment of rights and justice, and acting with honesty and respect for the dignity of others.⁶³ These six principles form a basic checklist:

1. **Welfare:** Is anyone being harmed, and if so, can the harm be justified?
2. **Duty:** What is my duty or obligation in this situation?
3. **Rights:** Are anyone's rights being violated, and if so, can the violation be justified?
4. **Justice:** Is everyone being treated fairly or justly?
5. **Honesty:** Am I being entirely honest in my actions?
6. **Dignity:** Am I showing respect for all persons involved?

These principles can be applied by financial institutions in their business models and internal culture. Again social banks can be role models as they have already included these questions in their business models and have proven the profitability of an ethical way of banking without compromising on the needs of humanity and nature.

Ethical codes for bankers

In the Netherlands, people working at any level in the finance sector are obliged to take an oath that they will as a minimum engage in no activity that knowingly does harm to individuals or the common good. The Chartered Institute of Bankers in Scotland has instigated an oath to be taken by all award recipients upon graduation. It has also played a major role with others in the European Banking and Financial Services Training Association (EBTN) development of the new ‘Triple E’ standard which is intended to provide a common, recognised foundation for European banking qualifications.⁶⁴ The new Banking Standards Board in the UK will seek to promote high standards (above the regulatory minimum) of professionalism, competence and ethics across banking. However, it recognises that its scope is limited to banking and welcomes the development of similar standards bodies in other areas of the financial system.

⁶³ J. R. Boatright (2014). *Ethics in Finance, Third Edition*. John Wiley & Sons, Inc.

⁶⁴ EBTN press release 8 April 2015 www.ebtn-triple-e.eu

3.6 Culture as a driver for change

The integrity of the financial system is shaped by the culture and values within its institutions. Values based banks are proof that it is possible to apply values holistically and profitably throughout a bank.

UNEP FI's *Guide to Banking and Sustainability*⁶⁵ notes that banks may take steps towards sustainability through individual projects or programmes but ultimately significant change depends on strong institutional commitment to sustainability which is then integrated through sustainability roles throughout the organization. It should not be overlooked that banks are big employers and need to rethink how to implement value-orientation amongst their employees.

Today, many banks have a Corporate Social Responsibility department, internal ethical policies or codes of conduct. Despite such efforts, this does not exclude them from irresponsible behaviour. Looking at the Sustainability Report of Banco Santander⁶⁶ highlighting its community commitment and environmental footprint improvements, it would be hard to imagine that such a bank could be able to finance deforestation, while the Crédit Suisse example also cited shows a bank ostensibly committed to climate change measures yet working against them in other ways. Arguably, the culture of sustainability does not penetrate throughout the whole organization. We have also seen, above, that strictly interpreted, Islamic banking rejects such 'greenwashing' as developed from a profit rather than societal standpoint.

On the other hand, there are values based banks which put meeting human needs at the very core of their business. This is exemplified by the position and influence of various values based committees, such as the ethics committees of Alternativ Bank Schwiez and Banca Etica.

⁶⁵ UNEP FI (2011). *UNEP FI Guide to Banking & Sustainability*. www.unepfi.org/fileadmin/documents/guide_banking_statements.pdf accessed 29 March 2015

⁶⁶ Banco Santander (2014). *Sustainability Report*.

4 Challenges to values based banking

Values based banks are providing examples of best practice day in, day out of a financial system more in tune with the environment and our society.

A 2012 study by the GABV compared key financial information about global systematically important financial institutions (GSIFIs) and a group of values based banks.⁶⁷ It revealed that the latter group were investing more in a greener and fairer society, and their business model was more robust and resilient. These findings confirm those of the 2009 study by Scheire and De Maertelaere⁶⁸ and were themselves confirmed by the 2015 DIW Report.⁶⁹

Table 1: Key indicators for GSIFIs and Values Based Banks

| | Global Systematically Important Financial Institutions | Values Based Banks |
|-------------------------------------|--|--------------------|
| Loans/total assets | 40.7% | 72.4% |
| Deposits/total assets | 42.0% | 72.5% |
| Equity/assets | 5.3% | 7.5% |
| Tier 1 Capital/Risk-weighted assets | 10.0% | 12.2% |
| Return on Equity | 10.8% | 9.7% |

However values based banks also face a number of challenges.

4.1 Viability: too small to survive?

Bank failures occur across the spectrum of banking. Of the 353 bank failures in the US between 2008 and 2011, 85% were small community banks. Credit unions were not immune. In the UK over 50 have closed since 2002 and recently were failing at around one per month. Notable values based banking failures have included Oekobank in Germany and a founding GABV member, ShoreBank in the US.

Banks can fail for many reasons, some more complex than others. Eleven commonly cited reasons include:

- Funding issues
- Bad loans
- Asset/liability mismatch
- Regulatory issues, including over-regulation
- Proprietary trading – deemed so serious that action has been taken to stop it
- Non-bank activities
- Risk management decisions
- Inappropriate loans to bank insiders
- Rogue employees
- Runs on banks
- Governance and mission drift

⁶⁷ GABV (2012). *Strong and Straightforward: the Business Case for Sustainable Banking*

⁶⁸ C. Scheire and S. De Maertelaere (2009). *Banking to make a difference*. Research paper Artevelde University College, Ghent

⁶⁹ See note 60

The Dunfermline Building Society was the largest building society in Scotland, but became insolvent after taking on too many risky assets, losing money in its own IT business and buying sub-prime mortgage securities. It became a test case in the UK for new bank legislation allowing the regulator to ‘takeover’ the building society and sell the good assets, which were taken over by the Nationwide Building Society. ShoreBank’s failure was caused by a mix of economic, governance and political issues. Like many other banks it had too little capital in the face of an unexpectedly deep recession. But had it been larger or its catalytic role in the communities it served more broadly understood and accepted, it might have mustered the necessary political support for a rescue package.⁷⁰

While some would argue that bank failures are a good thing because they evidence risk sharing and the effect of market forces, generally they are a bad thing if they impact upon people’s savings. The events in the UK and elsewhere post BCCI (Bank of Credit and Commerce International) suggest that bank failures do not make people more conscious of risk as well as reward.

4.2 Vulnerability: selling out?

In other cases some values based banks do not collapse or close, but move closer to the mainstream, eventually becoming indistinguishable in their approach to investment, transparency and inclusion. For example a number of banks were set up to provide financial services to a market that was not being served appropriately or at all. Some, including the founding families of some of today’s multinational banks, came from religious roots, often Quaker, Protestant or Roman Catholic or, more recently evangelical Christian. Others have emerged out of the anti-apartheid, fair trade and social justice movements. In India the Catholic Syrian Bank is one of the country’s oldest and was set up as part of the pre-Gandhi Swadeshi movement. However recent ownership and management changes will see the bank refocus away from its real economy-based image, which is seen as old fashioned.

An appropriate ownership structure and governance can help to preserve or underpin the culture and values but it is not a guarantee. Examples of this can be found in the Cassas di Risparmio of Italy and the Cajas of Spain which hived their shares up into foundations ostensibly to protect them from takeover. Similarly with the UK building societies that chose to demutualise, their structures did not prevent cultural change.

Some companies struggle to defend the mission-driven business model as pursuing the common good might be seen as harming shareholders’ financial interests. It has long been argued that one reason that RBS was able to buy NatWest Bank was that institutional shareholders saw short term market value dilution from NatWest’s community programmes.

4.3 Lack of supportive regulation

Policy makers and regulators, appear to be fixated on a one size fits all approach which tends to favour public listed companies as the model for banking and can hamper the ability of alternative models to provide sustainable value for consumers and communities.

Discrimination can take the form of too complex regulation for less complex banking institutions. The cost of regulation then falls disproportionately on smaller banks. Despite over 60 years of successful lending to charities and public good bodies, under Basel III rules Bank für Sozialwirtschaft in Germany still

⁷⁰ J.E. Post and F.S. Wilson (2011). *Too Good to Fail*. Stanford Social Innovation Review.

has to provide 100% risk weighting to its loans as do others such as Banca Etica and Charity Bank, while loans for property, where valuations can be more volatile, are weighted more lightly.

Regulation restricting consumer choice

Credit Coopératif introduced a service **Agir** which gives its customers the option of choice in which sectors they want their money to be used. There are options for planet, a just society, international solidarity or other social entrepreneurship. La Nef started this in 1989, as well as the choice of one's own rate of interest on savings, to foster the link with the customers, and include them in the process of solidarity with others. When Charity Bank started it offered savers a choice of interest rate up to 2% pa. While the Regulator was prepared to accept this 'novelty' the Banking Ombudsman Service felt it could not and initially excluded the bank from membership.

4.4 Disruptive technologies

The internet is changing the possibilities and challenges for values based as well as mainstream banking.

A number of values based banks have embraced internet banking. However the shift to online finance raises a specific issue for values based banking which has tended to focus on direct human interaction and long-term customer relationships. This is the social in social banking. Any move towards intermediation through the cloud must ensure that this principle is not lost.

Virtual values based banking

La Nef in France has developed '**Prêt chez moi**' as a form of crowd funding in collaboration with its stakeholders. Community 21 Australia is also developing a crowd platform to deepen its reach while in the UK, Ecology Building Society has joined with crowd funding platform Abundance to provide finance for the installation of solar panels on the roofs of a social housing project alongside the crowd.⁷¹ UK challenger bank Metro Bank has announced a partnership with crowdfunding platform Zopa⁷² to lend funds through the platform.

The challenge of financial education can be addressed by the internet. However, in so doing we need to ensure that the original promises of the internet, openness, transparency, freedom and universality are enshrined in any future development.

In *The End of Banking*⁷³ the authors argue online financial models, peer-to-peer and online financing will enable the disintermediation of traditional banks, with individual values and civil society able to play a greater role in directing and allocating resources towards human needs and opportunities. The opportunity is there for more agile values based banks to take advantage more easily than large mainstream banks weighed down by expensive but change resistant legacy systems.

⁷¹ http://www.ecology.co.uk/news/press-releases/158/ecology_building_society_makes_ground-breaking_250_000_investment_via_abundance_to_support_a_uk_renewable_energy_project

⁷² www.finextra.com/news/fullstory.aspx?newsitemid=27372

⁷³ See note 34

5 Scaling up values based banking innovations

Looking at the increasing use of values based banks, as well as other alternative investment routes it seems that people are already asking the powerful and most important first question: Where does my money go?

It is clear that values based banking is a viable model, yet many remain unconvinced that it can work beyond a relatively small scale niche, and can serve the broad needs of populations and business. However such thinking fails to recognise that the current financial system already marginalises and excludes many in the world.

We believe that scaling up values based banking approaches is critical to designing a sustainable financial system. This section outlines key channels and routes for achieving this.

5.1 Developing the values based banking sector

To be sustainable values based banks have to broaden their reach and diversify their portfolio by reaching across to stakeholders of the market-oriented economy and win them over to a values based economy.

The existing values based banks are demonstrating that they can grow whilst remaining true to their values. Individually they are comparatively small. In Germany for example, they have a market share of 0.2% of the private banking sector, but according to Zeb⁷⁴ 16 million Germans are potentially interested in such banks. Collectively they are also extending their reach through networks such as the GABV, FEBEA and INAISE and through the Institute for Social Banking and the Finance Innovation Lab, as well as through apex organizations and financial cooperation domestically and internationally. These networks provide a cost effective framework for institutional capacity development, inter-regional resource mobilisation, sharing of best practices; and support for innovation.

One area of potential is the development of standards. As social or values based bankers we think we know what we mean by values based banking. Many may not. Other areas such as fair trade and organic farming have established standards and certification systems, but similar standards are not widespread in banking. *Finansol* has been used as a label for socially responsible savings and investment products in France since 1995⁷⁵. Such a “seal of approval” would need to be published and regulated by an independent authority to ensure it is credible. While the UK Banking Standards Board is in its infancy, it intends to work closely with sister organizations internationally. As part of this it should open a dialogue with the values based banks and their networks.

In many ways values based banking is banking that sticks to the knitting or banking as it used to be which may make it more difficult to promote as a new clearly identifiable model. However, the GABV pillars do make it possible to differentiate amongst banks as to those that are values based and those that are not or merely using ‘green washing’ or weak community engagement as a PR strategy.

5.2 Influencing mainstream banks to adopt sustainable strategies

In his foreword to *Banking on Shared Value*,⁷⁶ Professor Michael Porter notes that “the past decade has been disastrous for the banking industry”. He goes on to write that the industry “can no longer focus on

⁷⁴ www.zeb.de/de/aktuelles/zeb-social-banking-study-2012.html

⁷⁵ www.finansol.org

⁷⁶ www.sharedvalue.org/banking-shared-value

short-term return optimization to benefit an increasingly small, elite segment of the global population. It can no longer rely on generating revenue by using opaque fee structures or engaging in risky financial engineering”. Banks must choose a new path. They need to turn their capacity for innovation to financing consumer, social and environmental solutions that benefit society while increasingly representing good investment opportunities for private capital.

“The connection [of banks] to the real economy is more resistant against crises and additionally more sustainable.”

The new path centres on creating shared value-addressing relevant societal problems with a business model generating measurable returns. Shared value must be approached through the lens of business strategy, not as a matter of public relations, CSR, sustainability programmes or isolated corporate philanthropy. It is an opportunity for banks to capture long term business value by enabling and financing societal solutions.

The Report identifies shared value opportunities at three levels:

- Furthering client prosperity by improving the financial health of individual and business clients and extending banking services to the excluded
- Fuelling the growth of regional economies by moving beyond individual transactions to proactively finance and strengthen entire ecosystems within a sector or community, just as *bancos comunales* are doing in Peru or the Philippines, but at scale.
- Financing solutions to global challenges by working with socially or environmentally beneficial client segments and by structuring, placing and /or investing in impact investments.

A few banks are embracing a new paradigm and making shared value a critical part of their core business strategies. Too many are missing the opportunity and investing instead in CSR and philanthropy programmes. Mainstream banks could instead adopt banking best practices developed in the values based banking sector, such as the small social loans on affordable terms, already developed at scale for example by VanCity in Canada.

5.3 Building the capacity of civil society to catalyse change

Civil society has an essential role to play in raising awareness amongst citizens of their role as owners, investors and consumers of finance and the impact that their money has in the world. Many people do not understand the connection between the impact of their money and the world around them. One interviewee reflected “I got through 30 years of my life without needing to know about finance”. Awareness raising will require an infrastructure that enables sustained awareness raising and advocacy campaigns. Around the world civil society is starting to become stronger in helping citizens understand what their money is doing. The Occupy Wall Street movement has helped to capture the imagination of a broader global public with a simple but compelling slogan: “Invest in Main Street, not Wall Street”. It claims to have led to more than 10 million people moving their money to local financial institutions.

Other important campaigns have included the Rainforest Action Group persuading Citigroup to cease funding projects that were extracting fossil fuels and destroying forests. In the UK Move Your Money has inspired 1000’s of people to register their vote against business as usual and switch to values based banks. ShareAction is working similarly to raise awareness amongst pension fund holders.

Yet, despite this activity more needs to be done in building the infrastructure. This includes helping civil society to become more organised and strategic in understanding the financial system, to enable it to

manage its own funds in line with mission and to challenge whose benefit the system works for. By developing more strategically convened initiatives such as the Transforming Finance Network, not only in the affluent west but throughout the world, citizens can be spurred to believe their money matters and so support the growth of values based banking.

5.4 Educating, engaging and empowering consumers

The financial system is a conduit through which financial products and services are provided to stakeholders. But the majority of citizens do not have access to easily digestible information as the financial system has grown too complex or are, indeed, excluded from it. Understanding how the financial system works is crucial to customers being better able to monitor and control where their money goes.

“The longer we don’t understand the financial system and how it works, the longer we won’t feel we own it. It owns us at the moment.”

There are a number of initiatives focused on basic financial literacy of customers and potential customers.

MyBnk is an award-winning UK charity that teaches young people how to manage their money and set up their own enterprise. Its vision is of a financially literate and enterprise driven generation. Since 2007 they have helped over 100,000 young people in more than 550 schools and youth organizations.

With more financial education and information, there would be a more democratic participation in the development of the financial system rather than the current behind closed doors approach. This could lead to greater engagement in governance structures.

Understanding would help recreate trust in banking. Some values based banks serve as a social hub rather than only a financial intermediary connecting people with similar values. Banks are then perceived as enablers and connectors and advisors beyond pure financial questions. Such approach sets up stable relationships and establishes banks as a valuable partner in economic processes beyond financial transactions.

Even though the wave of digitalisation has improved banking services in recent years, we see potential in how modern technology could support the engagement and responsibility but most importantly help building up new relationships. Peer-to-peer lending platforms and crowd-funding do not have to be only threats for banking but also opportunities to directly engage stakeholders and enable them to participate in the economy by getting insight and taking action.

“What we need is that citizens are enabled to be fully informed about new actions and to make their votes”

There could be a broader educational role for the Institute for Social Banking, possibly replicated on other continents, engaging citizens as well as values based banks’ co-workers. ISB could also develop core values based modules that are required to be taught in national banking programmes.

All Street is the only company in the world providing independent research to investors in crowd funding projects. It is a game changer within the emerging financial system. It is set up as a web based platform that collects and provides real time access to investment opportunities across the main crowd-funding platforms. It helps investors compare and investigate different equity, debt and rewards crowd-funding deals and quickly determine if the potential investment fits their portfolio strategy, risk appetite or other criteria. All Street has the opportunity to become the Bloomberg for ordinary investors and can be extended to potential investors in early stage projects as well as emerging markets.

5.5 Accounting for environmental and social impacts

Economic, social and environmental impacts of finance must be measured. The recent publication by the UK's Green Investment Bank of their credit assessment process represents a significant step in transparency and information awareness but it is only one financial institution, albeit Government owned.

In the existing system a bank's success is mainly measured along financial dimensions, with social and environmental effects being barely considered. Only if we include those two dimensions, or bottom lines, in an understandable and comparable way will we be able to make informed decisions.

There are already well-known concepts such as the Triple Bottom Line (People-Planet-Profit)⁷⁷, Environmental, Social and Governance (ESG) or Common Good balance sheet.⁷⁸ There are reporting standards developed along those concepts by organizations such as the Global Reporting Initiative⁷⁹ and B Corporation and many other sustainability ratings. However, the majority of these ratings focus across multiple industries⁸⁰ and so are able to reflect the specifics of banking in only a limited way. A problem of current sustainability metrics is that they often account for policies or techniques but do not assess whether and how they are implemented in reality. Measuring how sustainability is embedded in culture is, indeed, a complicated but not impossible task if processes are tracked from policies through implementation to identifiable results. Such a structure is being developed by the Global Alliance for Banking on Values in the GABV Scorecard.⁸¹

The Economy for the Common Good⁸² has a vision of an economic system built on values that promote the needs of the entire population. Its goal is to evaluate the management success of businesses based on values oriented towards promoting the common good. It is an open, participative process with a grassroots structure and global scope.

Making the Triple Bottom Line measurement mandatory would help to empower stakeholders who struggle to find relevant and comparative information. Governments could further support such sustainability accounting efforts by accepting public accounting to be of a similar nature. Bhutan's Gross National Happiness introduced to substitute for Gross Domestic Product is an inspiration.⁸³

⁷⁷ T.F. Slaper and T. J. Hall (2011). *The Triple Bottom Line: What Is It and How Does It Work?* <http://www.ibrc.indiana.edu/ibr/2011/spring/article2.html>

⁷⁸ *The Content of the Balance Sheet | Economy for the Common Good* (2015). <https://www.ecogood.org/en/balance-sheet/what-balance-sheet/contents-balance-sheet>

⁷⁹ *Global Reporting Initiative* (2015). *Introduction to G4*. <https://www.globalreporting.org/reporting/g4/Pages/Introduction-to-G4-brochure.aspx>

⁸⁰ *SustainAbility* (2010). *Rate the Raters: Taking Inventory of the Ratings Universe*.

⁸¹ See also www.smu.ca/webfiles/Hewitt-ValuesBasedBanking.pdf

⁸² www.ecogood.org

⁸³ *World Bank* (2014). *Bolivia and Bhutan: Learning to measure happiness*. <http://www.worldbank.org/en/news/feature/2014/05/06/bolivia-el-aprendizaje-de-medir-la-felicidad-intercambio-butan-sur-sur>

Changing, or enhancing accounting is a huge challenge as it will have a broad effect and need to change at an operational level. It is likely to incur economic costs but those should be balanced out by the positive effect of social empowerment. The Finance Lab is engaged with UK accountancy bodies to challenge the profession to consider how its role needs to change to support a sustainable society.

“Social values should be integrated into all economic activities”

To ensure smooth and efficient functioning a financial system needs frameworks and regulations. While we acknowledge that a global society needs global regulations these must be capable of application contextually, considering the different stages of development. Regulation should start from an understanding of what is and what is not needed for the real economy, set out to control risks within the system and disable or penalise misuse and incentivise or reward good behaviour that improves the common good. Regulation must be able to encourage diversity not stifle it.

A number of key policies for macroeconomic stability and financial regulation, aimed at supporting better risk management by banks, should support alignment between long-term value creation and social and environmental risks’ management:

- Central Banks, including the ECB, to act as a more effective lender of last resort with authorization for Governments to borrow directly from Central banks (without interest)
- Separation of investment from retail banking for better security of retail deposits
- Regulation of shadow banking. It is possible to have universal rules that are applied contextually
- Banks should be obliged to have representation of citizens on boards. Regulatory focus on what makes a good bank director should be broadened to include a wider understanding of the economy, **and** social and environmental issues. Ways also need to be found to encourage broader gender and age participation so that boards are genuinely diverse and represent their customer make up.

As doctors have their Hippocratic oath so we recommend that people working at any level in the finance sector be obliged to take an oath that they will as a minimum engage in no activity that knowingly does harm to individuals or the common good. Banks would be required to include this in all employee and director appraisals.

Actions to help to replicate and spread the best practices developed by the values based banking movement include:

- **Acknowledgment by law of the role of organizations with social and economic purpose** (including values based banking and social entrepreneurship) (see case below on the ESS law), and active support through incentives and promotion.
- **Governments could lead by example by investing in sustainable procurement** for their own consumption (for example the French public-owned railway – SNCF – putting sustainable cotton on new train fabrics)

- **Support for closer links between values based banks and those working on issues such as social welfare, water, sustainable agriculture or forestry, and education** for sustainability, including through incentives such as tax free donation of interest on savings.⁸⁴
- **Dissemination of values based banking experience on a global scale through South-South and triangular cooperation, such as on microcredit.**

If agreement cannot be reached to exclude certain activities deemed not to be for the common good such as high frequency trading which represents around 50% of all US stock exchange transactions then taxes should be levied to penalise those activities (the so called ‘Tobin tax’⁸⁵) It has been argued that the money from such a tax could usefully be reinvested in the real economy, in sustainable actions for environment, for example. Similarly, speculation on food commodities could be regulated as it can have a substantial impact on food prices.⁸⁶

“We need stronger taxes for speculation, tax incentives for sustainable investments”

Other possible and useful measures that should be taken are:

- Promote a standardization of acceptable tax planning behaviour. Make tax avoidance or evasion morally unacceptable.
 - Require multinational corporations to publish their accounts on a country-by-country basis.
 - Apply consistency in the tax treatment of loan interest and indebtedness.
 - Disclosure of beneficial ownership of all banking and securities accounts.
- Reinforce sanctions against economic and financial crime including imprisonment not just fines. “Capping” dividends at single figure percentages on shares in financial institutions⁸⁷. It has been shown that unrealistically high profitability objectives lead to excessive risk taking and potentially to unethical behaviour. Too little profitability on the other hand can be a destabilising concern. An important element in the redesign of the banking system is for regulators and policy makers to consider the appropriate and socially acceptable level of profitability of banks, especially those retail institutions where they benefit from depositor guarantees and effectively function as utilities.
- Include financial education in all curricula and values based finance to be required teaching in national banking education programmes and business schools.
- Adapt the definition of solvency and update the legal rules defining solvency.
- Make special investment compulsory: pension funds or employee savings programmes, to be invested partly in common goods or green economy (in France there is a variation on this theme: such funds are obliged to invest 10% that way- in “ Solidarity and Social Economy (ESS)”, mainly through social banking labelled institutions)
 - Limit the work of credit ratings agencies to exclude sovereign risk

⁸⁴ A stronger link can be made through sharing of interests (although we could have to wait for interest rates to grow a little more): citizens with savings in ethical banks are asked if they can donate part of their interest to such non-profit institutions (a policy of tax-incentives in addition can help even more)

⁸⁵ TabbForum (2014). High-Frequency Trading: An Important Conversation. www.tabbforum.com/opinions/high-frequency-trading-an-important-conversation

⁸⁶ Global Justice (2015). Food speculation. www.globaljustice.org.uk/food-speculation

⁸⁷ The cooperative movement seems to have understood this paradigm by making rules such as “dividends cannot exceed 2% or exceed rate of inflation +2% or so”

- Move the trading of derivatives from deregulated OTC markets onto well regulated public exchanges and introduce position reporting. Ban massive passive speculative activity.
- Introduce strict limits on the market shares held by traders to curb market abuse. Give authorities sufficient powers to act including ensuring full transparency and supervision of financial markets, caps on deal size and banning harmful activities.
- Provide incentives to alternative and non-financial hedging for small scale farming and agriculture.
- Appropriate regulations to allow development of (local) alternative currencies

A further area of change, establishing a register of information on lobbyists and lobbying, to reduce the influence of financial and corporate lobbying on politics (this law was voted in the European Parliament very recently). Another suggestion is the development of a European or World ethical banking federation, with independent auditors, working on a charter including ethical, financial and common welfare principles.

Public incentives can support and enable social and environmental investment. In France fiscal incentives encourage investment in the social and solidarity economy (ESS), while the UK offers community investment and social investment tax reliefs (both of these measures have approval of the EU as not constituting discriminatory state aid). Development of microloans for energy efficiency by XacBank in Mongolia was supported by USAID.

Fiscal incentives for investment in the social and solidarity economy

In France saving products directed at the social and solidarity economy (**économie sociale et solidaire – ESS**) were first developed in the 1980s by Crédit Coopératif bank and La Nef. Savings and investments are encouraged through the scheme by a policy of fiscal incentives. Savers that donate part of their savings interest to an association or foundation receive 66% as an income tax deduction. People investing in special ESS funds receive a 25% tax reduction on returns.

The scope of ESS investments can be social (such as services to older, unemployed or people with disabilities), or environmental (such as renewable energy, recycling, energy efficiency) or international solidarity. Criteria for investee companies initially related to the election of top management, and ratio of wages between highest and lowest paid. Later this was adapted to specifically recognise cooperatives, associations, mutuals and foundations as well as social enterprises. A category of funds was established called “90-10 Funds” which invest 90% in SRI Stock exchange listed companies and 10% in ESS organizations (companies, cooperatives).-

One example of an ESS investee is the Terre de Liens (TdL) movement which has raised 45 million Euros to buy 3,000 ha for 130 small scale sustainable farms. TdL is a laboratory for change in the development of community connected farming. Today it partners with 17 other values organizations in nine countries. The role of the values based banks is fundamental to its further development.

Values based banks that focus on the triple bottom line are well suited to co-operate with governments in their social or environmental innovation efforts where financing is often an obstacle to introducing better solutions to improve human wellbeing, and environmental impacts.

Microloans for energy efficiency in Mongolia

XacBank was created in 2001 from the merger of the two largest non-bank financial institutions in Mongolia with origins in funding from Mercy Corps, USAID and UNDP. To address fuel poverty in the freezing Mongolian winter it established a network of product centres selling energy-efficient products subsidized by the Clean Air Fund of Mongolia and the Millennium Challenge Corporation. It provided microloans with a reduced interest rate, simplified application procedures and flexible repayment terms to 160 000 families. By installing energy efficiency measures families reduced fuel consumption by up to 50%, improving health and releasing income to spend on other needs

Annex: Methodology

This report summarises findings from

- Online survey (565 responses) mainly in Europe– 36% from people working in banking and finance, including values based institutions, 21% from civil society organizations, 12% entrepreneurs, 10% Academia, 5% policy making, and 21% independent/other. 61% identified themselves as users of values based banking.
- Dialogue interviews (24 people) – social bankers, academics, business people, civil society
- Synthesis workshop
- Meetings with the Board of INAISE, FEBEA Secretariat and a workshop within the GABV 2015 Meeting

Our interviews and surveys have shown us that there is a high demand for a financial system that is related to the real economy and that is based on values.

Unsurprisingly, amongst the responses we found contradictory opinions and suggestions. This is not only due to the different needs of people but also because the economies around the globe are in different phases of their growth and therefore have different demands.

Although the online survey was available on the internet and our interviewees included people working in traditional banking spheres, we acknowledge that the respondents are predominantly people of broadly similar values.

One might argue that the answers show a bias as people are more attracted to answer if something is aligned with their own values. Getting so much feedback in such a short time and even getting timeslots from people who normally do not open their agenda for this kind of request suggest that there is a need in such processes for a place that gives a voice to the citizen.

Detailed responses may be found at <http://bit.ly/valuebank>

About the Partners

Finance Innovation Lab

The Finance Innovation Lab was founded by WWF-UK and ICAEW in 2009 in order to change the financial system so it serves people and planet. Since then, The Lab has grown into an award winning initiative that has engaged thousands of people and created change in government policy and enabled new campaigns and business models in finance.

The Lab empowers positive disruptors in the financial system. Our vision is a financial system that works for people and planet. One that is democratic, responsible and fair. We connect people who are changing the financial system, develop them as leaders and help them scale their work. We work with entrepreneurs creating alternative business models in finance, civil society leaders advocating for financial reform and ‘intrapreneurs’ in mainstream finance re-purposing their professions.

<http://financeinnovationlab.org/>

Institute for Social Banking

The Institute for Social Banking promotes a concept of finance and banking that specifically orients itself towards a perception of and responsibility for the development of both people and planet. It works with interested employees of banks and financial institutions, business and banking students, as well as interested people from other backgrounds.

The activities of the ISB in the area of research are targeted at examining both practical problems and successes of the socially oriented banks. This intends to support practitioners and to disseminate ‘best practice’. The insights gained from the research also ensure a high standard in the training activities.

<http://www.social-banking.org/>



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