Global Alliance for Banking on Values

Real Banking for the Real Economy: Comparing Sustainable Bank Performance with the Largest Banks in the World

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GLOBAL ALLIANCE FOR BANKING ON VALUES

Introduction

Five years after the financial crisis began in earnest with the collapse of Lehman Brothers, the negative impact from a damaged banking system on the real economy[1] continues to be felt. Continued stress in the global financial system provides the backdrop to high levels of unemployment, low levels of business borrowing, and unsustainable public finances in many countries. At the same time the impact of climate change increasingly challenges communities coping with a changing environment.

Public policy and banking regulation are now increasingly focused on the need to improve the quality of the banking system in general, with a view to supporting the real economy in particular. Underlying this effort is a back-to-basics approach that relies on traditional measures of capital strength and liquidity. Many in the banking industry oppose the changes, claiming that they will prompt a decline in lending to the real economy.

Throughout this period of private reflection and public debate, a group of sustainable banks, all members of the Global Alliance for Banking on Values (GABV[2]), have continued to successfully finance the real economy through business models based on the Principles of Sustainable Banking[3] that follow.

Principles of Sustainable Banking

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

Research Questions and Methodology

In 2012 the GABV published the results of new research comparing sustainable banks and Global Systemically Important Financial Institutions (GSIFIs) relative to the following key questions:

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

This research used publicly available financial results up to the year-end 2011. This research has now been updated to refine and expand the number of sustainable banks to include new members of the GABV, revise the list of GSIFIs for changes made in November 2012 to this peer group by the Financial Stability Board[4], and include financial information for 2012.[5]

1. The real economy relates to economic activities that generate goods and services as opposed to a financial economy that is concerned exclusively with activities in the financial markets.
2. More information on the GABV can be found at www.gabv.org.
3. An expanded description of the Principles of Sustainable Banking is found in Appendix 3.
4. More information available at www.financialstabilityboard.org.
5. Listing of Sustainable Banks and GSIFI peer groups can be found in Appendix 1.

The updated research provides additional support to the initial conclusions. In addition, the research that capital strength and lending to the real economy are positively linked, is supported by both a recent article in the Financial Times[6] and IMF working paper.[7]

In the updated research we have examined results for 2003 to 2007, 2008 to 2012, and over a ten year cycle. With the collapse of Lehman Brothers in 2008, signalling the point at which the financial crisis was recognised, these time periods capture two very different eras for the banking system.

Research Results – A Financial Perspective

The degree to which a bank finances the real economy is evident from the portion of assets on its balance sheet that are devoted to lending. The difference between the two groups in the research is striking. For sustainable banks this level is nearly double that of the GSIFIs. And it remains core to their activity. The proportion of the balance sheet devoted to lending by sustainable banks has increased by nearly 3% since the financial crisis began and declined by nearly 2% for the GSIFIs.

Loans to Total Assets			
	Post-crisis - 2008 to 2012	Pre-Crisis - 2003 to 2007	Over the Cycle - 2003 to 2012
Sustainable Banks	77.4%	74.5%	75.9%
GSFIs	39.3%	41.0%	40.1%

In addition to their strength in lending, sustainable banks rely much more on client deposits to fund their balance sheet compared with GSIFIs. This focus on deposit taking is not only another example of a focus on the real economy but also reduces the liquidity risk of their funding strategies.

Deposits to Total Assets			
	Post-crisis - 2008 to 2012	Pre-Crisis - 2003 to 2007	Over the Cycle - 2003 to 2012
Sustainable Banks	75.3%	74.5%	73.1%
GSFI's	42.8%	43.0%	42.9%

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

6. Thomas Hoenig, 'Safe banks need not mean slow economic growth,' Financial Times, 19 August 2013
7. Tümer Kapan and Camelia Minoiu, 'Balance Sheet Strength and Bank Lending During the Global Financial Crisis,' IMF Working Paper WP/13/102, May 2013

The sustainable banks did not show substantially higher levels of capital than the GSIFIs relative to risk based capital measures. However, the ratios for the GSIFIs were significantly impacted by the relatively low level of Risk Weighted Assets (RWA) compared to total assets, as calculated by their risk models. There is increasing discussion as to whether these calculated levels of RWAs fully capture the risks for which capital is required.[8]

Capital Comparisons			
	Post-crisis - 2008 to 2012	Pre-Crisis - 2003 to 2007	Over the Cycle - 2003 to 2012
Sustainable Banks			
Equity/Total Assets	7.8%	6.7%	7.2%
Tier 1 Ratios	12.1%	n/m[9]	n/m
RWAs/Total Assets	61.9%	n/m	n/m
GSIFIs			
Equity/Total Assets	5.9%	5.2%	5.5%
Tier 1 Ratios	11.8%	n/m	n/m
RWAs/Total Assets	39.4%	n/m	n/m

Comparing the financial returns for sustainable banks with GSIFIs provides a more complex picture. The sustainable banks have historically stable Returns on Assets although at levels below those reported by GSIFIs prior to the crisis. However, the sustainable banks provide resilient financial returns over the cycle with lower levels of volatility. As noted in earlier reports this result is surprising given prevailing assumptions that sustainable banks would deliver lower returns than bigger banks that have a focus on maximising financial returns.

Relative to Returns on Equity the GSIFIs perform better, on average, over the cycle. However again there is more volatility and post-crisis returns are lower for the GSIFIs. In addition, the lower level of Equity/Assets for the GSIFIs means that a portion of these higher returns come from greater leverage, implying greater risk. Investors and others assessing the Return on Equity should expect higher returns for GSIFIs given both the higher degree of leverage and the greater volatility of the returns.

8. The Dog and the Frisbee; Andrew Haldane, Executive Director Financial Stability, Bank of England, delivered to the Federal Reserve Bank of Kansas City Economic Policy Symposium; Jackson Hole, Wyoming, 31 August 2012. Back to Basics: A Better Alternative to Basel Capital Rules; Thomas M. Hoenig, Director, Federal Deposit Insurance Corporation, delivered to The American Banker Regulatory Symposium; Washington, D.C., 14 September 2012.
9. Due to changes in capital regulation over the full time period, Tier 1 Ratios and RWAs/Total Assets Ratios are not meaningful for the full cycle and in the pre-crisis period.

Financial Ratios			
	Post-crisis - 2008 to 2012	Pre-Crisis - 2003 to 2007	Over the Cycle - 2003 to 2012
Sustainable Banks			
Return on Assets	0.53%	0.59%	0.56%
Standard Deviation	0.16%	0.17%	0.21%
GSFIs			
Return on Assets	0.37%	0.78%	0.57%
Standard Deviation	0.37%	0.29%	0.36%
Sustainable Banks			
Return on Equity	7.5%	8.8%	8.2%
Standard Deviation	2.1%	1.9%	2.7%
GSFIs			
Return on Equity	5.2%	17.7%	11.5%
Standard Deviation	10.0%	10.6%	10.2%

The issue of growth demonstrates further marked differences between the two groups. The sustainable banks had much higher growth in Loans, Deposits, and Total Income compared with the GSIFIs over the cycle. Prior to the start of the financial crisis the GSIFIs showed strong growth but this slowed substantially post crisis. As a result the sustainable banks show a much more consistent growth pattern over the full period reviewed.

Growth			
	Post-crisis - 2008 to 2012	Pre-Crisis - 2003 to 2007	Over the Cycle - 2003 to 2012
Sustainable Banks			
Loans	12.5%	13.6%	12.6%
Deposits	13.9%	13.1%	12.3%
Total Income	8.0%	12.8%	10.4%
GSFIs			
Loans	3.8%	17.7%	8.4%
Deposits	6.5%	16.6%	9.5%
Total Income	2.0%	15.8%	6.1%

Regional Differences – The European Example

The research has been extended to specifically make a comparison in the European market. Eight sustainable banks and 14 GSIFIs based in Europe allowed for a comparison of their relative performance. Comparing these two groups of banks operating with similar market conditions further highlights the strength of the sustainable banking model.[10]

As shown in the global comparison, sustainable banks in Europe show significantly higher levels of finance for the real economy, stronger levels of equity capital, and better levels of Return on Assets. They also delivered significantly stronger levels of growth over the cycle, especially post 2008 when the crisis became evident.[11]

Conclusions

A strong banking system focused on the real economy is critical to support the modern economy. The financial crisis has called into question the predominant banking models of the largest banks in the world. It is therefore timely to review the performance of banks that have business models based on the Principles of Sustainable Banking. The evidence from this review supports the conclusion that over the long term the business case for banking models, based on these principles, offers a compelling route to a more stable and sustainable banking industry.

Growing and supporting sustainable banking will allow for:

- Greater focus on the real economy
- More resiliency in the banking system
- More profitable and less risky financial returns, and
- Sustainable growth for banks.

10. Although it was not possible to make a comparison, an analysis of the performance of six sustainable banks in developing markets with 10 years of financial information provides useful insight into the strength of this banking model for those markets. This analysis can be found in Appendix 2.
11. Full comparison details of European sustainable banks and GSIFIs can be found in Appendix 2.

Appendix I

Listing of Peer Groups

Global Systemically Important Financial Institutions as of 31 December 2012[11]

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

Sustainable Banks[13]

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

** These banks were not included as they did not have 10 years financial history

12. This list is defined and published by the Financial Stability Board (www.financialstabilityboard.org). Banks in orange were included in the European comparison.
13. Sustainable banks were defined to include all banks that were members of the Global Alliance for Banking on Values as of 31 March 2013. Banks in orange were included in the European comparison. Banks in blue were included in the in the developing markets analysis.

Appendix II

Financial Comparisons Summaries

All Banks	Financial Comparisons Post-crisis – 2008 to 2012		Financial Comparisons Pre Crisis – 2003 to 2007		Financial Comparisons Over the Cycle – 2003 to 2012	
	Sustainable Banks	GSIFIs	Sustainable Banks	GSIFIs	Sustainable Banks	GSIFIs
Real Economy						
Loans/Assets	77.4%	39.3%	74.5%	41.0%	75.9%	40.1%
Deposits/Assets	75.3%	42.8%	70.9%	43.0%	73.1%	42.9%
Financial Returns and Volatility						
Return on Assets	0.53%	0.37%	0.59%	0.78%	0.56%	0.57%
Return on Assets – Standard Deviation	0.16%	0.37%	0.17%	0.29%	0.21%	0.36%
Return on Equity	7.5%	5.2%	8.8%	17.7%	8.2%	11.5%
Return on Equity – Standard Deviation	2.1%	10.0%	1.9%	10.6%	2.7%	10.2%
Capital Strength						
Equity/Assets	7.8%	5.9%	6.7%	5.2%	7.2%	5.5%
Tier 1 Ratio	12.1%	11.8%	n/m	n/m	n/m	n/m
RWAs/Total Assets	61.9%	39.4%	n/m	n/m	n/m	n/m
Compound Annual Growth Rates						
Loans	12.5%	3.8%	13.6%	17.7%	12.6%	8.4%
Deposits	13.9%	6.5%	13.1%	16.6%	12.3%	9.5%
Assets	11.1%	3.8%	14.5%	20.3%	12.1%	9.7%
Equity	12.5%	8.5%	19.8%	18.8%	14.7%	11.6%
Total Income	8.0%	2.0%	12.8%	15.8%	10.4%	6.1%

European Banks	Financial Comparisons Post-crisis – 2008 to 2012		Financial Comparisons Pre Crisis – 2003 to 2007		Financial Comparisons Over the Cycle – 2003 to 2012	
	Sustainable Banks	GSIFIs	Sustainable Banks	GSIFIs	Sustainable Banks	GSIFIs
Real Economy						
Loans/Assets	74.7%	43.7%	66.8%	42.6%	70.8%	43.1%
Deposits/Assets	69.6%	32.8%	60.3%	34.2%	64.9%	33.5%
Financial Returns and Volatility						
Return on Assets	0.30%	0.19%	0.50%	0.62%	0.40%	0.41%
Return on Assets – Standard Deviation	0.09%	0.32%	0.16%	0.24%	0.17%	0.32%
Return on Equity	3.8%	3.4%	6.8%	17.9%	5.3%	10.6%
Return on Equity – Standard Deviation	1.1%	12.0%	1.2%	7.6%	2.3%	10.8%
Capital Strength						
Equity/Assets	9.2%	4.4%	7.8%	3.9%	8.5%	4.2%
Tier 1 Ratio	11.8%	11.1%	n/m	n/m	n/m	n/m
RWAs/Total Assets	71.0%	31.4%	n/m	n/m	n/m	n/m
Compound Annual Growth Rates						
Loans	15.1%	2.3%	11.2%	20.7%	12.1%	8.4%
Deposits	15.4%	2.0%	12.7%	18.7%	11.6%	7.4%
Assets	11.4%	-0.1%	13.4%	25.8%	11.1%	9.4%
Equity	11.9%	4.9%	23.6%	21.2%	15.5%	10.0%
Total Income	7.6%	-1.6%	14.8%	17.5%	10.2%	4.4%

Developing Market Sustainable Banks	Financial Comparisons Post-crisis – 2008 to 2012	Financial Comparisons Pre Crisis – 2003 to 2007	Financial Comparisons Over the Cycle – 2003 to 2012
Real Economy			
Loans/Assets	72.2%	73.3%	73.0%
Deposits/Assets	69.0%	61.0%	65.0%
Financial Returns and Volatility			
Return on Assets	1.9%	3.0%	2.4%
Return on Assets – Standard Deviation	0.6%	0.6%	0.9%
Return on Equity	22.3%	24.0%	23.2%
Return on Equity – Standard Deviation	7.8%	6.6%	7.1%
Capital Strength			
Equity/Assets	8.8%	12.4%	10.6%
Tier 1 Ratio	9.2%	12.8%	11.0%
RWAs/Total Assets	80.1%	76.8%	78.4%
Compound Annual Growth Rates			
Loans	27.7%	56.3%	39.1%
Deposits	33.5%	57.0%	42.1%
Assets	29.9%	51.3%	37.6%
Equity	27.8%	36.4%	30.4%
Total Income	25.8%	58.3%	38.4%

Appendix III

Expanded Principles of Sustainable Banking

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

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

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

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

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

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

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

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

Principle 5. Transparent and inclusive governance.

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

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

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

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