REAL ECONOMY – REAL RETURNS:

THE BUSINESS CASE FOR VALUES-BASED BANKING

RESEARCH ON PERFORMANCE
THROUGH YEAREND 2020

FEBRUARY 2022

Global Alliance for Banking on Values

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Since 2012 the Global Alliance for Banking on Values (GABV) has published an annual research comparing the results of values-based banks and banking cooperatives (VBBs) with the largest banks in the world, the Global Systemically Important Banks (GSIBs) [1,2]. On examining traditional metrics – growth, resilience, profit and contribution to the real economy – it is striking that the conclusions fundamentally remain the same, notwithstanding severe disruptions to financial markets and the real economy worldwide from the Covid-19 pandemic. VBBs continue to outperform GSIBs, and this outperformance is rooted in their practice of the Principles of Values-based Banking (Appendix 1).

The Covid-19 health crisis has directly affected more than 400 million people and indirectly impacted the lives of many more. To name a few, estimates indicate that between 65 million to 75 million people might have entered into extreme poverty in 2020 alone[3]. In many countries, the number of excess deaths over and above the historical average represents an increase of more than 50 per cent[4]. And restrictions on face-to-face interactions have resulted in significant reductions in both demand and supply. These, together with disruptions in labour markets, production and supply chain bottlenecks alongside difficulties in global energy markets, shipping and transportation constraints, have meant that the impact on the real economy activity has been significant. Estimates of the impact on global economic growth in 2020 point to an annualised rate of around -3.2%[5]. Excess mortality further adds to these costs to society in the form of longer-term impacts on physical and human capital[6].

From a real economy perspective, the immediate priority of many economic actors at the onset of the pandemic was to survive for long enough to recover eventually. Credit expansion policies that started in the aftermath of the 2008 financial crisis were accelerated[7] in the wake of lockdowns to address immediate effects on companies, particularly Small and Middle Size Enterprises (SMEs)[8]. Additional policy responses included the deferral of taxes and payments, loan guarantees, direct loans and grants, and wage subsidies. These responses mainly implied "give money now and check later"[9], heavily relying on financial institutions willing to act to accommodate the surge in liquidity demand. However, globally the intended lending largely failed to materialise[10].

[1] Learn more at the Financial Stability website.
[2] Listing of VBBs and GSIB Peer Groups can be found in Appendix 2.
[3] Congressional Research Service, "Global Economic Effects of Covid-19", Updated November 20, 2021.
[4] "Coronavirus tracker: the latest figures as countries fight the Covid-19 resurgence", Financial Times, 20 December 2021.
[5] Congressional Research Service, "Global Economic Effects of Covid-19", Updated November 20, 2021.
[6] Rocco, L., E. Fumagalli, A. J. Mirelman and M. Suhrcke (2021), "Mortality, morbidity and economic growth", PLOS ONE, 27 May.
[7] Echarte Fernandez, M.A., S.L. Nanez Alonso, J. Jorge-Vazquez and R.F. Reier Forradellas (2021), "Central Banks' Monetary Policy in the Face of the Covid-19 Economic Crisis: Monetary Stimulus and the Emergence of CBDCs", Sustainability, 13, 4242.
[8] "Coronavirus (Covid-19): SME policy responses", OECD Policy Responses to Coronavirus (Covid-19), Updated 15 July 2020.
[9] Kamal-Chaoui, L. (2020), "Rescuing SMEs from the Covid storm: What's next?", The Forum Network, May 26.
[10] Çolak, G. and O. Öztekin (2021), "The impact of Covid-19 pandemic on bank lending around the world", Journal of Banking and Finance, 10 June.

Yet, VBBs have been both willing and well placed to address Covid-19-related challenges. Having historically met the very real banking needs - especially access to credit - of enterprises and individuals within their communities, VBBs chose to react to the pandemic's uncertainty and risk very differently from their conventional counterparts. For example, they provided access to banking services for clients investing in expanding basic digital services and participated extensively in government support programmes[11]. VBBs have not only supported clients and communities but protected co-workers while sustaining stable financial returns.

While government support programmes have helped eligible financial institutions to offer more credit support and alleviate losses, exiting them, unless carefully managed, may yet undermine the recovery[12]. Citing an uncertain economic outlook, banks have tightened lending[13]. Once again, this appears not to be the case for VBBs. In a survey conducted by the Global Alliance of Banking on Values among their member CEOs in the Fall of 2021, more than half of the 52 respondents reported loan growth of more than 5% in the first half of 2021. In terms of deposit growth, more than 70% of respondents observed at least a 5% growth.

While disruptions to the real economy[14] remain unevenly distributed both within and between countries[15] , the impact on the financial markets has been comparatively short-lived. The S&P 500 Index, which lost one-third of its value in February and March 2020, had fully recovered by August 2020[16].

Unprecedented financing in an environment of excess liquidity from central banks has contributed to excessive corporate leverage and high market valuations[17,18]. But increases in money supply have not translated into corresponding investments in the real economy, as indicated above. Disconnects between the performance of stock markets and the real economy[19] have been seen before; not least in 2014 when the commitment of the US Federal Reserve to quantitative easing further stimulated asset prices[20]. In a global pandemic with high societal costs, financial markets alone have not succeeded in revitalising inclusive and sustainable real economic activity[21].

The scale and complexity of global challenges, including climate change, biodiversity and ecosystem degradation, and rising inequality, call for a wholesale transformation of economic systems to operate within a ceiling of planetary boundaries and a social floor[22]. Such large-scale reallocation necessitates stakeholder participation and commitment to an inclusive and sustainable economy. Government action and a more fundamental transformation of markets to sustainability are needed[23]. To this end, many are turning to ESG or Environmental, Social and Governance integration in decision-making. However, despite its rapid rise, the effectiveness and transformational potential of ESG investing has been questioned. As with the calls for stakeholder capitalism, the ESG industry has yet to deliver widespread behavioural change[24].

[11] Internal Survey of 42 members of the Global Alliance for Banking on Values, Fall 2020.
[12] OECD (2021), *Covid-19 Government Financing Support Programmes for Businesses: 2021 Update*, OECD Paris.
[13] Çolak, G. and O. Öztekin (2021), "The impact of COVID-19 pandemic on bank lending around the world", Journal of Banking and Finance, 10 June.
[14] 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.
[15] See, for example, regional and country-level assessments of the socio-economic impacts at undp.org/coronavirus/socio-economic-impact-covid-19.
[16] The challenges posed by the historical health crisis have resulted in a flurry of research ranging from disruptions in financial markets to shocks to the real economy. See the special issue Goldstein, I., R.S.J. Koijen and H. M. Mueller, "Covid-19 and Its Impact on Financial Markets and the Real Economy", The Review of Financial Studies (2021).
[17] OECD (2021), *Covid-19 Government Financing Support Programmes for Businesses: 2021 Update*, OECD Paris,
[18] "Prospering in the pandemic: winners and losers of the Covid era", Financial Times, 3 January 2022.
[19] Deniz Igan, Divya Kirti, and Soledad Martinez Peria, "The Disconnect between Financial Markets and the Real Economy", Special Notes Series on Covid-19, International Monetary Fund, 26 August 2020.
[20] Sender, H. (2014), "Fed's easy money has disconnected markets from the real economy", Financial Times, 6 June.
[21] The 2020 Social Progress Index anticipates a delay in achieving the Sustainable Development Goals to 2082, over 50 years after the 2030 target date, and another decade more as a result of the Covid-19 pandemic. See Social Progress Imperative, "Announcing the 2020 Social Progress Index", 10 September 2020.
[22] Raworth, K. (2018), *Doughnut Economics. Seven Ways to Think Like a 21st Century Economist*, Great Britain. [23] Simons, L. and A. Nijhof (2021), Changing the Game. Sustainable Market Transformation Strategies to Understand and Tackle the Big and Complex Sustainability Challenges of our Generation, Routledge London.
[24] Bebchuk, L. K. Kastiel and R. Tallarita (2022), "Stakeholder capitalism in the time of Covid", Working Draft, 9 February. See also Bebchuk, L. and R. Tallarita, "The Illusory Promise of Stakeholder Governance", 2 March 2020.

Critics argue that ESG investing is largely, sometimes wholly, driven by a search for financial returns and does not drive or deliver the kind of expected change to the fundamental inequities and environmental challenges. Besides, if driven mainly by financial considerations, the expectation of low returns[25] might halt capital shifting towards companies that try to do the right things[26]. Tariq Fancy, a vocal critic of ESG, has gone further to question the extent ESG factors can contribute to sustainability[27], setting aside the risk of greenwashing[28]. Absent a coherent approach to integrating ESG factors in decision making and profound changes in the business models of banks to reflect VBBs best practices, the battery of regulatory initiatives to manage climate and environmental risks [29] and address the impact of climate change on financial stability across the globe will be even less likely to halt the climate crisis and green the financial system[30] .

Past reports have brought attention to both government and industry-led global initiatives designed to facilitate the integration of sustainability and impact into finance. They include the United Nations Environment Programme Finance Initiative (UNEP FI's) Principles of Responsible Banking with its 275 signatories[31], and the UN-convened Net Zero Asset Owners Alliance committed to transitioning investment portfolios to net-zero Greenhouse Gas (GHG) emissions by 2050[32]. Other relevant initiatives include the World Benchmarking Alliance's Financial System Benchmark[33] and the ISO Technical Committee 322 on Sustainable Finance[34]. Advances in transparency, which bring improvements in accountability and comparability, are essential for sustained change in the sector. But they are not enough to drive behavioural change at the scale and with the speed that is required.

VBBs practice banking with a holistic focus on the real economy to deliver clear societal benefits (environmental regeneration, economic prosperity and social empowerment). They have consistently shown that serving the real economy leads to better and more stable financial returns than those shown by the largest banks in the world. These VBBs, members of the GABV, operate in numerous markets and serve diverse needs. They use distinct business models to address the very real banking needs, especially access to credit, of enterprises and individuals within their communities.

[25] Armstrong, R. (2021), "ESG's lower (expected) returns", Financial Times, 25 June.
[26] ETF Hub, "ESG outperformance looks set to end, study suggests", Financial Times, 6 July 2021. See also, Lioui, A. and A. Tarelli (2021), "Chasing the ESG Factor", July 1.
[27] See Tariq Fancy (2021), "The Secret Diary of a "Sustainable Investor", August, and Armstrong, R. (2021), "Team ESG fights back", Financial Times, 26 August.
[28] Flood, C. (2021), "Regulators step up scrutiny over investment industry 'greenwashing'", Financial Times, 8 November.
[29] The European Banking Authority in 2021 published a report explaining how ESG factors and ESG risks should be included in the regulatory and supervisory framework for credit institutions and investment firms. The report explains the relevant time horizons for business strategies and risk management frameworks and points to the need of incorporating and pricing the harm caused by the allocation of capital. EBA's report should be considered in conjunction with other disclosure publications under the Capital Requirements Regulation (CRR), the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation (SFDR).
[30] The establishment of a Network of Central Banks and Supervisors for Greening the Financial System in 2018 recognised environment and climate challenges as opportunities and vulnerabilities for financial institutions and the financial system. Environment and climate risk management and the need to mobilise mainstream finance to support the transition toward a sustainable economy are two areas of focus of the NGFS.
[31] List of signatories to UNEP FI's Principles for Responsible Banking.
[32] The 70 alliance members represent over $10 trillion assets under management. See, unepfi.org/net-zero-alliance/.
[33] The Financial System Benchmark will rank the 400 most influential financial institutions on their contribution to the achievement of the Sustainable Development Goals. See Scoping Report.
[34] The scope of this Technical Committee is standardization in the field of sustainable finance. For more information, see iso.org/committee/7203746.html.

Why isn’t all banking done this way?

The business case for values-based banking is compelling. It has contributed to the rise in visibility and relevance of sustainable finance globally and could indicate that the sector has reached a tipping point. Yet, despite the growing realisation of the limits of banking driven by only profit, it is still to emerge as a dominant force in the banking sector. Inertia and the power of the status quo, including existing personal incentive structures, piecemeal or fragmented ESG integration, and a lack of courage and innovation by banking executives and shareholders, remain barriers to the pursuit of deep-seated, systemic change.

Research Approach

The GABV annual research comparing the results of VBBs with GSIBs focuses on the following key questions:

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

This report provides the eleventh update of that research and incorporates financial results up to the end of 2020. This GABV research is based on publicly available financial information.

What is most striking is the consistency of conclusions over the years. The findings strongly support the business case for investing in, and banking with, VBBs that serve the real economy, and the business case for banking institutions that operate under the Principles of Values-based Banking.

RESULTS – FINANCIAL PERSPECTIVE

What support does a bank provide to the real economy?

Publicly available financial information still does not provide an entirely clear distinction between bank activities in the real economy in contrast to the financial economy. Furthermore, there is limited disclosure of relevant non-balance sheet activities. So this research uses lending and deposit information as a proxy for the distinction between the real and the financial economy activities of banking institutions.

The proxy calculation for determining a bank's intermediation in the real economy is evaluated through the portion of assets on its balance sheet that is allocated to lending. As a result, it reflects the real economy intermediation of the target financial institutions (see Table 1). As a group, the difference between VBBs and GSIBs is clear. The level of lending is on average 30% higher for VBBs than for GSIBs, even after considering the immediate decrease in lending due to the pandemic[35]. Moreover, it remains core to VBB's activity, with 69% of their balance sheets devoted to lending compared to 40% for GSIBs in 2020. The decline observed in 2020 for both VBBs and GSIBs may be driven by excess liquidity, as with other ratios examined in this report.

TABLE 1 – Loans to Total Assets

Loans / Total Assets	2020	2015	2011
VBBs	68.8%	73.8%	73.3%
GSIBs	40.1%	41.6%	40.0%

In addition to a focus on lending, VBBs rely much more on client deposits to fund their balance sheets than GSIBs (Table 2). This reliance on deposit taking is another example of their focus on the real needs of individuals and enterprises in the real economy. In addition, this reliance on customer deposits by VBBs reduces the liquidity risk of their funding strategies. At the same time, it represents a return to the roots of banking that intermediates between clients with excess money and those in need of money to make productive investments. The research does show that GSIBs are beginning to use deposits to fund more of their balance sheet in 2020. Still, that funding continues to be deployed primarily in the financial economy and may be used to fund speculative activity.

TABLE 2 – Deposits to Total Assets

Deposits/Assets	2020	2015	2011
VBBs	79.9%	78.2%	76.6%
GSIBs	54.9%	52.5%	47.4%

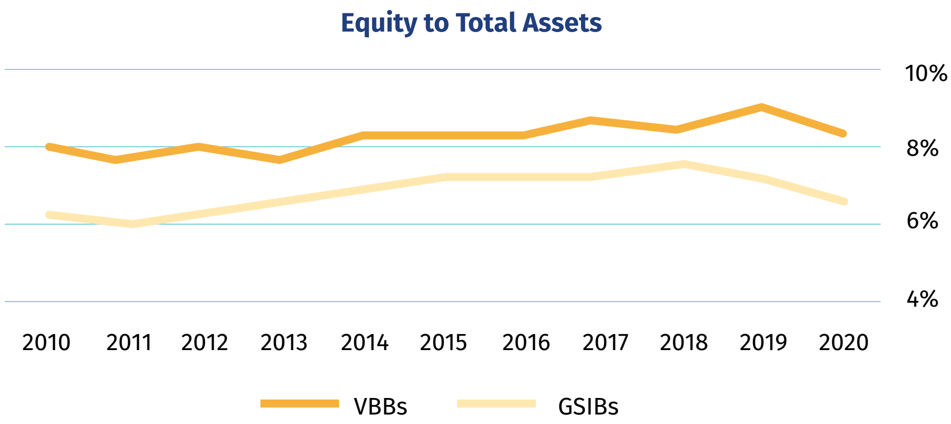
[35] Kapan, T. and C. Minoiu (2021), "Liquidity Insurance vs. Credit Provision: Evidence from the Covid-19 Crisis", 19 September. Available at: Kapan, Tumer and Minoiu, Camelia, Liquidity Insurance vs. Credit Provision: Evidence from the Covid-19 Crisis (September 30, 2021).

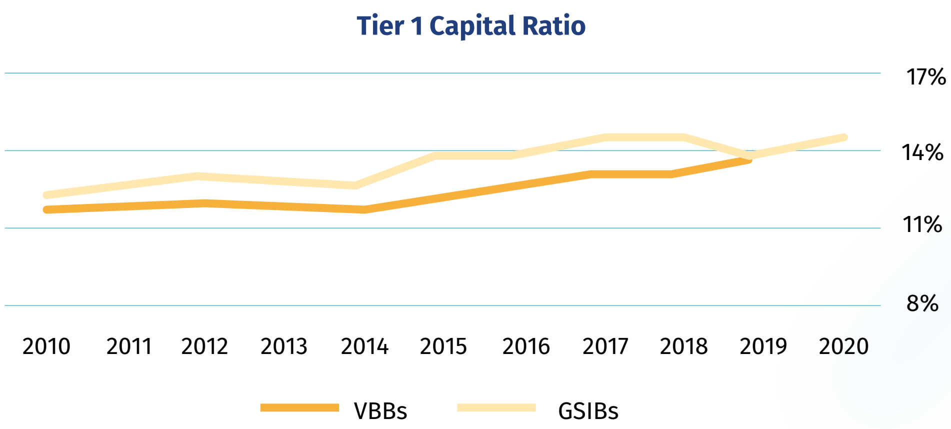
How resilient is a bank in the face of economic challenges?

The capital comparisons (Chart 1) between VBBs and GSIBs over the years have reflected growing regulatory pressure on all banks and banking cooperatives, and especially GSIBs, to increase capital. Shifts in capital comparisons provide evidence that this regulatory pressure has improved the resilience of the overall banking system making the higher financial stability levels of VBBs relative to GSIBs statistically insignificant[36]. Even during the historical height of the Covid-19 pandemic, an analysis of aggregate capital ratios points to compliance with regulatory minimums. The exceptions to this are a relatively small number of banks whose capital adequacies are not sufficient in the face of rising non-performing loans[37].

When measured by Equity/Total Assets VBBs have stronger capital positions, and the gap with the GSIBs that had narrowed to just over 1% in 2015 has reverted to almost 2% observed at the beginning of the 10-year period of this research. As noted in prior research, higher levels of equity held by VBBs did not reduce their appetite to lend, challenging claims by some larger banking institutions that higher equity requirements lead to less lending. The fact that the pace of growth in equity did not keep up with the growth in total assets of banks in 2020 accounts, in part for the drop in the E/A ratio observed for both VBBs and GSIBs. Yet, in the case of GSIBs, it might also suggest a return to old practices focused on maximising financial returns.

CHART 1 – Capital Comparisons





[36] Schäfer, T. and S. Utz (2021), "Values-based and Global Systemically Important Banks: Their Stability and the Impact of Regulatory Changes After the Financial Crisis on it", *Asia-Pacific Financial Markets*, 22 March.
[37] OECD (2021), "The Covid-19 crisis and banking system resilience: Simulation of losses on non-performing loans and policy implications", OECD Paris.

Equity / Total Assets	2020	2015	2011
VBBs	8.4%	8.5%	7.9%
GSIBs	6.6%	7.3%	6.0%
Tier 1 Ratio			
VBBs	14.6%	12.6%	11.9%
GSIBs	15.0%	14.0%	12.4%
RWA / Total Assets			
VBBs	45.9%	62.1%	62.3%
GSIBs	36.4%	44.2%	41.3%

Risk-based capital measures show historically stronger levels of capital by GSIBs, although the gap with VBBs has all but disappeared in 2020. Strong growth in Tier 1 Ratio of VBBs might be, in part, due to a substantial decrease in Risk Weighted Assets (RWA)/Total Assets ratio, which could be the result of more liquidity on the balance sheet. This should be further examined.

In looking at Tier 1 Capital Ratios, it is important to consider the impact of RWA used in the denominator of the ratio. Tier 1 Capital ratios for GSIBs are significantly impacted by the relatively low level of RWAs compared to total assets, as calculated by their internal risk models. Important concerns regarding observed variability in risk weights under Pillar 1 have prompted action from the Basel Committee on Banking Supervision to harmonise capital calculations[38].

Over the 10-year period, banks have strengthened their capital significantly, an indication of a healthier banking system. It is still too soon to see the effect on capital ratios of the amendments that followed the extraordinary measures adopted to alleviate the financial and economic impacts of Covid-19, including a range of different payment moratoriums and government guarantees[39]. The figures reported here are more likely to reflect the impact of increased liquidity in the system impacting the denominator than the industry's anticipatory response to regulation[40].

Keeping this in mind, the strength of the Equity/Total Assets ratios of VBBs positions them well for challenging economic conditions, in contrast to GSIBs with lower levels of equity to total assets.

[38] The start date for a gradual implementation of Basel IV rules has been deferred to 1 January 2023 due to Covid-19. The impacts of the new rules will vary across geographies reflecting level of losses across portfolios well below those under the new rules. An early assessment of the potential impact of Basel IV on European banks can be found here.
[39] The Basel Committee on Banking Supervision provided technical guidance to governments and banks related to exceptional measures introduced to alleviate the impact of Covid-19 and the associated credit losses expected to impact capital requirements. See bis.org/bcbs/publ/d498.htm.
[40] McKinsey&Company (2017), "Basel 'IV': What's next for banks? Implications of intermediate results of new regulatory rules for European banks", April.

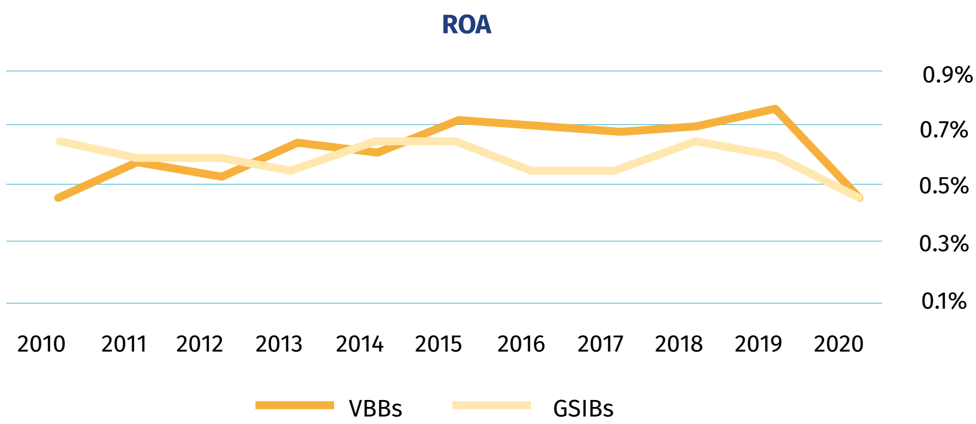
What returns does a bank provide to society, clients and investors?

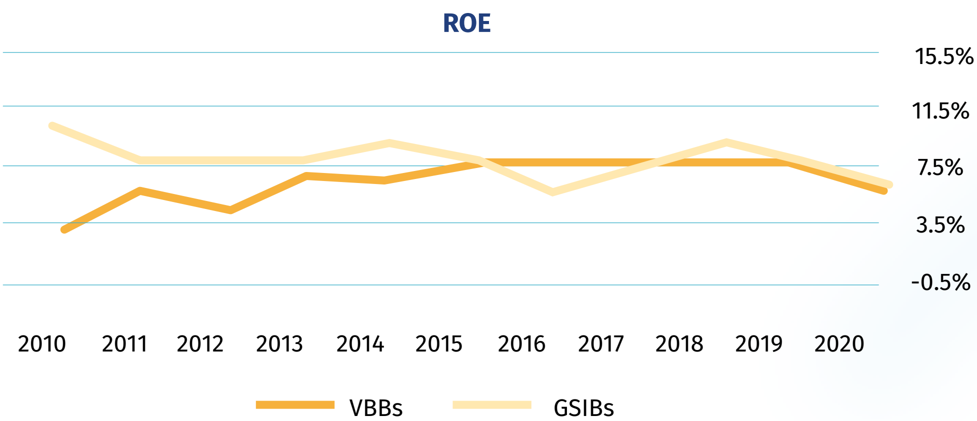
VBBs have historically stable Returns on Assets (ROA) with limited volatility as measured by the standard deviation of these returns (Chart 2). Furthermore, the ROA for the VBBs is, on average, slightly higher when compared to the GSIBs. The volatility of VBBs is slightly greater over the 10-year period reflecting the impact on returns in the period after the financial crisis and again in 2020 during the Covid-19 pandemic.

The uneven impact of the pandemic globally may in part be responsible for a greater decrease in the ROA of VBBs in 2020, with growth lagging in developing nations as major economies register stronger growth and a faster pace of recovery[41].

Digitalisation costs are likely to have affected the returns of smaller financial institutions to a greater degree than larger ones. The latter may have benefited from existing infrastructure and can better integrate the costs of new infrastructure both for employees working from home and for clients who are unable to visit the bank. To illustrate the importance of these changes in the way VBBs operate, a survey of 52 VBBs in the Fall of 2021 found that 62% of respondents expected that many aspects of banking operations introduced during the pandemic will be retained, including virtual service delivery, remote working, fewer branches, and fewer clients in the branch after Covid-related restrictions are lifted.

CHART 2 – ROA and ROE Comparisons





[41] The World Bank (2021), "The Global Economy: on Track for Strong but Uneven Growth as COVID-19 Still Weighs", 8 June.

	Return on Assets	
	5y (2016-2020)	
	Average	St. Dev.
VBBs	0.68%	0.20%
GSIBs	0.57%	0.21%
	10y (2011-2020)	
	Average	St. Dev.
VBBs	0.68%	0.28%
GSIBs	0.59%	0.25%

	Return on Equity	
	5y (2016-2020)	
	Average	St. Dev.
VBBs	8.4%	2.3%
GSIBs	7.4%	3.1%
	10y (2011-2020)	
	Average	St. Dev.
VBBs	8.4%	3.8%
GSIBs	7.9%	3.8%

Relative to Returns on Equity (ROE), VBBs have superior performance over both time periods analysed with lower volatility over the five-year period and comparable over the 10-year one. The ROE is impacted by the level of equity capital. On balance, it appears that banking focused on meeting societal needs can provide acceptable returns to investors in bank equity instruments.

What growth does a bank achieve to expand its impact?

The issue of growth (Table 3) further demonstrates marked differences between the two groups. VBBs have had much higher growth in Loans, Deposits, Assets, Equity and Total Income compared to GSIBs over the period analysed. One element driving higher growth for VBBs is their relatively small scale. Another is that VBBs with a strong and long-term client focus tend to have higher client loyalty and lower client attrition. In addition, in some markets, clients are consciously choosing to move banking activities to VBBs. Further research on the sources of growth for both groups could be informative.

TABLE 3 – Growth

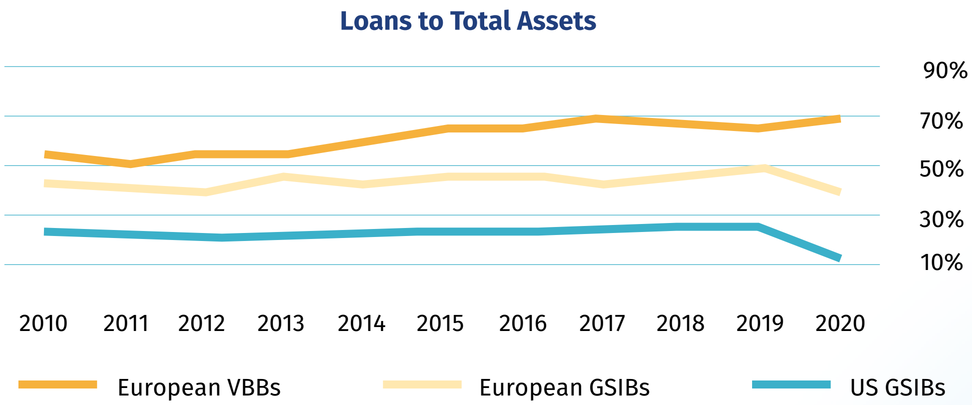
	5 years (2016-2020)	10 Years (2011-2020)
Loans		
VBBs	9.0%	10.9%
GSIBs	2.5%	2.5%
Deposits		
VBBs	9.5%	10.7%
GSIBs	4.4%	4.5%
Assets		
VBBs	9.4%	10.1%
GSIBs	4.1%	3.1%
Equity		
VBBs	11.0%	12.6%
GSIBs	2.4%	4.2%
Total Income		
VBBs	7.1%	9.6%
GSIBs	-0.3%	0.05%

EUROPEAN CHALLENGES

Over the past few years, our research has looked in more depth at the European market (Chart 4 and Appendix 4). There are 15 VBBs, as defined in the research, and 14 GSIBs based in Europe[42]. Comparing these two groups operating under similar market conditions further highlights the strength of the values-based banking model. As shown in Chart 3 and Appendix 4, VBBs in Europe registered significantly higher levels of finance for the real economy, superior levels of equity capital and better levels of Return on Assets and Return on Equity, with lower volatility. They also delivered significantly stronger levels of growth over the period of analysis; especially noteworthy is their performance in 2020. Even with their greater exposure to real economy shocks the European VBBs still outperformed their GSIBs counterparts in the region.

The challenges facing European GSIBs and their ability to meet the needs of the European real economy is further illustrated by comparison with GSIBs in the US. Differences in accounting rules complicate such comparisons, especially relating to the balance sheet impact of derivative portfolios as detailed in the Federal Deposit Insurance Corporation Global Capital Index calculated[43]. This analysis showed that under comparable International Financial Reporting Standards, the US GSIBs would have just over 17% higher assets than reported under US Generally Accepted Accounting Principles. Nevertheless, the US GSIBs show both strong capital and earnings making them formidable competitors for the European GSIBs as well as potential sources of strength to the US economy.

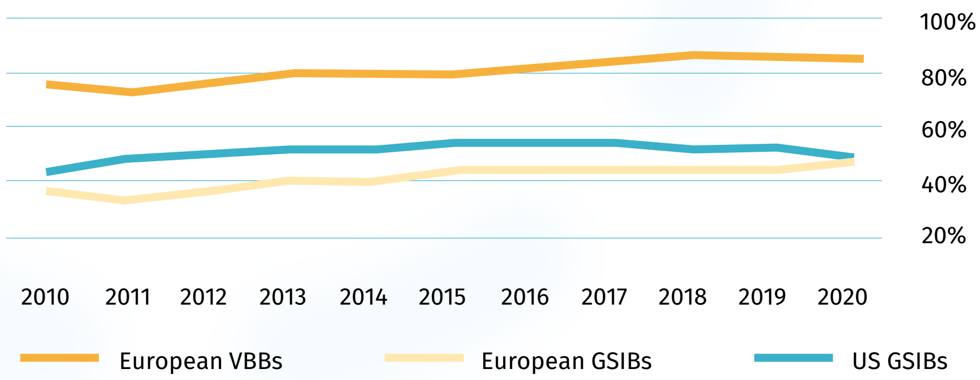
CHART 3 – European Comparison Graphs



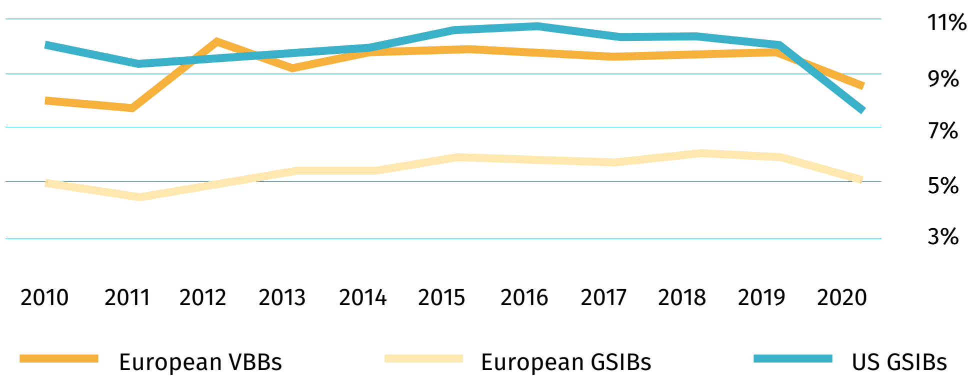
[42] Full comparison details of European VBBs and European and US GSIBs (Appendix 4).

[43] "Global Capital Index: Capitalization Ratios for Globally Systemically Important Bans (GSIBs)," Federal Deposit Insurance Corporation. Index calculated as of year-end 2017.

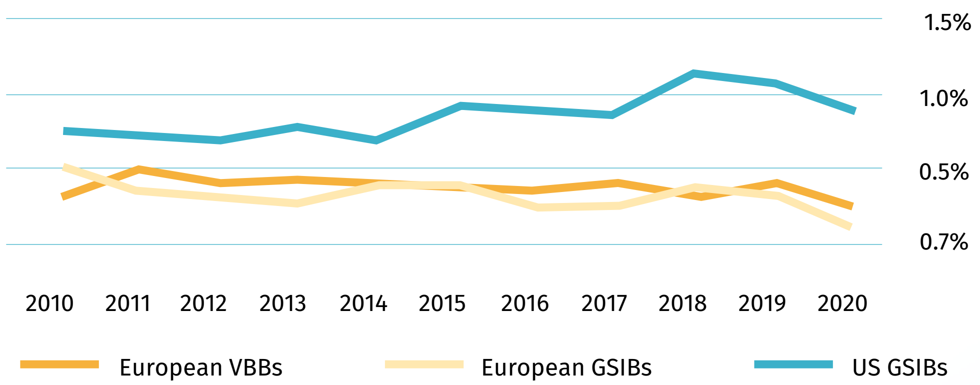
Deposits to Total Assets



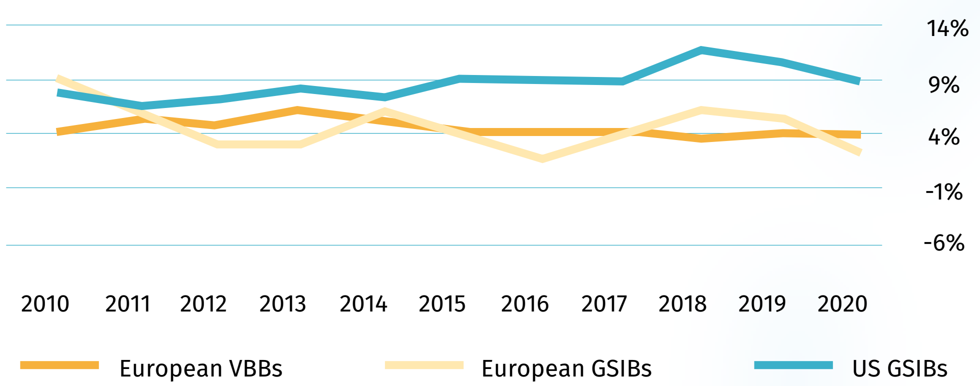
Equity to Total Assets



ROA



ROE



RESEARCH OPPORTUNITIES

The "Real Economy-Real Returns" annual research from the Global Alliance for Banking on Values has shown over the years that financial returns have not been reduced through a focus on the real economy and banking models driven by supporting individuals and enterprises creating societal value. Indeed, values-based banks have outperformed their conventional banks counterparts.

The financial returns associated with the rise of ESG factors must not be equated with actual transformations in the real economy, partly because of greenwashing. For this reason alone, it is essential to examine and understand the differences in the banking models of VBBs and GSIBs. The former is driven by their commitment to support individuals and enterprises that create societal values, while the latter continues to pursue higher financial returns above all else.

The previous report identified examining the economic consequences of the Covid-19 pandemic and the role of banking as a research opportunity[44]. This year the invitation is rather to examine the consequences of regulation[45] on ensuring that the costs and benefits of finance are transparent and allocated fairly. The developments in sustainable finance space, discussed in the introduction under ESG, call for a comprehensive reformation of incentives that inform economic decisions that mainly appropriate regulation can ensure.

To transform the real economy for sustainability and achieve a low carbon future requires concerted action on both the social and environmental front. The 2021 Social Progress Index is clear: "Achieving sustainability is tied to improving key areas of social progress"[46]. In this context, a research opportunity is to further understand the differences between VBBs and GSIBs in terms of coherence of business models and sustainability commitments and the drivers behind their growth, both in the economic indicators examined here (see Table 3) and their impact[47].

[44] See, for example, Jan, A., M. Nuno Mata et al. (2021), "Alignment of Islamic Banking Sustainability Indicators with Sustainable Development Goals: Policy Recommendations for Addressing the Covid-19 Pandemic", *Sustainability* 13 (5), 2607.
[45] See, for example, banking regulation in the European Union, including the European Banking Authority's Report on ESG risks management and supervision for credit institutions and investment firms, and Basel Committee on Banking Supervision Consultation on Climate related Risk & the Basel Core Principles (BCPs).
[46] See Social Progress Imperative, 2021 *Social Progress Index.*
[47] Kocornik-Mina, A., R. Bastida-Vialcanet and M. Eguiguren-Huerta (2021), "Social Impact of Values-based Banking: Best Practises and a Continuity Framework", *Sustainability* 13 (14), 7681.

CONCLUSIONS

Values-based banks continue to demonstrate steady financial returns and growth with a strong focus on the real economy, built on solid capital positions. These entities support the intermediation of money to individuals and enterprises that deliver positive economic, social and environmental impact. They operate in numerous markets, serving diverse needs, using different business models. And they are united by a set of common guidelines, the Principles of Values-based Banking.

The strength of values-based banks lies in their commitment to serve their clients and communities. In a changing world, these purpose-driven banks continue to excel in this important work. They remain coherent with their purpose and in their comprehensive response to the immediate challenges arising from the global health pandemic and the global challenges of climate change, biodiversity and ecosystem degradation and social inequality.

APPENDIX 1

PRINCIPLES OF VALUES-BASED BANKING

Principle 1. Social and environmental impact and sustainability are at the heart of the business model.

Values-based 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 recognised as an essential requirement of values-based banking but is not a stand-alone objective. Importantly, values-based banks embrace an intentional approach to triple-bottom-line business – they do not 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 people.

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

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

Values-based banks establish strong relationships with their clients and are directly involved in understanding and analysing their economic activities and assisting them to become more values-based 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.

Values-based 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 recognise that no bank, or its clients, is entirely immune to such disruptions.

Principle 5. Transparent and inclusive governance.

Values-based 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 leadership and the culture of the member financial institution.

Values-based banks seek to embed these principles in the culture of their institutions so that they are routinely used in decision-making at all levels. Recognising 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 values-based business models. These banks also have specific reporting frameworks to demonstrate their financial and non- financial impact.

APPENDIX 2

LISTING OF PEER GROUPS AS OF 31 DECEMBER 2020

Global Systemically Important Banks (GSIBs)

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

Values-based banks (VBBs)

1. Alternative Bank Schweiz^
2. Amalgamated Bank New York*
3. Banca Popolare Etica^
4. Banco Ademi
5. Banco Mundo Mujer
6. Banco Popular de Honduras
7. Banco Solidario*
8. BancoSol
9. Banfondesa*
10. Bank Australia*
11. Bank Muamalat
12. Bank of Palestine
13. Beneficial State Bank
14. BRAC Bank
15. Caisse d'Économie Solidaire Desjardins
16. Caja Arequipa*
17. Centenary Bank*
18. Center-Invest Bank^
19. Charity Bank^
20. City First Bank N.A.*
21. Clearwater Credit Union
22. Cooperativa Abaco
23. Cooperative Bank of Karditsa^
24. Group Crédit Coopératif^
25. Credo Bank*^
26. Cultura Bank^
27. Dai-Ichi Kangyo Credit Cooperative
28. Decorah Bank & Trust Co.
29. Ecology Building Society^
30. Ekobanken^
31. First Microfinance Bank Afghanistan
32. First Microfinance Bank Tajikistan
33. Freie Gemeinschaft Bank Schweiz^
34. GLS Bank*^
35. Kindred Credit Union
36. Lead Bank
37. Lapo Microfinance Bank*
38. MagNet Bank*^
39. MegaBank^
40. Merkur ^
41. Muktinath Bikas Bank
42. National Cooperative Bank*
43. NMB Bank
44. 3Bank^
45. Integral
46. Southern Bancorp
47. Sunrise Banks
48. Teachers Mutual Bank
49. Triodos Bank^
50. Umweltbank^
51. Vancity
52. Verity Credit Union
53. Vermont State Employees Credit Union*
54. Visión Banco*
55. XacBank

Note: 3Bank was formerly named Opportunity Bank Serbia

* These banks and banking cooperatives did not have financial history for the full period covered for a variety of reasons including conversion to banks from micro-finance organisations as well as being de novo banks. The data for these banks was included in the analysis for all available years.
^Banks included in in the European analysis
` Banks part of the US subset in the European analysis

APPENDIX 3

FINANCIAL COMPARISONS

All Peer Groups

	2020		2015		2010	
Real Economy	VBBs	GSIBs	VBBs	GSIBs	VBBs	GSIBs
Loans/Assets	68.8%	40.1%	73.8%	41.6%	73.3%	40.0%
Deposits/Assets	79.9%	54.9%	78.2%	52.5%	76.6%	47.4%
Capital strength						
Equity/Assets	8.4%	6.6%	8.5%	7.3%	7.9%	6.0%
Tier1 Ratio	14.6%	15.0%	12.6%	14.0%	11.9%	12.4%
RWAs/Total Assets	45.9%	36.4%	62.1%	44.2%	62.3%	41.3%

Financial Returns and Volatility	5y (2016-2020)		10y (2011-2020)	
	VBBs	GSIBs	VBBs	GSIBs
Return on Assets	0.68%	0.57%	0.68%	0.59%
Return on Assets - Standard Deviation	0.20%	0.21%	0.28%	0.25%
Return on Equity	8.4%	7.4%	8.4%	7.9%
Return on Equity - Standard Deviation	2.3%	3.1%	3.8%	3.8%

Compound Annual Growth Rates	5y (2016-2020)		10y (2011-2020)	
	VBBs	GSIBs	VBBs	GSIBs
Loans	9.0%	2.5%	10.9%	3.5%
Deposits	9.5%	4.4%	10.7%	4.5%
Assets	9.4%	4.1%	10.1%	3.1%
Equity	11.0%	2.4%	12.6%	4.2%
Total Income	7.1%	-0.3%	9.6%	0.05%

APPENDIX 4

EUROPEAN COMPARISON

European Peers Comparison

	2020			2015			2010		
	European VBBs	European GSIBs	US GSIBs	European VBBs	European GSIBs	US GSIBs	European VBBs	European GSIBs	US GSIBs
Real Economy									
Loans/Assets	69.9%	42.3%	15.3%	64.8%	46.5%	25.9%	56.0%	45.0%	24.0%
Deposits/Assets	84.9%	48.0%	47.9%	79.6%	43.0%	54.4%	74.9%	36.3%	44.1%
Capital Strength									
Equity/Assets	8.6%	5.2%	7.6%	9.8%	6.0%	10.6%	7.9%	4.9%	9.8%
Tier 1 Ratio	16.6%	15.7%	15.2%	12.7%	14.6%	14.3%	11.5%	12.2%	14.0%
RWAs/Total Assets	33.8%	23.3%	31.5%	60.3%	34.7%	57.5%	71.1%	33.2%	52.3%

Financial Returns and Volatility	5y (2016-2020)			10y (2011-2020)		
	European VBBs	European GSIBs	US GSIBs	European VBBs	European GSIBs	US GSIBs
Return on Assets	0.4%	0.3%	1.0%	0.46%	0.32%	0.82%
Return on Assets - Standard Deviation	0.1%	0.3%	0.2%	0.14%	0.31%	0.23%
Return on Equity	5.5%	4.2%	10.3%	7.2%	4.3%	9.2%
Return on Equity - Standard Deviation	1.3%	4.5%	1.8%	1.9%	4.6%	2.4%

Compound Annual Growth Rates	5y (2013-2017)			10y (2008-2017)		
	European VBBs	European GSIBs	US GSIBs	European VBBs	European GSIBs	US GSIBs
Loans	9.2%	1.2%	3.2%	11.9%	0.2%	7.0%
Deposits	10.7%	3.1%	6.3%	13.2%	2.6%	5.9%
Assets	5.9%	1.8%	5.3%	7.2%	-0.1%	4.1%
Equity	12.6%	0.7%	1.9%	15.7%	1.5%	3.2%
Total Income	8.3%	-2.4%	1.4%	10.7%	-2.9%	0.3%

ACKNOWLEDGEMENTS

This report was undertaken by the Global Alliance for Banking on Values (GABV) and builds on a March 2012 report developed by the GABV with financial support from The Rockefeller Foundation. This research was originally supported by extensive input and guidance from GABV members, from Laurie Spengler, CEO, Courageous Capital Advisors, LLC on the research and its consequences for banking, and from Tom Cummings relative to the values-based banking approach. Input and challenges from David Korslund, formerly Senior Adviser to the GABV and this research's original author, remain invaluable. The primary author of this updated report is Adriana Kocornik-Mina, Metrics and Research Senior Manager (adriana.kocornik@gabv.org). Extensive data support was provided by GABV interns Jamie Hollywood and Adam Kurowski. All conclusions and any errors remain the responsibility of the author.

Global Alliance for Banking on Values
Amsterdam, The Netherlands
T +31 (0) 615 254 228
E mail@gabv.org
www.gabv.org

The Global Alliance for Banking on Values is an independent network of banks and banking cooperatives with a shared mission to use finance to deliver sustainable economic, social and environmental development.