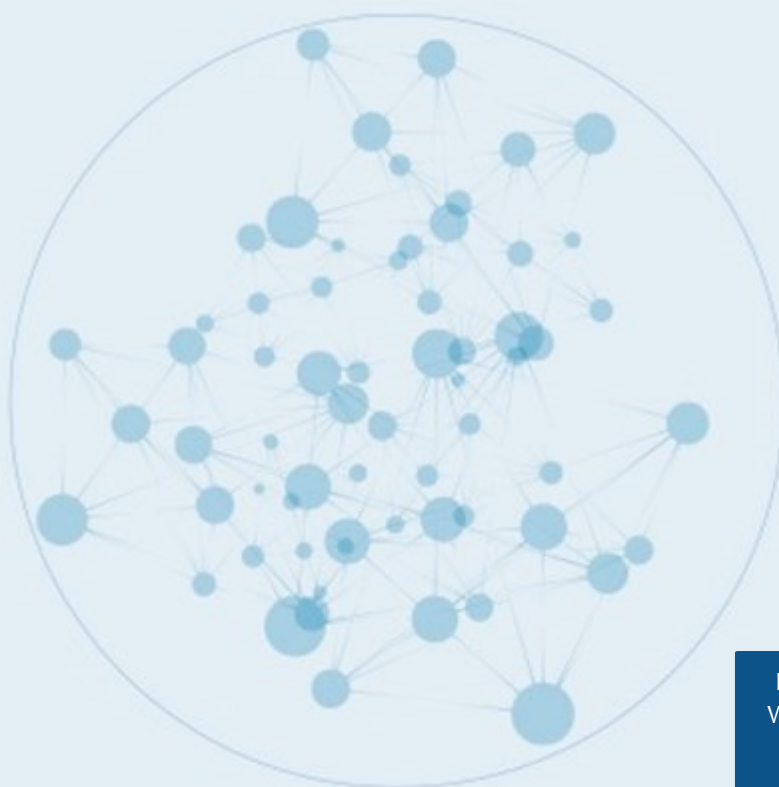




VALUES BASED BANKING

Bringing the voice of the
citizen into finance



INQUIRY
WORKING
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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 (FEBA), 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

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