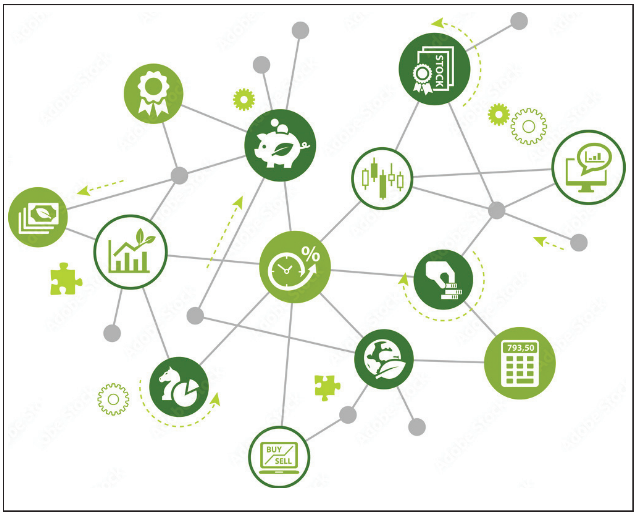
Sustainable Banking : The Future of Banking



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"The greatest threat to our planet is the belief that someone else will save it."

Robert Charles Swan Co-author of "Antarctica 2041: My Quest to Save the Earth's Last Wilderness", environmentalist and the first person to walk both poles.

The Perspective

The topic of sustainability has been at the forefront of discussion among global leaders as a key component to societal progression. Sustainability principles promote an intrinsic balance among the economic, social, and ecological perspectives of business, enabled by a wise amalgamation of technology, innovation, and collaboration. Banks are emerging as a driving force in the sustainability effort. The industry is uniquely positioned to meet the challenge—and the opportunity. With the push for sustainability in business and net-zero grows across the globe, the demand for going green has hit the financial sector also. The banking and finance sector can play a driving role in mobilizing, investing and directing capital toward the Sustainable Development Goals (SDGs) and towards climate outcomes. It is high time that businesses pivoted from their policies that emphasized profit generation to prioritizing sustainable practices that preserve the natural and human infrastructure that supports them and all commerce and industries. Banks have to lead the way in this transformation since they regulate the cash flow that enables business operations.

What is Sustainable banking ?

A formal definition of sustainable banking is still being developed. At this stage, it is widely understood that sustainable banking implies carrying out banking operational and business activities, with conscious consideration for the environmental and social impacts of those activities. Sustainable banking is a strategy that refers to banking and investment practices that pursue profit, while prioritizing social responsibility and/or environmental sustainability. A new "triple bottom line" approach to banking contextualizes the relationships between profit, social equity and environmental accountability. Sustainable banking integrates environmental, social and governance (ESG) criteria into traditional banking, and sets ESG benefits as a key objective. This relatively new form of banking has changed vastly in recent years. Old notions of sustainable banking conjured sentiments of trade-offs and charity – doing the right thing used to mean doing the less profitable thing. This no longer holds true. The following are the Dimensions of Sustainable Banking

- Aligning financial flows with sustainable development goals
- Incorporating sustainability into banks' governance and culture
- Measuring and managing E&S impacts and risks
- Engaging customers, clients and stakeholders to develop sustainable financial products
- Sustainability reporting: A critical tool for enhancing corporate transparency and accountability

Sustainable banking is defined as the delivery of "financial products and services, which are developed to meet the needs of people and safeguard the environment while generating profit. Banks started to deal with sustainability during 1990s, increasing their interest in 2000s. Nowadays, sustainability is seen as an extra lever of economic growth by the banking sector. Practically, banks can stimulate sustainable development directing their financial policy towards sustainable companies. The banking industry is important to achieving sustainable development due to its unique intermediation role, which is essential for mobilizing financial resources toward sustainable goals. Sustainable banking ensures that internal and external banking activities meet sustainability requirements of internal and external stakeholders. The discernible shift that many banks have made in recent years towards addressing the environmental and social impacts of their financial services is a welcome and important first step in this direction. More and more banks realize that ignoring social and environmental issues could considerably increase their exposure to credit, compliance and reputational risks.

Objectives of Sustainable Banking

Profit at all costs ceases to be the primary objective of sustainable banking. While a healthy bottom line continues to be a goal, other objectives that will encompass environmental and social criteria start being significant considerations in selecting investments and formulating policies. The objectives of sustainable banking include:

- **Quality of life considerations:** These include investments that directly improve the standard of living. Investments in improving access to education, affordable housing, public transportation, and low-cost healthcare get priority over investments in financial instruments.

- **Promotion of clean energy:** Actively pursue and promoted investments in alternative energy instead of investments in coal, gas, and oil. They will also invest in the development and popularization of vehicles utilizing electricity and natural gas. Concurrently, invest in technologies to lower the emissions and improve the mileage of gasoline-powered vehicles.

- **Financial inclusivity:** Support responsible banking initiatives like microloans that help family-owned businesses and small businesses in economically disadvantaged communities. While returns on such initiatives are not as high as on investments in big business, the track record of similar institutions worldwide have demonstrated that microloans are indeed profitable investments.

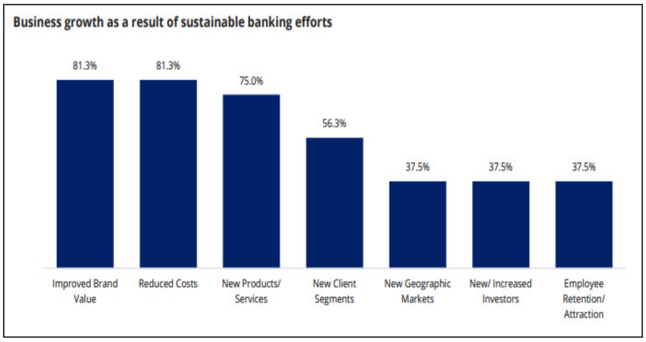
Sustainable agriculture: Support green banking policies that encourage investments in pollution-free and toxin-free agriculture. Since the production, processing, and distribution of food are foundational to human society's health and well-being, sustainable banking objectives must include sustainable agriculture.

Why is Sustainable Banking Important?

A business as usual approach to banking, that ignores the far-reaching implications of investments, will end up costing global markets an estimated $30 trillion. By limiting an investment strategy to profit only, banks are headed into the direction of not only environmental disaster but economic ruin as well. Changing course will open up an estimated $12 trillion in market opportunities. Simply put, sustainable banking just makes good financial sense. In 2015, the world recognized the urgent need to act. Setting a path for prosperity, sustainability, and equity, the Sustainable Development Goals (SDGs) aim to meet the needs of today's people without compromising the ability for future generations to meet their needs. Sustainable banking is an integral piece to achieving these goals.

Yesterday just the shareholders mattered, today it's all the stakeholders

Banks are highly committed to sustainability but need key success factors in place to realize the full benefits of their sustainable banking efforts. Improved brand value and reduced costs are the areas of greatest improvement as a result of sustainable banking efforts



Sustainable banking isn't just a philosophy – it's about action

Financial institutions must expand their missions from ones that prioritize profit maximization to a vision of social and environmental sustainability. A commitment to sustainability would require financial institutions to fully integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas (including credit, investing, underwriting, advising), to put sustainability objectives on an equal footing to maximization of shareholder value and client satisfaction, and to actively strive to finance transactions that promote sustainability. Following action strategies are imperative for building sustainable Banking architecture

- **Define the role:** Banks have started defining the role they want to play in their ecosystems, which can be global and/or local. Each bank can define its own role depending on its current positioning as an investor, as a shareholder, or as a lender. This strategic exercise is key to on boarding all stakeholders in the process.

- **Redefine your mission :** A crucial landmark on the road towards sustainability is the redefinition of the bank's long term mission. This demands a profound rethinking of the reason of existence of your bank, what the bank has to offer to this world. A truly sustainable bank's mission cannot be purely defined from the perspective of the maximization of shareholder value and client satisfaction. It needs to incorporate wider sustainability goals.

- **Evaluate your portfolio :** Using the perspective of the redefined mission, the bank needs to evaluate its portfolio. Assess all direct and indirect environmental and social impacts of the financial services provided by the bank to its clients, including retail banking (saving accounts, credit, mortgages), commercial banking (company loans, trade finance), investment banking (stock issuances and trading, project finance, stock analysis, M&A and other corporate advising), asset management, private banking, trust banking and other forms of financial services.

✷ **Redefine your strategy :** The evaluation of the bank's portfolio will lead to strategic choices. To become a sustainable bank, a redefinition of the bank's strategy is inevitable. Based upon an assessment of its past experience, its present capabilities and its future ambitions, the bank needs to select the social and environmental issues it wants to assign top priority to

✷ **Develop sector and regional/country policies :** For the specific sectors and countries the bank chooses to be active in, it needs to develop concrete policies that allow the bank to deal with challenges that will inevitably arise. These policies serve a dual purpose: they define the ambitions and goals the bank wants to achieve and help promote, its vision of sustainability in concrete terms.

✷ **Build capacity, train, motivate and reward employees :** To put the ambitions formulated in specific policies into practice, the bank needs to devote considerable attention and resources to capacity building, training, motivating and rewarding its employees. All employees involved need to be trained with regard to the social and environmental issues related to the sectors, issues and countries in which the bank is active. Specific attention should be paid to internalising the bank's mission and specific goals by employees. Additionally, a sustainable human resources policy attracts, stimulates and rewards people who are able to contribute to the bank's mission and sustainability goals most effectively.

✷ **Foster innovation :** Global sustainability is not an easy goal to achieve. Radical changes are needed to use our natural resources efficiently, equitable and prudently to fulfil the needs of a growing global population, while preserving existing ecosystems and preventing climate change. At the same time, the global wealth and opportunities have to be redistributed, providing equal chances, securing human rights and a decent living to all global citizens. To achieve all these goals, we need many innovations. Banks and other financial institutions need to use all their intellectual and financial skills to help other companies nurture technical innovations and bring them to the market, to assist the poor in creating a means of living, and to set up businesses which manage resources and ecosystems in a sustainable way.

✷ **Environmental and Social Risk Management System:** To ensure that the minimum standards of the banks policies are applied to all financial services, banks need a rigorous Environmental and Social Risk Management System. This should include the following elements: Perform an initial sustainability review to identify the bank's key sustainability risks and opportunities, and to guide appropriate policy development; adopting strong and comprehensive policies is not enough; implementing a well-functioning Environmental and Social Risk Management System is of crucial importance.

✷ **Ensure fair and inclusive retail financing practices :** Take all necessary steps to ensure that the bank's retail products are equally available to all retail clients, irrespective of race, ethnicity, gender or other community characteristics, for the same interest rates. Ensure that appropriate reinvestment is made of disadvantaged communities' deposits. Take all necessary steps to avoid engaging in or enabling so-called predatory lending to retail consumers. Similarly review the lending patterns of any retail lender, particularly subprime lenders, which the bank may purchase or whose loans it may help securitize or for which it may serve as trustee.

Challenges for sustainable Banking

The move towards sustainable banking also entails certain challenges

✷ **Clear priority for sustainability in organizations' budgets:** The biggest challenge for sustainable banking, as reported by the respondents, is budget limitations. Closing this budget gap is essential to ensuring that banks have the resources needed for long term and meaningful investment in sustainable banking activities. Convincing decision makers using an evidence-based business case can facilitate the prioritization of sustainability in the organization's budgets

✷ **Data collection and analysis :** Some of the banks struggle with linking their realized benefits with their sustainable banking activities. Establishing a strong data collection and analysis culture, as well as being equipped with the tools to implement this, is pertinent to establishing such linkages.

Conclusion

Financial institutions should bear full responsibility for the environmental and social impacts of their transactions. Financial institutions must also pay their full and fair share of the risks they accept and create. This includes financial risks, as well as social and environmental costs that are borne by communities.

It is high time that businesses pivoted from their policies that emphasized profit generation to prioritizing sustainable practices that preserve the natural and human infrastructure that supports them and all commerce and industries. Banks have to lead the way in this transformation since they regulate the cash flow that enables business operations. The first step in this transformation is to realize that the old policies motivated by profits alone are short-term thinking results. Sustainability policies are born of long-term thinking. They do not hinder businesses but instead enable them to maintain healthy operations and profits well into the distant future. Sustainable banking is not for the weak; it involves creating a profound change in your business. While it may still feel that this is a choice open to individual banks (or corporations in general) to either follow or ignore, the trends in the financial world and expectations within society unmistakably point toward a obligation to take up this challenge. Banks that visualize and execute their sustainability agendas now will have first-mover advantage in the race to meet their sustainability goals.

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