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Charity banking: utopia or an alternative to greedy finance?

Introduction

The financial crisis of 2007 led to a drop in the greed and naivety of the participants in the financial sector (banks, investors and insurance companies) as well as the conformism of ratings agencies. There was a lack of trust not only by bank clients but also on the banking market. The lack of transparency about the investment policy of funds meant that clients started to look for a safer place for their savings.

This brought about a mass questioning of banking values being a catalyst for economic growth and their moral responsibility for the reckless and short-termed credit policy on the American market (Keys et. al. 2010). The crisis led to a wide range of scientific papers analysing the causes and effects, and even the film The Big Short by Adam McKay.

Interventions by central banks flooded the most needed institutions with extra liquidity. These institutions turned out not just to be investment banks, but also classical, deposit banks, which were also involved in the process of selling and buying credit portfolios. This could be the reason why, against the background of their main activities of deposit and investment banking, banks focused on the development of other forms of banking, such as social or charitable banking. During the difficult period for the financial sector of 2007-2011, this type of banking experienced fast growth. Based on the experience of the financial crisis, placing the two words "banking" and "charitable" together does not seem to not make any sense and seems to be a contradiction in terms. This article will present what social banking is on the market and whether it really is social.

This article is part of a range of studies by the author into social banking, with a special focus on the financial instruments associated with social responsibility used by the actors on the financial market. Furthermore, the planned studies aim to examine the factors which have an effect on the financial decisions of bank depositors and donators to non-profit organisations (NGOs).

1. Understanding the concept of social / charity banking

To date there is no extensive literature about social / charity banking. There is also no uniform and clearly accepted definition. In the literature about the subject and the publications of the institutions themselves the following terms appear: charity, social, ethical, value-based and sustainable banking. Currently it comprises a few items which are often associated with the principles of gift economy (Andreoni 1990, Akerlof 1884) or the social function of money (Zelizer 1994), an area with extensive literature concerning socially-responsible investment. One of the most popular books published on this topic was edited by Olaf Weber and Sven Remer (Weber and Remer 2011). The principles of literature about this topic are considered in the economics of social responsibility (Becchetti, Borzaga, (eds) 2010), the economy of happiness (Easterlin and Angelescu 2009) as well as the anthropological considerations about donations (Berg, Dickhaout and McCabe 1995). A model study linking results from the financial sector with the productivity of the real economy was presented by Cecchetti, Kaharoubbi (2012, 2015) in their two articles in BIS Working Papers. In their own words "Two main conclusions emerge from the models. First, at the aggregate level, financial sector growth is negatively correlated with total factor productivity growth. Second, this negative correlation arises both because financial sector growth disproportionately benefits low productivity/high collateral sectors and because there is an externality that creates a possible misallocation of skilled labour" (Cecchetti and Kaharoubbi 2015, pp. 17).

As is confirmed by Weber and Remer (2011) as well as the banks which are members of the Global Alliance for Banking on Values (GABV), an agreed definition of social / charity banking does not exist. Furthermore, the use of these terms interchangeably is imprecise albeit not incorrect. This type of banking activity has not been the focus of attention of a wider group both on the financial market and academically. This is why it is necessary to examine the issue of classification, the evaluation of the effectiveness and popularity of a way of banking based on different principles than the maximization of yield and profitability. In general terms "*social banking describes a way of value-driven banking that has a positive social and ecological impact as it heart, as well as its own economic sustainability*" (Weber and Remer 2011, p. I). "*In some regions social banking is equated with government banking, in others it is equated with microfinance*" (Weber and Remer 2011, pp. 1).

The Institute for Social Banking has provided a very complex and multi-dimensional definition of social banking. At the same time, they also make the reservation that a single, short and conclusive definition of this activity does not exist "*We acknowledge that a generally accepted definition of "Social Banking" does not exist, and – given the variety of its historic origins and underlying values – arguably cannot exist. But we believe that there is a common denominator of many organisations that can be subsumed under this notion of social banking"* (http://www.social-banking.org/the-institute/what-is-social-banking/). Combining both definitions, GABV stated in its research report Real Economy-Real Return, that what makes sustainable banks stand out from other banks is that they are "*reassessing their role in supporting the delivery of social, economic and environmental impact*" (GABV 2015, pp. 2).

2. Scope of activity of social banks

It can be said that the activities of banking institutions which are the members of the GABV focus on lending. Analysing the missions of individual banks, it is difficult to formulate a uniform vision of the representatives of social banking. The common denominator of the missions of these institutes is actually the transparency of the use of deposits, the support of local social projects, or projects which are deemed to be ethical, necessary and of added value not just on a local but also on a global scale. It is necessary to highlight that the mission and type of borrowers receiving support from the bank are a key decision-making element for bank depositors. They are depositors who are aware of the needs, or are actively involved in the development, of the local community, or the fight against global social problems (work and the lack of child education, poverty, exclusion from health care, environmental pollution). By observing banks associated with the GABV it is possible to differentiate between two main regions of credit: north and south. Southern banks focus on increasing the standard of living of people in areas of poverty. They focus on local social projects. They mainly concern the support of micro-businesses, the development of basic infrastructure (sewage-water networks and irrigation of agricultural terrain) and increased access to science for children. The fundamental instruments for supporting borrowers are microloans, guarantees and consultation. Northern banks focus on the ethical side of their activities, on account of the higher level of economic development. This division affects the mission, organization and structure of the

institutions. As per March 2016, 28 banks are affiliated with GABV, which comprise a total of $100 billion.

Table 1. The members of the Global Alliance for Social Banking, split by geographic regions

Europe	North America
• Alternative Bank Switzerland (Switzerland) • Cultura Bank (Norway) • Ekobanken (Sweden) • Ecology Building Society (United Kingdom) • Merkur Cooperative Bank (Denmark) • Crédit Coopératif (France) • Triodos Bank (Netherlands) • GLS Bank (Germany) • Banca Etica (Italy)	• Affinity Credit Union (Canada) • Assiniboine Credit Union (Canada) • Vancity (Canada) • Beneficial State Bank (USA) • City First Bank of DC (USA) • First Green Bank (USA) • Sunrise Banks (USA) • New Resource Bank (USA) • Southern Bancorp (USA)
South America	**Asia**
• Banco Fie (Bolivia) • BancoSol (Bolivia) • Vision Banco (Paraguay) • SAC Apoyo Integral, S.A. (El Salvador) • Banco Ademi (Dominican Republic)	• BRAC Bank (Bangladesh) • XacBank (Mongolia) • NMB Bank Limited (Nepal)
Australia	**Africa**
• Bank Australia	• Centenary Bank (Uganda)

Source: GABV data available from www.gabv.org, as per 1st March 2016.

Examples of southern lending are the following credit decisions.

- Granting of loans for the building of greenhouses in areas with varying temperatures in Bolivia – this has had a considerable effect on economic productivity and the certainty of good harvests.
- Support with investment credit for the development of a catering company working in areas affected by unemployment in the Dominican Republic. The company is now financing meals for 300 children from poor families.
- The financing of a pilot project to provide electricity from solar plants in remote villages in Nepal, who did not have access to electricity. The availability of electricity did not just increase the standard of living of the villages, but also allowed them to develop their businesses (convenience stores, farming, laundry services and tourist services), and therefore brought the economic region to life.
- Financial support for a micro-company producing mats from coconut fibre. Through its activities, the company allowed the inhabitants of the village, where there was a high rate of unemployment, to develop professionally, and also increased the level of ecological awareness.
- Preferential lending for the purchasing of economical and efficient stoves in Ulaanbaator. The micro-loans of this program were characterised by reduced requirements regarding securities and a lower rate of interest. Thanks to the program, the least-affluent households were able to allocate the released funds to clothes and food. The costs of running the old stoves make up 80% of the income during the winter. The capital of Mongolia is not just one of the coldest capitals in the world but the atmosphere is also one of the most contaminated. Making efficient stoves more popular has a positive effect on the environment, because the vast majority of pollution in the air comes from stoves.

The focus of the support of banks and credit unions in the north (in developed economies) is on programs which are usually of a different nature than the programs in less-developed countries. This includes resocialization programs (for adults and young people), projects encouraging organic nutrition and renewable energy, as well as projects to provide professional opportunities to people with physical and mental disabilities, and people excluded from society. Examples of the support of these programs include:

- Lending for projects of French public benefit organisations dealing with the fight against drug addiction and HIV.
- On-going support and lending to public benefit foundations which are involved in the resocialisation and inclusion of people in Sicily. Thanks to support from the bank, the foundation has developed a program for the teaching of traditional crafts.
- The support and on-going lending to a Swiss foundation running a hotel, where they employ women with physical or mental handicaps, who were previously unemployed or working in difficult conditions.
- A loan for a micro-company providing organic food to Norwegian households. The capital obtained from the bank allowed the company to expand its client base from 10 to 1500. A restaurant was also opened which focuses on organic food, and already has three Michelin stars.
- Financing of the purchase and modernisation of an innovative pre-school, submerged in the ground at a listed UNESCO Heritage building in Germany.
- The granting of a mortgage to funds created by inhabitants of agricultural areas in Great Britain, in order to build affordable shared ownership houses. The co-ownership of the project means that it is unusual on the mortgage market, and therefore was rejected by traditional banks. The housing market in Great Britain is characterised by extremely high prices. Households are usually unable to save enough money for the required down payments. The bank reduced the requirements concerning down payments and applied combined mortgage security. The bank's decision did not just help to meet the needs of the inhabitants of young households, but also protected the agricultural community from depopulation and ageing.

Reading the examples given above it is hard to specify a particular general rule of the credit policy of social / charity banks. The range of topics and the support groups are incredibly diverse. However, an element that links all of them is the conviction of lenders and shareholders of banks to observe an ethical and balanced use of credit instruments. The feeling of social responsibility in an investment is even stronger once the technocracy and greed of banks as well as the other participants on the financial market have been stripped away. What's more, in the long-term a banking approach focussed on profit has failed even the most experienced players, such as global investment banks. Social banking is still not part of mainstream on the

financial market, although it is no longer going unnoticed, mainly due to the good financial returns and the increased role of ethics in the financial sector.

3. The financial returns of social banks by sector

This section was developed on the basis of the results of surveys performed by GABV (GABV 2015). It split the respondents into two groups of institutions: sustainability-focused banks (SFBs) and global systematically-important financial institutions (GSIFIs). The assumption was made that the indicator (proxy) of how involved a bank is in financing the real economy, and not in funding activities on the financial market, is the level of lending. The indicators of loans to assets confirm that sustainable banks lend twice as much to the real economy as much as banks that focus on financing, in relation to their assets.

Table 1. Loans to assets ratio

Loans/Total assets	2014	2011	2008	2005
SFBs	75.2%	77%	75.7%	73%
GSIFIs	39.6%	39.4%	39.8%	41.8%

Source: GABV 2015, pp.3

It has to be noted that social banks mainly focus on using deposits as a source for refinancing assets. The method of using deposits for refinancing creates a stronger relationship between the borrower and the lender, and also increases the expectations on the bank concerning the transparency of their credit policy. It is this ethical approach which attracts depositors to ethical banks. Banks thereby provide capital for the refinancing of projects of an ecological and social nature. The ratio of deposits to assets is greater for social banks, than for other banking institutions.

Table 2. Deposits to assets ratio

Deposits/ Assets	2014	2011	2008	2005
SFBs	78%	76%	71.6%	73.9%
GSIFIs	49%	46.1%	43.6%	45.1%

Source: GABV 2015, pp.3

The interpretation of these indicators needs to be correlated to the size of the institution. Social banks are incomparably smaller than the global banking institutions examined in the study. This also means that less capital can be invested in more profitable assets (credit agreements) than can be done in larger institutions with greater capital resources. As a result, the profitability of equity capital and the profitability of assets (ROE and ROA) are at a similar level to the indicators of the GSIFI group of banks. However, during the worst period of the financial crisis (2008) the profitability indicators ROE and ROA did not register as big a drop in ethical banks as in other banking institutions, which have a wide range of activities on the financial market. In 2008 the ROA for SFBs was around 0.5%, while for GSIFIs it was 0.2% while the indicator ROE was 6.5% and minus 1% respectively (GABV 2015, p.5). Furthermore, the standard deviation of ROE and ROA is lower for social banks compared to other institutions. This means that if the level of profitability for both groups of banks is similar, the credit risk is lower.

Table 3. ROA and ROE averages and standard deviation in 2005-2014

ROE	**Average**	**St. dev**
SFBs	0.63%	0.24%
GSIFIs	0.52%	0.38%
ROA	**Average**	**St. dev**
SFBs	8.4%	2.8%
GSIFIs	8.9%	8.7%

Source: GABV 2015, pp. 5.

The strong criticism of global financial institutions and their separation from the real economy in securitization procedures overshadowed the innovative financial instruments and their salespeople (originators). The extensive scientific debate about the ethical values of instruments like collateral debt obligations (CDOs) and the mechanism of up-front banking without an in-depth credit analysis, led to a sentimental return by investors to the idea of classical bank financing. It does, however, need to be underlined that it is not the innovative financial instruments themselves, but their incorrect use that was the origin of the crisis on the financial market, which then affected the real economy. The natural path of development of sustainability-focused banks seems to be the path of capital refinancing. With an

increasing conviction that the activities of social banks are right, their deposits will rise, as will the demands of borrowers. It is not the method of financing that decides whether a bank is social or not. What attracts depositors and capital investors is the nature of the bank's activities, its mission and the transparency of the credit policy. The surveys run by GABV indicate that the financial results of the few small players on the banking market are similar and are actually better during a financial crisis. This means that the portfolio of social banks is interesting for responsible social investors on the capital market. In this potential case, innovations in the securitization process could bring a range of benefits to the real economy, and not just short-term profit for investors on the financial market.

Summary

In response to the question of whether charity banking is at all possible, it is necessary to state that it is fully dependant on the ethical expectations of depositors at banks and investors on the capital market. The crisis in 2007 turned out to be not just a crisis on the financial market, but also a crisis of the values of its participants. The allegedly safe derivative instruments, which were far removed from reality, as well as the obligations which were synthetically affected by the problems of the real economy, were not able to provide security to investors or guarantee a return in investment. Ratings agencies working for investors but paid for by originators, acted against the interests of the buyers of securities (He, Qian and Strahan 2016). It needs to be highlighted that this conflict of interests is still to be resolved. After the indulgement in financial innovations, which did not generate any added value, but just a positive rate of return, things turned to disappointment for the participants of the financial market in 2008. The need to return to classic brokering on the banking market grew. As the surveys show (Cecchetti and Kaharoubbi 2012, 2015) the dynamic growth of the financial sector came at a cost to the development of the other sectors of the economy. The financial sector competes with the other sectors for capital and human resources. With the best executives being hired by the financial sector, the other sectors are left without executives and therefore the sectors with large security potential receive preferential credit. "This evidence, together with recent experience during the financial crisis, lead us to conclude that there is a pressing need to reassess the relationship of finance and real growth in modern economic systems" (Cecchetti and Kaharoubbi 2012, pp. 14).

Charity banks are not philanthropic, which would be a much more difficult task. Currently, corporations that want to improve their image are becoming sporadic philanthropists on the side. The goal of social banks is not to give away capital, but to assign it responsibly to the areas when corporate philanthropy does not reach.

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