Ethical finance in Europe

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A publication by
ETHICAL AND SUSTAINABLE FINANCE IN EUROPE: THE PICTURE IN THE 5TH REPORT

Peace banks since forever. Ethical and value-based banks do not invest in weapons. Their finance is truly sustainable: resilient, profitable and greenwashing proof.

The new Report on Ethical and Sustainable Finance in Europe shows, for the fifth consecutive year, how ethical banks are performing and resilient, Europe is drowning in sustainability and leaving room for greenwashing by conventional banks. Not only in the environmental field, but also in the social one. And, at a time when the European Commission is also questioning the option of including arms in sustainable finance, ethical finance stands firmly and absolutely against any financing of arms production and trade. Since always.

The Report on Ethical Finance in Europe is realised by Fondazione Finanza Etica and Fundación Finanzas Éticas, the cultural foundations of Banca Etica Group, this year for the first time together with FEBEA - European Federation of Ethical and Alternative Banks. The ethical and value-based banks considered are represented by all the European members of Gabv, two members of Inaise and seven members of Febea. Only those organisations that do banking with a predominantly social and environmental orientation and have disclosed financial statements for at least seven of the last ten years were included.

Finance and climate: ethical banks lead the Copernican balance sheet Revolution.
The fifth edition of the Report on Ethical Finance in Europe shows how ethical banks are pioneers and forerunners also in accounting. In fact, they are among the first banks in the world to account for indirect greenhouse gas emissions from loans and investments according to the PCAF methodology. A path that conventional banks are also beginning to take. Although the suspicion is that marketing departments prefer to push banks and conventional finance towards greenwashing rather than changing business models. We discuss how in the second part of the Report.

Ethical finance and social taxonomy
A few years ago, the world of ethical finance warmly welcomed the launch of the EU sustainable finance initiative. At the same time, we pointed out the clear shortcomings of the European approach and published together with FEBEA a position paper in outlining several points to be improved and reviewed in order to truly achieve sustainable finance.

Today, unfortunately, it is no longer a question of different approaches or criticism of some specific issues that needed to be improved. The approach followed by the EU runs the risk of making the word sustainability quite meaningless. See the third part of the Report, where we have looked at the EU’s approach to the so-called ‘social taxonomy’.

Ethical banks: resilient even in the first year of the pandemic
Even in 2020, ethical banks proved to be much more focused on providing services to the real economy than traditional banks. As well as being more profitable on average.

The European banking system as a whole turned out to be resilient in 2020, in stark contrast to the 2008 crisis. The trend in deposits through 2020 seems to have been influenced positively by the pandemic, which led to a decrease in consumption and an increase in savings. Thus, the volume of bank deposits increased. This trend seems to have been more beneficial for ethical and value-based banks than for the European banking system as a whole. Read about it in the first part of the Report.

Ethical banks: different origins, common goals
A snapshot of European ethical finance as it is today, by interviewing representatives of six ethical and value-based banks.

The elements they have in common: a ban on funding the arms industry, since always; the reference to founding values; process innovation; assessment of the social and environmental impact of loans and investments and their contribution to change; constant revision of internal processes, as can be read in the first part of the Report.

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1 Global Alliance for Banking on Values
2 International Association of Investors in the Social Economy
3 European Federation of Ethical and Alternative Banks and Finances
4 Partnership for Carbon Accounting Financials.
THE REPORT

Ethical and value-based banks: resilient even in the first year of the pandemic

For the fifth year running, in this report we compare the capital and financial performance of European ethical and value-based banks with those of all banks in the euro area.

The focus of the benchmarking remains the same: whether ethical banks are financially sound and can stand up to comparison with other banks. This year’s confrontation was particularly remarkable, as for the first time the data available also included 2020, the first and most challenging year of the Covid-19 pandemic.

Even in 2020, ethical and value-based banks turned out to be much more committed to providing services to the real economy than traditional banks. They are also more profitable on average, in terms of ROA and ROE.

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**ROA - RETURN ON ASSETS**

<table>
<thead>
<tr>
<th></th>
<th>5 years (2015-2020)</th>
<th>10 years (2010-2020)</th>
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<tbody>
<tr>
<td></td>
<td>Average</td>
<td>Standard deviation</td>
</tr>
<tr>
<td>European ethical and value-based banks</td>
<td>0,40%</td>
<td>0,13%</td>
</tr>
<tr>
<td>European banks</td>
<td>0,30%</td>
<td>0,12%</td>
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**ROE - RETURN ON EQUITY**

<table>
<thead>
<tr>
<th></th>
<th>5 years (2015-2020)</th>
<th>10 years (2010-2020)</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Average</td>
<td>Standard deviation</td>
</tr>
<tr>
<td>European ethical and value-based banks</td>
<td>4,84%</td>
<td>1,40%</td>
</tr>
<tr>
<td>European banks</td>
<td>4,35%</td>
<td>1,51%</td>
</tr>
</tbody>
</table>

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The first year of the Covid-19 pandemic witnessed a drop in profitability for both ethical and value-based banks and the European banking system, although the decrease was milder for ethical and value-based banks. Both groups of banks analysed increased their assets during 2020 in comparison to 2019. The rise for ethical banks was much more significant: +15.24% vs. +8.6%.
In the first year of pandemic, ethical and value-based banks experienced less profitability and grew more (in terms of assets, deposits and loans) than the European banking system.

**GROWTH 2020 ON 2019**

<table>
<thead>
<tr>
<th></th>
<th>EUROPEAN ETHICAL AND VALUE-BASED BANKS</th>
<th>EUROPEAN BANKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>15.24%</td>
<td>8.6%</td>
</tr>
<tr>
<td>Deposits</td>
<td>15.66%</td>
<td>8.69%</td>
</tr>
<tr>
<td>Loans</td>
<td>4.37%</td>
<td>3.45%</td>
</tr>
</tbody>
</table>

Growth in assets, deposits and loans in 2020 compared to 2019 for European ethical and value-based banks and the European banking system as a whole.

In general, the European banking system as a whole has proven resilient in 2020, in stark contrast to the global financial crisis of 2008. For both bank groups, the trend in deposits in 2020 seems to have been affected positively by the pandemic, which led to a broad reduction in consumption and a growth in savings, increasing the volume of bank deposits. This trend seems to have benefitted ethical and value-based banks much more than the European banking system as a whole.

**Europe's ten largest ethical and value-based banks by asset volume**

*Banca Etica compared with European ethical and value-based banks.* The amount of money raised by Banca Etica from deposits has increased by an average of 16.46% per year over the past ten years, compared to 7.70% for European ethical and value-based banks. From 2015 to 2020, Banca Etica’s profits grew by an average of 53.23%, while European ethical and value-based banks registered a decrease (-15.77%). A significant difference. Banca Etica’s results improved in all other items examined as well.


**DEPOSITS/TOTAL LIABILITIES**

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2019</th>
<th>2015</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>European ethical and value-based banks</td>
<td>73.29%</td>
<td>73.29%</td>
<td>73.56%</td>
<td>69.32%</td>
</tr>
<tr>
<td>European Banks</td>
<td>40.96%</td>
<td>40.83%</td>
<td>37.86%</td>
<td>33.49%</td>
</tr>
</tbody>
</table>

Deposits as % of total liabilities (simple averages calculated on total aggregate data).

**GROWTH** *5 YEARS (2015-2020) 10 YEARS (2010-2020)*

<table>
<thead>
<tr>
<th></th>
<th>2015-2020</th>
<th>2010-2020</th>
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</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>16.95%</td>
<td>13.81%</td>
</tr>
<tr>
<td>European and value-based banks</td>
<td>10.37%</td>
<td>10.23%</td>
</tr>
<tr>
<td>Loans</td>
<td>10.10%</td>
<td>7.11%</td>
</tr>
<tr>
<td>European and value-based banks</td>
<td>9.46%</td>
<td>9.79%</td>
</tr>
</tbody>
</table>

**GROWTH** *5 YEARS (2015-2020) 10 YEARS (2010-2020)*

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<thead>
<tr>
<th></th>
<th>2015-2020</th>
<th>2010-2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits</td>
<td>18.34%</td>
<td>16.46%</td>
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Growth calculated on total values of aggregates. *Compound Annual Growth Rate, or CAGR*
Growth of Banca Etica’s assets from 2010 to 2020. Data in Euro

<table>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>€440.000.000</td>
<td>€880.000.000</td>
<td>€1.320.000.000</td>
<td>€1.760.000.000</td>
<td>€2.200.000.000</td>
<td>€0.000.000</td>
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Growth of Banca Etica’s deposits and loans from 2010 to 2020. Data in euro

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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans (gross of reserves)</td>
<td>€0.000.000</td>
<td>€440.000.000</td>
<td>€880.000.000</td>
<td>€1.320.000.000</td>
<td>€1.760.000.000</td>
<td>€2.200.000.000</td>
<td>€0.000.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits and Liabilities from Clients</td>
<td>€0.000.000</td>
<td>€0.000.000</td>
<td>€0.000.000</td>
<td>€0.000.000</td>
<td>€0.000.000</td>
<td>€0.000.000</td>
<td>€0.000.000</td>
<td></td>
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**FOCUS AREA**

- INAISE 1989
- FEBEA 2002
- GABV 2012
- BANCA ETICA 1998 AND 2017

**DEFINITION OF PRINCIPLES**

1. Transparency
2. Trust
3. Justice
4. Excellence
5. Sustainability
6. Cooperation
7. Democracy
8. Territoriality

**CREDITS**

- Transparency
- Transparency
- Economic, social and environmental criteria
- Responsibility in choice

**USE OF RESOURCES**

- Excellence
- Long-term vision
- Long-term vision
- Resilience
- Efficiency

**DEMOCRACY**

- Participation and collective action
- Broad participation in governance
- Broad participation in governance
- Credit as a right

**GOALS**

- Justice
- Working for common good
- Working for common good
- Justice

**LOCAL ACTION**

- Territoriality
- Rooting in local community
- Rooting in local community
- Active members on the ground

Ethical and value-based banking at its roots
Finance and climate: ethical and value-based banks lead the Copernican balance sheet revolution.

Ethical and value-based banks have always been aware of the environmental impacts of banking and financial activities. Since their foundation, they have set clear exclusion criteria in their lending and investment policies. By statute, they do not finance fossil fuels or industries with a high environmental impact. Historically, they invest in renewable energy and environmental conservation projects. In general, compliance with social, environmental and governance criteria is embedded in all processes which, for example, have always excluded investments in weapons. On the contrary, conventional banks have for many years only considered the direct environmental impacts of their offices and branches (paper consumption, use of company cars, etc.) without taking into account the indirect ones, arising from their financing (coal-fired power stations, oil pipelines, etc.).

A new agreement post-2020 was reached at the 2015 Paris Climate Conference committing all countries for the first time to reduce their greenhouse gas emissions by setting clear targets. The agreement also aims to steer private and state financial flows towards low greenhouse gas emission development.

As a result ethical and value-based banks were among the first to adopt clear guidelines on how to account for indirect emissions from their offices and branches (paper consumption, use of company cars, etc.) without taking into account the indirect ones, arising from their financing (coal-fired power stations, oil pipelines, etc.).

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Budgets and climate: ethical banks lead the revolution

<table>
<thead>
<tr>
<th>ETHICAL AND VALUE-BASED BANKS</th>
<th>PCAF JOINING</th>
<th>CREDIT IMPACT MEASUREMENT from</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALTERNATIVE BAN [DANKR]</td>
<td>✔ 2020</td>
<td>✔ 2020</td>
</tr>
<tr>
<td>bancaetica</td>
<td>✔ 2020</td>
<td>✔ 2020</td>
</tr>
<tr>
<td>Triodos® Bank</td>
<td>✔ 2018</td>
<td>✔ 2018</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CONVENTIONAL BANKS</th>
<th>PCAF JOINING</th>
<th>CREDIT IMPACT MEASUREMENT from</th>
</tr>
</thead>
<tbody>
<tr>
<td>MEDIOPINIONA</td>
<td>✔ 2022</td>
<td>❌ NO</td>
</tr>
<tr>
<td>UniCredit</td>
<td>❌ NO</td>
<td>❌ NO</td>
</tr>
<tr>
<td>Santander</td>
<td>✔ 2021</td>
<td>❌ NO</td>
</tr>
<tr>
<td>BBVA</td>
<td>✔ 2021</td>
<td>❌ NO</td>
</tr>
<tr>
<td>CaixaBank</td>
<td>✔ 2021</td>
<td>❌ NO</td>
</tr>
</tbody>
</table>
ventional bank (Mediobanca) and the three Spanish conventional banks (Santander, BBVA and Caixabank) joining PCAF. A few conventional banks are starting to join PCAF and thus measuring the emissions of their portfolios. However, they are all only measuring emissions from their offices and their employee travel.

But soon they will also start reporting on credit and investment-related issues. This is a Copernican revolution in financial statements, of which ethical banks have been pioneers. They will most likely continue to play a leading role in the global banking system in this field. A revolution that even conventional banks will not be able to escape. In the coming years, their conversion to environmental accounting, followed by strategies to reduce portfolio emissions, will be inevitable.

**Banca Etica**

In 2021, Banca Etica published its second Impact Report (covering 2020), including a specific section dedicated to the financial accounting of its carbon footprint. The analysis covered Scope 1 and Scope 2 emissions for all of bank’s assets and covered Scope 3 indirect emissions for 87% of assets. A total of 116,572 tonnes of CO2 equivalent emissions resulted from Banca Etica’s activities in 2020 (about 40% less than in 2019). Regarding carbon intensity of assets, each million employed by the Bank produces on average 43 tonnes of CO2. Currently, this data is not comparable with other Italian banks as Banca Etica is the first, and so far only, bank having measured its portfolios’ indirect emissions.

**Ethical and sustainable finance and social taxonomy**

“Sustainable development is that development which enables the current generation to meet its needs without affecting the ability of future generations to meet their own needs”.

Our Common Future (so-called Brundtland Report), World Commission on Environment and Development (WCED), 1987

For some years now, EU has started a process to frame and define sustainable finance. What emerged is a taxonomy of eligible activities for a financial manager willing to offer a ‘sustainable finance’ product according to EU definitions. Regarding this long-term and in-depth work on the basis of scientific criteria, in recent months governments and lobbies tried to broaden the stakes and loosen the constraints so as to ensure an increasing number of activities fall under those considered ‘sustainable’. As a result of this broadening on the basis of economic or geopolitical criteria, rather than scientific ones, gas and nuclear have ended up, in early 2022, among the activities eligible in the environmental field. Work recently started on social and governance aspects, according to the traditional ESG approach to sustainability, seems even more disappointing, at least to judge from the approach taken so far. The Report aims to explain why, thanks to Ugo Biggeri, Daniel Sorrosal and Antje Schneeweiß.

**Why the EU regulation on sustainable finance a good news, but not enough**

That sustainable finance is acquiring a regulatory definition by the European Union is positive per se. For decades, ethical and value-based finance has crafted financial practices and processes so as to be able to combine financial management with positive social, environmental and cultural impacts. In order to answer questions of meaning on the use of savings, these banks began to be highly open about their lending and investment choices. They built internal practices and processes suitable for improving their ability by measuring and reporting on their impacts. Even other conventional banks have a history of social attentions, but unlike ethical and value-based banks, such attention usually did not evolve into clear operational and management choices, also included in internal control system audits. On a more general level, until a decade ago ethical finance not only was a minority movement, it was also looked down upon by mainstream finance. Thus, that the focus on sustainability in finance today is being regulated is an acknowledgment that a change in finance is needed and, above all, that the insights of the pioneers of ethical finance are deeply grounded.

European Union came to regulating sustainable finance mainly for climate change urgency and Sustainable Development Goals push. Its underlying idea is to boost private finance and also savers’ choices to encourage long-lasting and needed changes in the economy.
Ethical and value-based finance and social taxonomy

- Responsible Consumption
- Supply Chain Monitoring
- Workers' Rights
- Governance
- Non-Aggressive Tax Policies
- Forced Labour
- Weapons
- Speculation
- Child Labour Exploitation
- Short-Term Profit
Like and dislike of the Final Report on Social Taxonomy currently under review by European Commission

"On social taxonomy the European Commission is not sufficiently ambitious. But the road is now marked," says Antje Schneeweß, co-ordinator of the Final Report on Social Taxonomy. In an exclusive interview given to the Report, she talks about the challenging task of defence and armaments. “There was a lot of discussion: there are those who think this sector should be completely excluded, while others think it has to be considered ‘social’. In the end, defence has been placed in a neutral area. This is consistent with our approach of building up a social taxonomy on internationally agreed norms and principles and, in this context, armaments have never been defined as positive anyway.”

Concerning the risk of the non-profit sector and grassroots organisations and NGOs being seen as a ‘crutch’ and not as a key economic player, Schneeweß remarks: ‘Taxonomy is a tool for investors and we had to look at where investments actually occur. So we had to relate taxonomy to investments, which is why we included microfinance. NGOs, on the other hand, cannot be invested in, and therefore were not included’.

“Sustainable investment,” she then recalls regarding the future steps of the social taxonomy, “is defined as ESG (environmental, social and governance) investment. Currently, without a social taxonomy only green investments can be considered officially sustainable. And this, in the long run, is out of the question.”

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8 Rapporteur of Subgroup 4 (on extending taxonomy to social targets) of the Platform on Sustainable Finance, co-chair of AKI, the working group of Protestant Church investors in Germany.

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<tbody>
<tr>
<td><strong>NO</strong></td>
<td>Change cannot be tackled by regulation alone; sustainable finance is considered just one ‘shelf’ product among many others on the market.</td>
</tr>
<tr>
<td><strong>YES</strong></td>
<td>A major common ground relates to the ‘do not significantly harm’ (DNSH) principle, i.e. the requirement that activities elected for investments do not significantly harm the so-called environmental (and in the future social) objectives of the ‘taxonomy’. European regulation, by introducing the DNSH, pushes for a broad and potentially challenging approach to sustainability. Perhaps this is where the greatest common ground with ethical finance practices is to be found and if applied properly, could be very effective.</td>
</tr>
<tr>
<td><strong>NO</strong></td>
<td>The word ‘speculation’ never occurs within the regulation framing ‘sustainable investments’ and neither the time frame nor the objectives of financial investments are taken into account. The connection between pressure to maximise short-term profits and environmental impacts of companies is completely overlooked. Ethical finance is clearly against speculative practices and has a clear commitment to real economy: finance’s social functions, both in terms of an efficient resource allocation and social and environmental impacts, are fulfilled in business activities.</td>
</tr>
<tr>
<td><strong>YES</strong></td>
<td>Practices such as forced labour and exploitation of child labour are excluded.</td>
</tr>
<tr>
<td><strong>NO</strong></td>
<td>Other workers’ rights, from safety to trade union rights to fair pay, are not regulated. Monitoring of supply chains is not firmly addressed, although it would be required.</td>
</tr>
<tr>
<td><strong>NO</strong></td>
<td>Non-profit world is seen merely as a ‘crutch’ in order to carry out social impact activities and not as an economic actor in its own right. Value-driven organisations with a clear, sound and steady social (or even environmental) agenda are not valorised as much as they should be.</td>
</tr>
</tbody>
</table>
That is why the approval of a social taxonomy taking into account social and governance criteria is inevitable in the long run. EU support to the social and sustainable economy, however, extends beyond green and social taxonomies (and Green Deal). During 2022, two major EU initiatives will come into effect, contributing to the development of a social and sustainable economy until the end of the decade.

SEAP (EU Action Plan for the Social Economy) is an important political initiative promoting the development of social economy in Europe over the coming decade. The Plan engages ethical banks for two reasons: as organisations, being part of social economy, and as promoting social economy development.

Social economy in figures!

- 2.8 million organisations and entities in Europe
- more than 13 million paid jobs
- 6.3% of the work force
- 0.6-9.9% of all paid work across Member States

But what does it mean?

“Social economy” mainly refers to:

- cooperatives
- mutual benefit societies
- associations (including charities)
- foundations
- social enterprises

Social Economy Dimensions in Europe. Source: European Commission

These policies will be sustained by the InvestEU fund. The resources provided by the Fund ensure a key asset to ethical and value-based banks in growing their loan portfolios over the next decade, as well as taking more risks and venturing into new business areas. They can count on 3.6 billion euros available in collateral as part of InvestEU’s social investment and skills framework. The European Investment Fund (EIF) has been appointed on behalf of the EU to identify financial intermediaries receiving these warranties. Both EU and EIF share years to work with ethical and value-based banks.

The Green Deal, green and social taxonomies, SEAP and InvestEU are all acting as a driver that will certainly boost growth of ethical finance in Europe. However, there is no hiding that the war in Ukraine could overturn everything.

The combined impact of rising energy prices, sanctions against Russia and a growing refugee crisis are having the effect of an unprecedented rise in inflation, a more than likely economic recession and a growing humanitarian crisis, with millions of refugees reaching the EU. Against this backdrop and should this situation continue for a longer period of time, the EU and its Member States could conceivably abandon or postpone their sustainability agenda and focus on more urgent issues.