SUSTAINABLE BANKING

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Economic crisis sows seeds of change

Winds of change: financing renewable energy projects, such as this one in Brazil, is increasingly favoured as part of a sustainable banking policy Jacques Jangoux/Alamy

Sustainability may be a winner in the fallout from the global credit crunch, writes **Brooke Masters**

A once-in-a-lifetime opportunity has come to sustainable banking. The credit crunch and collapse of the structured products market have turned much accepted financial wisdom on its head. The world has gained a new appreciation for long-term risk, and regulators around the globe seek to impose new standards on institutions they supervise. "Sustainability is not a luxury at all. It is just good business. People are paying even more attention than they were before because they are more conscious of their images," says Fabio Barbosa, president of Grupo Santander Brasil, which now owns Banco Real, winner of last year's FT Sustainable Bank of the Year award. "Society is demanding a more conscious attitude."

Many proponents of sustainable banking have emerged from the crisis relatively unscathed, because they were never big issuers of credit derivatives and other complicated debt instruments. While markets in the developing world have been hit by the downturn, they are not – unlike many western bankers – facing the disappearance of entire product lines, nor are they having to completely rework their overall strategy.

"Microfinance has slowed somewhat, which is not a bad thing," says Bob Annibale, global director of microfinance at Citigroup, a finalist in last year's awards. "We had institutions that were growing at 50, 100, 200 per cent a year. Most microfinance institutions have felt less pressure from the loss of credit than the impact of rising prices and slowing remittances from overseas workers."

Financing conservation and sustainable energy projects as well as other community-supported development is a viable, even admired, strategy. There is also support for providing banking and insurance services to underserved populations.

Interest in the sector remains high, as reflected by the 165 entries for this year's FT Sustainable Banking awards, sponsored by the FT and the International Finance Corporation, part of the World Bank. Submitted by 117 institutions in 42 countries, the number of entries reflects a slight decrease from the 182 entries in 2008, but is higher than any previous year.

The judging panel, of figures in sustainable finance and development, agreed a short-list for each category of award. This panel will choose the award winners.

"The crisis has underscored the vital role of finance in economic growth and development, as well as the need to incorporate the principles of sustainability into business and banking models," Lars Thunell, IFC chief executive, says. "The high level of interest in this year's awards is an encouraging sign that commitment to sustainability remains strong in the financial community."

Bankers and investors alike say they are still committed to the Equator Principles, which set out guidelines for managing social and environmental issues. Nearly 70 institutions have signed on, including Santander in April and big global banks such as JP Morgan Chase and Citibank.

"Sustainable banking is more important than ever," says Pam Flaherty, Citibank's director of citizenship and president of the Citi Foundation.

"We have always looked for the sweet spot between what is good for our communities and resources and what is also good for our business. It is good business sense to underwrite clients who have all the environmental and social risk management issues addressed."

A recent survey by Co-operative Group's investment arm found that 18 per cent more UK investors plan to invest in ethical funds this year than last year. Inflows into ethical funds outpaced outflows throughout the financial crisis, a stark contrast with other retail funds.

Zack Hocking, head of investments at Co-operative Investments, says: "The financial crisis appears to have encouraged investors to think not only about how much money they make, but importantly, how it is made."

Within the sustainable banking world, microfinance remains one of the hottest topics because it taps into communities and markets that are under-served. The sector has room for both global financial institutions and community organisations, and in some cases they work closely together, allowing the big commercial banks to access populations they would otherwise be unable to reach. Citibank, for example, lends to microfinance lenders rather than directly to small customers.

"Microfinance is profitable and we continue to invest in it. Our objective is to ensure that this is sustainable and that we get appropriate returns but that we continue to do it with greater reach and lower costs," says Citi's Mr Annibale.

Sustainable energy project

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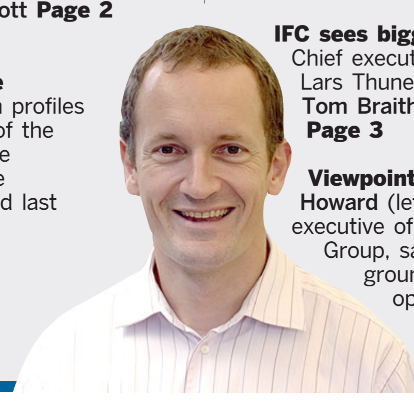

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Leading banks reap benefit of environmental agendas

COST-CUTTING

The rewards for thinking green can be considerable, says **Sarah Murray**

As banks struggle to return to profitability, they are trimming everything from IT budgets to research teams. But while finance departments might have once considered corporate sustainability initiatives as costly add-on programmes, there is a growing recognition that conserving resources and cutting carbon emissions can help save money. And as they implement sustainability policies, leading banks appear to be reaping the financial benefits of their green agendas.

Much of the activity surrounds the energy efficiency of offices and branches. "We have seen numerous financial services companies make strong green-building commitments," says Mindy Lubber, president of Ceres, a US-based coalition of investors and environmental groups.

Bank of America is deploying an energy management system in 3,300 banking centres across the US that will result in savings of up to 50 per cent in costs related to heating and cooling.

Similar initiatives are in place at Standard Chartered, which wants energy standards for its new buildings to be 50 per cent more efficient than existing buildings, says Andrew Hunter, group head of corporate real estate services.

"You may have to spend a bit more on a green building but, at the end of the day, it pays back," says Mr Hunter. "If you consume less energy you're cutting costs."

At HSBC energy efficiency measures implemented last year across its global branch and office network saved $7.3m. In the UK, the bank reckons new heating and cooling technologies will, when rolled out across 800 branches, save more than £2m in costs a year, as well as cutting up to 10,200 tonnes of carbon dioxide emissions.

Timur Galen, managing director at Goldman Sachs, says that the bank's initiatives – which include consolidating data centres, moving to more energy-efficient real estate and reducing water consumption – are "commercially smart and represent a return on investment that typically pays back over a period of seven years".

Banks should view environmentally sustainable initiatives as providing long-term value, argues Francis Sullivan, adviser on the environment at HSBC Holdings. "Having said that, a large number of our initiatives are cost-effective and provide HSBC with a short-term return on investment," she adds.

Another potential return on investment lies in installing virtual communications technologies to cut business travel. Ms Lubber cites State Street's 2007 investment of $1.84m in video and audio conferencing equipment. "This is a clear indication that the company believes it can make money and reduce pollution by reducing air travel," she says.

Communications technology has made a dent in travel costs at HSBC. The $8.1m spent on videoconferencing facilities last year helped it reduce business travel by 7 per cent.

Banks also use large amounts of electricity to power data servers, computers and other electronic equipment. Here, energy-saving initiatives have a financial as well as an environmental payback.

Cisco Systems reckons that banks using its EnergyWise system – which helps clients to monitor the power used by all their Cisco-connected devices – could help the average bank branch to cut annual energy bills by more than €28,000 ($39,000).

But people play a critical role. Standard Chartered uses a social networking site called Greenstorming to promote staff engagement in environmental activities.

"They can come up with ideas and ask other members of staff to join their campaigns," says Mr Hunter. "It's a bit like Facebook but all around the environmental initiatives taking place internally."

At HSBC, a dedicated team established in 2008 has responsibility for ensuring sustainability is built into decisions on purchasing, real estate and IT. It also has a global network of employees with responsibility for measuring and managing performance.

At the same time, senior-level commitment is critical. "HSBC . . . has strong board-level engagement on climate change," say Ms Lubber. "It's not a coincidence that HSBC received the highest ranking among 40 banks we evaluated in last year's Corporate Governance and Climate Change: The Banking Sector report."

However, some banks have yet to put issues such as climate change at the heart of their business strategies. The Ceres report Ms Lubber cites found that many of the banks surveyed had "done little or nothing to elevate climate change as a governance priority".

Shortlist

Shortlist of nominees for 2009 FT Sustainable Banking Awards:

Sustainable Bank of the Year
-Deutsche Bank, Germany
-Grupo Santander Brasil
-Industrial Bank, China
-Standard Chartered, UK
-Triodos Bank, Netherlands

Emerging Markets Sustainable Bank of the Year
Africa/Middle East
-Access Bank, Nigeria
-Equity Bank, Kenya
-Nedbank, South Africa
Asia
-ACLEDA Bank, Cambodia
-Industrial Bank, China
-YES BANK, India
Eastern Europe
-AccessBank, Azerbaijan
-Center-Invest Bank, Russia
-Industrial Development Bank of Turkey (TSKB)
Latin America
-Banco do Brasil
-Banco Galicia, Argentina
-Itau Unibanco, Brazil

Achievement in Basic Needs Financing
-Acumen Fund, US
-MicroEnsure, UK
-ParaLife Group, Switzerland
-The Trust Bank, Ghana
-Water Capital, Mexico

Achievement in Banking at the Bottom of the Pyramid
-ABN AMRO, India
-Bank of Kathmandu, Nepal
-Opportunity International, UK
-Root Capital, US
-WIZZIT, South Africa

Sustainable Investor of the Year
-Actis, UK
-Calvert Foundation, US
-E+Co, US
-Global Environment Fund, US
-Pictet Asset Management, UK

Economic crisis sows seeds of change

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have had a more difficult time in the past year, as commodity prices have fallen, making it harder to turn a profit.

"The change since last year is that the price of oil has come down dramatically so this has put pressure on sustainable energy projects," says Bert Heemskerk, chief executive of Rabobank, 2008's runner up for FT Sustainable Bank of the Year. "Companies have stopped investing in sustainable energy. We think this is wrong."

Considered one of the world's safest banks, Rabobank's broader focus on food and agriculture has made it relatively resilient amid the banking crisis. and its management has not scaled back its commitment to renewable energy.

"Even if today a few of these energy projects face some problems, we are confident that when the economy starts moving we will see fossil fuel prices coming up," Mr Heemskerk says.

Governments and non-profit organisations also have less to spend on sustainable projects, says Christine Eibs Singer, chief executive of E+Co, winner of last year's FT Sustainable Investor of the Year award.

"Clearly we are seeing a constriction in the availability of grants. In some cases, budgets have been annihilated," she explains.

The financial crisis has also pushed climate change off the top of the agenda at many banks and insurance companies, but advocates say they hope the economic downturn and the new emphasis on risk will move the issue back to the top.

"Boards are obviously distracted at the moment," says Emily Farnworth, senior adviser for finance to the Climate Group, a coalition that seeks to get businesses and government to reduce carbon emissions.

But, she adds, "there is a correlation between saving money and not using as much energy."

The unforeseen nature of the market meltdown has added power to calls for more attention to long-term environmental change and socially responsible investing.

"Let's not let climate change catch us out in the same way," Ms Farnworth says.

And the equity market meltdown that occurred in the second half of last year has made investors more respectful of the solid 3 to 5 per cent returns that socially responsible investment companies such as E+Co can provide, says Ms Singer.

"Our 3 per cent in some portfolios is looking pretty darn good," she says.

E+Co also benefits from being able to tap two streams of sustainable investing: it also handles clean energy projects in the developing world.

"We really feel we are poised for a significant win-win," Ms Singer says.

Sustainable bankers also have a unique – but perhaps shortlived – opportunity to reach out to the rest of the financial community and convince them to pay more attention to the broader social and environmental issues.

"For the first time in my lifetime, the investment community is in such disarray that there is an opportunity to change minds," says Simon Zadek, managing partner of AccountAbility, not-for-profit partnership that focuses on corporate governance and responsibility.

"It's the first time that Anglo Saxon short-termism has an alternative," he adds. "But the window will close."

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Big institutions learn to think small

OPPORTUNITIES

Developed countries have good reasons to look at the developing world, says **Mike Scott**

The world has recently lost its faith in the global financial system as an engine of prosperity, but there is one area that shines through as a success.

Microfinance, pioneered by economics lecturer (and now Nobel laureate) Mohammed Yunus in the 1970s, has improved the lives of millions of people by lending them tiny sums that enable them to take the first step on the road to financial inclusion.

The sector has developed from Professor Yunus's first loan of $27 in a Bangladeshi village to be embraced around the world. While those first loans came out of Prof Yunus' own pocket, the poorest people in the world are now, indirectly, receiving money from some of the biggest banks in the world and – through specialist investment firms such as BlueOrchard – some of the world's wealthiest individuals.

Microfinance ticks many boxes for the large institutions. "It has high social impact, it is commercially viable and it helps people to become our customers," says Maggie Crompton, head of sustainable business development at HSBC. Many banks see bringing the unbanked into the financial system as a long-term business opportunity but prefer to lend to microfinance institutions (MFIs) rather than individuals.

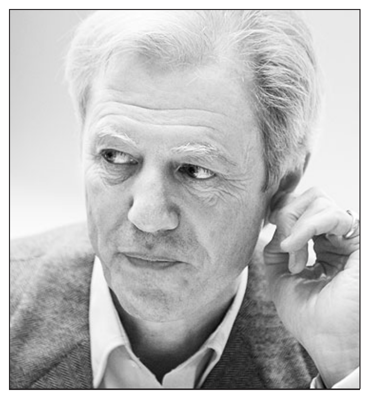
This is because serving the unbanked and underbanked is not easy, says Prashant Thakker, head of microfinance at Standard Chartered. The size of individual loans is small, the number of loans is high and it is very labour-intensive, he says, which is why the bank has taken a wholesale approach of investing in MFIs, which have the local knowledge and the manpower needed.

"We are sowing seeds," says Marcus Agius, chairman of Barclays, which is providing microfinance to Khmer communities in Vietnam as part of a £10m partnership with CARE International. At one end of the spectrum, there will be business for Barclays, he says. While at the other end: "We are trying to help people in a way that is good for them and intelligent for our shareholders."

There is a critical role for mainstream commercial banks in microfinance, says Jon Williams, a partner in PwC's sustainability and climate change team. "I am very pleased this has moved out of CSR departments to be seen as a customer segment like any other." Banks need to be realistic about profit margins available, but the sector is definitely self-financing, he adds.

Sava Dalbokov, chief executive of good.bee holding, an initiative by Austria's Erste Bank, which is rolling out mobile banking in Romania and Ukraine, adds: "We do not expect to make huge amounts of money, although it must be economically sustainable. But one day, the people we help now will be good bank customers."

While the initial focus was on loans, microfinance is now about more than lending, says Mr Thakker. "It is about developing a full commercial banking relationship." To this end, Stanchart helps client MFIs with payment and collection mechanisms and with access to the capital markets. It has recently helped one organisation with foreign currency syndication and helped another to raise money on the bond markets.



'We are trying to help people in a way that is good for them and intelligent for our shareholders'
Marcus Agius
Barclays chairman

However, to be successful, banking for the unbanked needs more than just financial products, says Jo Crawshaw of consultancy africapractice. "The right technologies and appropriate infrastructure is necessary before services can reach the unbanked."

Mobile phones are seen as a promising tool for spreading access to banking to areas that do not have any physical banking infrastructure. By 2012, there are expected to be 5bn mobile phone subscribers, with growth largely from developing countries that have the biggest unbanked populations.

In Nigeria, for example, says Matthew Talbot, vice-president of mcommerce at mobile messaging service provider Sybase 365, eight out of 10 people do not have a bank account. "A consumer's first experience with technology is likely to be the mobile phone."

Customers can add money to their Sim card by buying credits at mobile phone shops and they then have the ability to buy goods, pay bills or transfer money to someone else.

There are parallel initiatives to make it easier for foreign workers to send money home. Citigroup has developed a system for a large construction company in the Middle East where workers can have payments deducted and remitted home automatically, saving them having to queue for hours at a money transfer bureau – and saving them transfer costs.

Improving access to finance will aid development, reduce poverty and open up new markets and opportunities as more people become financially independent, says StanChart.

As EU Development Commissioner Louis Michel said at a recent conference: "The poor are not destined to remain poor forever. If they are offered opportunities, they can be entrepreneurs and consumers."

Credit crunch holds many key lessons for the future

DANGERS

Banks can benefit from the chaos – if they know what to avoid, says **Mike Scott**

The most high-profile attempt to boost financial inclusion in recent years has been in the news for all of the wrong reasons. The sub-prime crisis in the US has its roots in attempts by Bill Clinton to increase access to credit for low-income families.

So does the sub-prime debacle hold lessons for institutions looking to extend access to financial services to the unbanked and underbanked in other parts of the world?

"There is a huge difference between access to finance and predatory lending," says Greg Larkin, banking analyst at RiskMetrics. "A huge proportion of the world's population earns income, holds assets and is financially responsible but does not get the access to credit that they deserve – and that is an enormous profit opportunity."

It is generally estimated that microfinance has given about 100m people access to financial services, but that leaves 3bn-4bn people still unbanked, says Jon Williams, a partner in the Sustainability and Climate Change practice at PwC.

Murray Gardiner, microfinance and community banking strategy manager at Temenos, a provider of banking software, says: "At the moment microfinance is sufficiently profitable to attract mainstream funding that has some altruistic intent, but not [generally] sufficiently profitable to attract a more unscrupulous, predatory element. Sadly, this is likely to change, especially as microfinance becomes more complex, and especially in middle-income (such as Indonesia) to high-income (such as Mexico) developing countries." Prashant Thakker, head of microfinance at Standard Chartered, says: "There is already a feeling that in some parts of the world, the growth of microfinance institutions (MFIs) is putting stress on their governance and the systems that support them."

Good governance within lending institutions is an essential part of risk management, says John Wilcox, chairman of Sodali, a governance consultancy.

Rather than turn their backs on the underbanked, banks should learn lessons from the sub-prime episode, Mr Larkin says. The most important factor is transparency on both sides.

'These sound like basic issues but they were clearly forgotten over the past few years'

"Products that enable a poor person to conceal his income are a bad idea, as are those where the principle of the mortgage is hard to understand."

Louise Holly, deputy director of Results UK, an anti-poverty NGO, says: "Lots of work is needed to educate people who have no experience of dealing with money or financial services."

Other lessons include the need for a thorough understanding of the business and the quality of the products being offered, as well as the quality of the borrower, says Mr Wilcox. "These sound like basic issues, but they were clearly forgotten over the past few years."

Pointer for financial inclusion: the sub-prime debacle in the US cast a spotlight on the need for financial education Kimberly White/Bloomberg News

While repayment rates for microfinance loans are very good at the moment, there must be systems in place to avoid over-indebtedness, says Mr Thakker. These systems should be able to cope if people are unable to repay – and to consider the various combinations of circumstance that might bring this about. "Our advice is to temper your growth rates and choose your customers carefully," he adds.

The sub-prime problems developed partly because the uncharacteristic stability of the economy, combined with low interest rates, meant that proper analysis of the fundamentals of economic health went by the wayside, Mr Larkin says.

Some people point out that microfinance is a product very different from sub-prime loans. Balaji Iyer, vice-president, Microfinance, HSBC India, says that while mortgages are long-term loans that last for years, microfinance loans are very short-term, with most loans being extended for less than a year.

Also, mortgages are a consumer product while microloans are used for productive purchases that boost economic output and activity, says Dr Gabriel Montes-Rojas of London's City University.

Many microfinance loans are made on a group basis to a community of lenders who vet the quality of the loan and the borrower, while sub-prime mortgages were offered to individual consumers who took the full risk of what was essentially a speculative bet on the property market, Dr Montes-Rojas adds.

And yet as the sector grows it is branching out to offer a wider range of products, including micro-insurance, consumer loans and even mortgages. Most MFIs are currently financed by large banks such as Standard Chartered or HSBC, by specialist investment funds such as Geneva-based BlueOrchard or from their own deposits. However, microfinance is beginning to be introduced to capital markets, "which needed to happen," says Mr Larkin. "But it was when the sub-prime sector met the capital markets that we got the banking crisis. If you accelerate loan growth at an unsustainable rate, that is destabilising."

Beyond microfinance there are dangers, too, says Mr Larkin. In many markets, consumer credit is expanding much faster than wage growth, with Russia especially vulnerable. Consumer credit is more than 100 per cent of income in a number of countries, including many thought to be in relatively good shape such as Malaysia, South Korea and Chile. That could lay the foundation for future banking crises.

Maoism to microfinance: a journey of hope

CASE STUDY
ASA

David Chazan profiles last year's winner of the award for Banking at the Bottom of the Pyramid

One night in March 1978, seven fervent young men brimming with radical ideology swore an oath in a village west of the Bangladeshi capital Dhaka.

Kneeling, each touched the soil with one hand, holding the other to their breast. They pledged to educate groups of villagers in the hope that they would take power and turn Bangladesh into a Maoist-style state run by the rural poor.

That ceremony marked the birth of the Association for Social Advancement, better known by its acronym ASA, which means hope in Bengali.

It was an unlikely beginning for an organisation that was eventually to mutate into one of the world's most successful microfinance institutions, acclaimed for cost-efficiency and a capacity for rapid growth.

The initial change came at the start of the 1980s. ASA's founders decided that they should educate the rural poor and provide them with services.

At that time they distrusted lenders such as microcredit pioneer Grameen Bank run by Muhammad Yunus, who won the Nobel peace prize in 2006, because they thought such organisations were feeding off the rural poor. But they changed their minds after villagers repeatedly asked for small loans, such as those Mr Yunus had been providing since 1976, to help them buy cows or invest in other farm activities.

ASA's president, Shafiqual Haque Choudhury, masterminded a swift transition, says Stuart Rutherford, an expert on microcredit and the author of a recently published book about ASA. "In 1989 Mr Choudhury flipped his organisation from a service-providing organisation with mostly male members to a microcredit organisation with women members, like Grameen," says Mr Rutherford, himself a former ASA board member.

But Mr Choudhury says his approach was not like that of Grameen or other microlenders.

"We invented a new way of doing microfinance," he says. "Ours is a highly-decentralised system which is lean and low-cost."

Vijay Mahajan, chief executive of Basix, an Indian rural finance institution, says ASA is a "no-frills version of Grameen which looked at the Grameen model, improved on it significantly in terms of cost efficiency and scaled it up."

Professor Jonathan Morduch of New York University says: "No other microfinance organisation has so deeply tackled cost reduction." Mr Choudhury wrote a manual for his branch managers to guide them in almost every detail of their work.

"Branch managers can make most decisions on loans themselves," he says. "Decision-making takes less time."

The manual even specifies the lay-out and furnishings of branch offices. Each office is allowed just one table with one ceiling fan hung centrally above it – no unimportant detail in Bangladesh's humid climate.

ASA also simplified the paperwork. "We don't keep or gather unnecessary information," Mr Choudhury says. But he stresses that ASA screens loan applicants carefully to make sure they do not borrow from several microcredit institutions, a practice that has caused problems in the past.

Unlike Grameen during its early years, ASA never asked each group of borrowers collectively to guarantee the loans made to each individual member. Grameen itself has dropped the system, which sometimes led to animosity among villagers and tended to penalise good clients for defaults by others.

ASA also has a flatter hierarchy than most other microlenders. "ASA has always had just two levels: the branch and the head office, without regional offices requiring more buildings, furniture and staff," Mr Rutherford explains.

ASA also made it compulsory for borrowers to deposit savings so they would have something to fall back on and there would be fewer defaults.

This made ASA less vulnerable to the natural disasters to which Bangladesh is prone.

After unusually severe floods in 1998, Grameen repayments declined and it had to borrow more than $60m.

It was a Financial Times article written by this journalist while based in Dhaka that helped to alert the wider donor community to Grameen's difficulties.

Grameen from 2001 made a number of significant changes, including encouraging savings more actively. Today deposits at the bank exceed the value of loans outstanding and Grameen is self-sustaining.

"ASA figured out how to do things on a commercial basis and they avoided making the same claim as Grameen that microcredit was ridding the world of poverty," Prof Morduch says. "The hype has not been useful."

Mr Mahajan of Basix agrees. "Microcredit has value but it's been over-hyped. Grameen was criticised for overstating its self-sufficiency when in fact it absorbed a lot of donor money. Now it has learned from the criticism and from newcomers."

ASA of Bangladesh stopped accepting donor funding in 2001 and it now serves more than 6m borrowers from more than 3,000 branches around the country.

ASA International also works in a number of other Asian countries and in Africa.

Last year it secured $125m in capital commitments from institutional and private investors, including major funds in the US and Europe – the largest-ever collective equity capital commitment to microfinance.

Institutions lead the way in investments

INVESTORS

Socially responsible funds have held up well in the crisis, says **Deborah Brewster**

Socially responsible investing, a lynchpin of the sustainable investing model, appears to be enjoying strong growth among institutional investors, especially European pension funds. However, it is less popular among US retail investors.

European sustainable and responsible investment assets under management rose to a high of €2,600bn ($3,600bn at current exchange rates) at the end of 2007, more than twice the level of two years earlier, according to the European Social Investment Forum, an industry organisation. Since then, the funds' assets have fallen slightly along with financial markets.

European investors account for more than half of total global socially-responsible investments (SRI), according to the forum. Dutch pension funds are especially active. The US, despite being the largest region in assets under management, accounts for less than 40 per cent of total SRI.

Paul Hilton, director of advanced equities research at Calvert Funds, one of the largest SRI fund managers, says: "The institutional market has been growing much faster. Pension funds are starting to catch on in the US, and foundations too.

"We're putting a lot of resources into the institutional business," he says. Calvert manages $10bn on behalf of 400,000 investors.

SRI funds have recently become extremely popular in France, where in five years they have tripled their assets to about €20bn. However, that still accounts for only 1 per cent of total fund assets in France.

And despite much talk about SRI funds in the US, in the past five years US retail funds do not appear to have grown any faster than the rest of the industry.

Total net assets of SRI funds in the US stood at $41bn by April 2009, according to Morningstar, a fund tracker – a rise of 29 per cent since 2003. The entire fund industry, meanwhile, rose by 31 per cent over that time, to $5,700bn.

However, SRI funds have overall held up well in during the financial crisis, with proportionately smaller outflows than the rest of the industry.

Of 183 SRI funds, 109 had net inflows during 2008, according to data from Strategic Insight, a research firm. That is a much better result than the industry average.

Mr Hilton says: "Over the last year there has been a lot of concern over corporate governance, and the SRI funds have largely managed to shield investors from some of the worst of that.

Also, he says: "SRI investors are more likely to be 'sticky', so the funds have higher investor retention rates. We see SRI funds generally hold up better in down markets because investors are more committed to the full story, they are not just chasing performance."

He and others say the relatively robust state of the funds is also due to an upsurge of interest in green funds, which is the latest trend to emerge.

Calvert's Global Alternative Energy fund, a "green" fund, had inflows of $174m last year, he says. This was despite the small fund's volatile returns.

The performance of SRI funds does not appear to be any better than other non-SRI funds. There have been several attempts to measure performance, but there is no consistent evidence that investing according to SRI principles outperforms using non-SRI methods of investing.

Screening out tobacco stocks remains the single most popular veto used by SRI investors. Divesting stocks that have interests in Sudan has become the fastest-growing screen, following a strong push from activists over genocide in Sudan's Darfur region. Green investment funds, which are increasingly popular, do not necessarily screen out companies on social or governance grounds.

A recent report by Trucost, a research firm, examines the carbon footprints of leading US mutual funds, and says that the carbon intensity of mutual fund holdings varies hugely.

The highest-carbon fund is 38 times more carbon intensive than the fund with the smallest footprint.

> There is no consistent evidence that investing according to SRI principles outperforms using non-SRI methods of investing

The combined global emissions associated with fund holdings amount to more than 615m metric tonnes of greenhouse gases, the report says.

Issues such as carbon emissions have only recently been elevated in importance by SRI funds, which have traditionally considered environmental issues along with labour issues, corporate governance and social issues.

The strategies are becoming increasingly sophisticated and have long since moved beyond the practice of screening out half a dozen tobacco and defence stocks.

Pension funds, endowments and foundations are increasingly under pressure from board members to consider SRI implications of their investing.

Mr Hilton says: "Maybe I'm optimistic, but I think we are just seeing the tip of the iceberg in SRI growth."

Big footprint: combined global emissions associated with fund holdings amount to more than 615m tonnes of greenhouse gases, a report claims Wolfgang von Brauchitsch/Bloomberg News

IFC foresees a bigger role in wake of global crisis

INTERVIEW
LARS THUNELL

The International Finance Corporation chief talks to **Tom Braithwaite**

Lars Thunell was in rural Maryland when the world changed. The chief executive of the International Finance Corporation was holding his organisation's annual strategic retreat last September and swiftly changed the agenda to address the financial crisis.

As part of the World Bank, the Washington-based IFC focuses on loans to the private sector – backing projects in developing countries and working with local and international banks.

As the former head of Sweden's "bad bank" – set up to right the country's floundering banking system in the early 1990s – Mr Thunell was under no illusion about the fallout from the collapse of Lehman Brothers on September 15.

With the failure resounding around the world the concern of the IFC was – and has been since – the fate of business in developing countries.

"In terms of the financial crisis and the immediate effect, the need for IFC is bigger than ever – many commercial banks have pulled back from emerging markets at the same time as the need for financing is increasing," he says.

It is not just commercial banks' flight to safety that has endangered projects in poorer countries but the nature of the global financial rescue efforts, which have targeted countries at the expense of companies.

At April's Group of 20 meeting, leaders from large economies agreed to boost the lending capacity of the International Monetary Fund to ensure that someone stepped in as private capital retreated from regions such as eastern Europe and governments struggled to cope.

But, says Mr Thunell, the extra funds available to the international financial institutions such as the IMF and the World Bank have obvious limitations. "If you look at what's happening at the international financial institutions – including the IMF – they're getting additional resources. Many of the multilaterals are focused on helping the governments. You have a crowding-out effect of the private sector."

It comes amid a shift in IFC investments towards "frontier" countries in greatest need. In 2006, the IFC lent $6bn to the poorest countries; last year it was $11bn-$12bn. In 2006 a quarter of projects were in countries with an average gross domestic product per capita of less than $1,000 a year; this year, says Mr Thunell, it will be over 50 per cent.

That shift began before the crisis and it certainly is not charity. "That's where we have good financial results," says Mr Thunell. "We're not subsidising, we're supporting good projects." He also rejects the notion that the presence of the IFC competes with or discourages other sources of capital, pointing to the rule of co-investment in the IFC's charter.

"From a competitive advantage point of view, our role is to crowd the private sector in," he says. This can mean operating on the Paraguayan banking system or the Uganda mortgage market. Increasingly, it means projects in less-developed countries.

Thunell: 'You have a crowding-out effect of the private sector' Mario Vedder/Getty Images

> 'We have to think about what is the world after the crisis and where are the business opportunities going to be'

But grand projects in countries higher up the development league table are also continuing – especially if they fulfil the IFC's remit to consider schemes that could have a positive impact on the environment.

A €55m investment for Turkey's biggest wind farm in May saw the IFC partnering with multilaterals, including the European Bank for Reconstruction and Development. Commercial banks were notably absent.

For all the overwhelming attention garnered by the financial crisis, Mr Thunell is adamant – in a sentiment shared with US President Barack Obama – that support for renewable energy projects and other environmentally-positive schemes must carry on alongside an economic response.

"We have to address both of them and it's really right at the core of our mission," he says. "People try to say you have to choose one or the other but we have to do both. We have to think about what is the world after the crisis and where are the business opportunities going to be. There are going to be massive needs related to climate change."

Business opportunities that come as a result of climate change – or as a means to mitigate the impact – will be in frontier countries too. Those, after all, are the geographic regions often least able to cope.

Mr Thunell is determined that more should be done to generate foreign investment and trade between developing countries.

He says this need has been made clear after the "decoupling" of the big global economic blocs proved to be a myth in the past two years, with problems at US banks quickly spreading around the world. "There is going to be a rebalancing in the relationship between China and the US" to mitigate the glut of saving in China and spending in the US, he says. "And that means the world cannot rely on the consumers of the US."

Value of awards shines in the gloom

Guest Column
JOHN WILLMAN

Sustainable banking? The turmoil in the world's financial markets over the past 18 months makes the concept seem like an oxymoron.

Yet the scale of entries for this year's FT Sustainable Banking Awards shows that it is in exceptional circumstances such as these that the commitment of the financial services industry to sustainability emerges – and the value of the awards can be appreciated.

There was scepticism about the project when it was launched four years ago, through a unique partnership between the Financial Times and the International Finance Corporation.

Smaller institutions feared the prizes would go to the global giants, with their slick marketing of sustainability policies and their access to generous funding in an era of cheap credit. Non-governmental organisations pooh-poohed the idea of giving any but the purest, greenest banks the title "sustainable bank of the year".

Some still fear that the awards will encourage "green-washing" and some of the winners in the first year or two of the awards were indeed banks whose names were familiar around the world. Yet as entries have risen, an increasing number of smaller organisations – many from emerging markets – have been recognised.

Then last year, Banco Real of Brazil was declared to be sustainable bank of the year, the first time that an emerging market institution won the top award. It reappears in this year's shortlist under its new ownership as part of Grupo Santander, along with the first Chinese bank to reach the final stage in this category.

The growth in entries has also been impressive. The first year's field of 90 entries from 48 banks in 28 countries was a respectable start, but it quickly rose to 151 entries in 2007 and to 182 last year – from 129 institutions in 54 countries.

New categories such as Sustainable Investor and Banking at the Bottom of the Pyramid for those serving the 4bn people living on less than $2 a day drew entries from outside the world of banking. Tiny microfinance organisations whose small loans and insurance policies empowered a new generation of entrepreneurs in emerging markets began to enter.

This year's awards cover 2008, a year when the world's financial system appeared close to collapse.

> 'It quickly became clear institutions had recognised the need to become more sustainable'
> **John Willman**

It is hardly surprising that the organisers of the awards feared a dramatic fall in entries.

Certainly some of the global groups that had featured in previous years decided they would not enter the 2009 awards – the fight for survival had made further progress towards sustainability difficult.

Yet 117 institutions from 42 countries submitted 165 entries, a fall of less than 10 per cent. While the field was dominated by smaller institutions, there were still many large international groups.

Even in the short history of the awards, sustainability has become part of more and more banks' licence to do business. The quality of the entries has jumped each year, and there has been fierce competition.

After four years as co-chairman of the judges, this is my last year of involvement. I will admit to some scepticism when I was first asked to join the judging panel. As a former Banking Editor of the FT, I had a somewhat jaundiced view of the industry and shared some of the doubts of the non-governmental organisations about its commitment to sustainability.

Yet it quickly became clear that institutions from the largest to the smallest had recognised the need to become more sustainable. In some cases, they had learnt through being involved with projects whose lack of sustainability had damaged their businesses. But in many others, there was a deep-seated commitment by staff at all levels to make their institutions more sustainable.

Year by year, the judges – who bring many different perspectives to the panel – have become more rigorous in reaching their decisions.

They recognise that sustainability is not an end but a journey. The world faces great threats from climate change and from the poverty that scars many continents, and others will no doubt emerge.

Yet the fact that the financial services industry continues to develop more sustainable practices even as it struggles with the biggest global economic crisis since the second world war should be cause for optimism. There is no certainty of success, but some of the best brains in banking around the world are at least asking the right questions.

John Willman is co-chairman of the 2009 FT Sustainable Banking Awards and a former FT journalist.

Resource shortages yield investment opportunities

AGE OF SCARCITY

Environmental and population shifts need to be understood, writes Mike Scott

Environmental problems are combining with global population growth to create shortages in food, energy and water – our most fundamental commodities.

In 2008, the world had a taste of resource constraints – oil priced at $147 a barrel and sharp increases in the price of many foodstuffs. Since then, prices have dropped sharply. While this has eased pressure in some areas, the volatility of prices is bad for businesses everywhere, particularly small farmers in emerging markets.

Knowing what environmental changes will occur and how to deal with them is crucial for banks and their customers. In a recent report on Banking and Climate Change by Swiss group Sustainable Asset Management, Matthias Kopp of the environmental group WWF says: "Growing global environmental and social challenges are posing future risks of dramatic magnitude and consequence. These risks are of material significance for financial markets, especially in a resource-constrained world."

Alex Barratt, head of research at Standard Chartered, says "Because we operate in emerging markets, the issue of sustainable growth and the environmental aspects of that are vital. If we do not have sustainable policies in our markets, they are not going to grow and the financial sector will not grow."

Water is the most pressing issue. Climate change means drinkable water will become scarcer, rainfall distribution will change and there will be more floods, more droughts and more storms. The key to coping with changing conditions is information, and a number of companies are providing data on the changing climate and its impact on the economy.

This information highlights apparent absurdities such as Saudi Arabia growing wheat using desalinated water while the US subsidises farmers to grow biofuels, says Mr Barrett. It is far more efficient for Saudi Arabia to produce oil for fuel while the US grows wheat. But recognising the problems with growing water-intensive products in water-stressed areas will also have far-reaching consequences for big agricultural producers in areas such as California and Australia, which face increasing water scarcity.

Environmental consultancies such as WSP Environment & Energy provide tools to help businesses work out the stress points in their supply chain.

"Banks and investment houses that understand how climate change will affect business will have a competitive advantage, enabling them to invest in the right areas and avoid the wrong ones," says David Symons, director of corporate services at WSP Environmental.

Investors have a big role to play, he adds. "There is a very substantial adaptation gap in the world at the moment. Companies will start taking this more seriously if investors start asking probing questions about how well companies are prepared to deal with climate change."

Eckhard Plinke, head of sustainability research at Bank Sarasin, the Swiss private bank, says: "The economic and social risks associated with scarcity result in interesting investment opportunities." These include energy efficiency and renewable energy; water purification and water efficiency; and agricultural technologies such as irrigation and fertilisers.

For some banks, this is a long tradition. Rabobank, established in the late 19th century to provide financial services for Dutch farmers, is now replicating that model in emerging markets, says Arnold Kuijpers, head of Rabobank Development.

"Demand for agricultural products will grow exponentially because of the growth of the world population and the increase in wealth in emerging markets," Mr Kuijpers says. Over the next 30 years, there will be significant trade flows from places such as Mozambique, which is using only 15 per cent of its vast resources of agricultural land, and China, which has a quarter of the world's population but only 8–9 per cent of the arable land.

The sector is inherently risky but companies such as Swiss Re are helping farmers to manage unpredictability with weather insurance. In Malawi, for example, working with the World Bank, Swiss Re has created a scheme whereby it will pay out up to $5m in the event that Malawi's farmers suffer from a drought-related shortfall in maize production.

Another approach to the perennial volatility of the commodities market is taken by Credit Agricole Asset Management. Rather than invest directly in commodities, it invests in the companies that produce them. "We do not want to invest in a speculative way, looking for quick wins," says Anne Ruffin, head of CAAM's global resources fund. "Last year's massive commodity price rises were in no one's interests. The only way to manage resource scarcity cleverly is to help commodity producing companies to grow their resources and expand their markets."

Rabobank's CSR director Ruud Nijs sums up the way forward: "Our clients' CSR risks are huge opportunities for us. Sustainability is the new way of banking – banks will not survive unless they have this as a long-term strategy."

Thirst for solutions: the prospect of more floods makes the need for safe water more pressing AP Photo

> 'The only way to manage resource scarcity cleverly is to help commodity producing companies grow their resources'

Brazilian lender focuses on both profit and growth

CASE STUDY
BANCO REAL

Jonathan Wheatley profiles last year's overall winner

Jeronimo Ramos, a director at Banco Real in São Paulo, sounds like a man with a mission. "You have to operate inside local communities. You have to know your customer's story at first hand. Because by giving people credit, you are creating well-being. About 70 per cent of people that get credit are lifted out of poverty as a result."

Yet as Mr Ramos insists, Banco Real is not in the business of delivering social services. "We are not a philanthropic organisation," he says. "You don't just give people credit because they need it. They have to be able to pay. We're here to make a profit."

Banco Real was named Sustainable Bank of the Year by the FT in 2008, beating competition from banks in Europe, Asia and Africa where microfinance – lending small amounts to small and very small businesses – is more developed.

Yet Banco Real is not typical of low-income banking in Brazil as a whole. Its model is similar to that found in Asia, Africa and the rest of Latin America: giving loans to small businesses to promote development from the ground up. But the fastest expansion of low-income banking in Brazil has been in making small loans to consumers rather than to businesses.

The sector received a huge boost at the start of this decade, when the government began tackling the problem of access to the banking system for huge sectors of the population that were too poor – and too intimidated – to step inside a high street bank.

Its solution was to encourage "correspondent banking" – creating outlets offering simple banking services such as taking deposits and accepting bill payments. One network is Banco Postal, run by Bradesco, a big private bank, through Brazil's nationwide network of post offices. Another was run by Banco do Brasil, a big public-sector bank, through its branch network. Others, such as Lemon Bank, a private-sector initiative, set up kiosks at petrol stations, bakeries and shops.

"Brazil is certainly a world leader in increasing the number of access points," says Martin Holtmann, chief microfinance specialist at the International Finance Corporation, the division of the World Bank that lends to the private sector. "I don't think there's any country in the world to compare with Brazil's 95,000 access points – even in the most remote villages."

The government also created funding for low-income banks, allowing them to use 2 per cent of their reserve requirements – the share of their deposits that they must park at the central bank – for lending at interest rates capped at 4 per cent a month. That is low by Brazilian standards, where rates to consumers can be as high as 20 per cent a month.

> 'I don't think there's any country in the world to compare with Brazil's 95,000 access points'

Microfinance banks in other parts of the world had demonstrated that the poor make surprisingly good borrowers. But Brazil's experience was different. Banco do Brasil created a subsidiary, Banco Popular do Brasil, offering simplified bank accounts and easy access to cheap loans. Non-performance rates were much worse than expected and the subsidiary was soon absorbed back into the main bank.

Robson Rocha, director responsible, says the bank learned a lot. It operates three types of credit: "free" credit, for any use at the borrower's discretion; "directed" credit for small and very small businesses; and community development initiatives, where credit agents work with local bodies such as farming and fishing co-operatives. Non-performance, he says, is in line with the broader market in the first sector but much less in the others.

Banco do Brasil declines to reveal non-performance rates. But its experience is mirrored at Banco Real, where Mr Ramos says non-performance of microfinance, at about 3 per cent, is lower than the broader market, at 8 to 10 per cent.

One reason for Banco Real's success is that it does not restrict itself to small loans. As businesses grow, they are allowed to take on more credit.

In Heliópolis, a shanty town on the outskirts of São Paulo, Almir Araújo is a typical customer. His first loan from Banco Real was for R$250 ($122), in 2000. At the time, he ran a bar in a room in his house. Now, two streets away, he has an internet cafe and a DVD rental shop. His latest loan was for R$20,000.

"Banco Real grows along with you," he says. "If you have the structure to support a loan of R$1,000, that's what you'll get. If you have the structure for R$20,000, you'll get it."

Green risks and rewards: grounds for optimism

Viewpoint
STEVE HOWARD

The world is taking a temporary holiday from growth. But the economy will bounce back, doubling or tripling in size by mid-century.

Over the same period we will have developed policy frameworks that lock us into reducing global greenhouse gas emissions by 60 to 80 per cent. There will be about 2bn more people and the world's urban population will have almost doubled.

If we put it all together, all future growth will either need to be low or zero carbon growth – and the financing will have to match it.

In the past few months, the financial crisis and the election of Barack Obama to the US presidency have recalibrated global debate. With a climate champion in the White House, the global shift to a low-carbon economy will increasingly favour low-carbon players, whether they be companies, cities or states or nations.

The current financial crisis creates an opportunity to build a future that is less dependent on carbon and the uncertain price of fossil fuels. As bail-out packages are raised around the world, national leaders are increasingly aware of how their economies are interconnected and that they must work together to overcome common hurdles such as climate change.

A sizeable chunk of the stimulus packages – 15 per cent, according to a recent HSBC report – has been allocated to greening the recovery. The $3,000bn global bailout puts into perspective the price of tackling climate change, estimated at about 1 per cent of GDP by Lord Stern, UK government adviser on the economics of climate change.

The international flow of support from industrialised to developing countries to help finance the costs of shifting to low carbon growth and adapting to the consequences of climate change is estimated at around $100bn.

Green stimulus packages have set the context for further investments to follow. The global finance sector needs to not just manage climate risk, but unlock the economic opportunities presented by climate change.

New low-carbon technologies such as LED (light emitting diode) lighting and electric vehicles are capital-intensive in the short term, but give strong predictable returns over time. The rapid scale-up of these technologies requires new approaches to financing and there is an increasing need for global financial institutions to understand.

There are causes for optimism. Late in 2008, some of the leaders in sustainable finance launched the Climate Principles – an over-arching framework to develop best practice on climate change within the finance sector.

A key question that the adopting group of financial institutions is trying to answer is which policies should be prioritised to help the finance sector support the transition to a low-carbon economy. Similarly, finance leaders and organisations, such as IIGCC (Institutional Investors Group on Climate Change) representing €4,000bn of assets under management, recognise that putting a stable cost on carbon and ambitious caps on emissions are critical to the behaviour change required to deliver such a huge economic transition.

> 'Europe risks panting along in third place'
> **Steve Howard**

The carbon market looks set to expand from current European leadership into the US and Australia. The finance sector should be signalling real support for a global carbon market, not just for the trading opportunities, though these are considerable, but because it is the best mechanism we have for stimulating a low-carbon economy.

China and the US are entering a competitive race to lead the world's transition to a low carbon economy, and are already demonstrating extraordinary low-carbon growth. Europe, after an early lead, risks panting along in third place.

Supported by an increasingly strong and comprehensive low-carbon policy framework, China is making progress reducing its carbon intensity and building capacity to supply the world with low-carbon technology. It is the world's leading renewable energy manufacturer, the top maker of wind turbines and a leading manufacturer of solar technology.

Under Mr Obama, the US is under starter's orders to join the new technology race. The lumbering heavy manufacturing industries of the Midwest need to be re-skilled to compete in the clean-tech future. Silicon Valley is fast becoming low-carbon valley, with a host of venture capital clean-tech companies.

The shift to a low-carbon economy promises to be every bit as transformative as the internet, but on a bigger scale.

It may be difficult for our cash-strapped, risk-averse financial institutions to raise their gaze from the current recession to focus on the looming climate crisis. But the prize for doing so will be low-carbon prosperity and new markets. Financial institutions will need to put their best people on it.

Steve Howard is chief executive of The Climate Group and chair of the World Economic Forum's Global Agenda Council on Climate Change.