What is...
ethical banking?

BANKTrack

"Ethical banking" refers to financial services that are designed to promote equity and sustainable development. So-called 'ethical banks' believe that profitability should not only be measured in financial terms, but also in social terms. In principle, the term "banking" refers to services like deposit taking and payment services. But in practice, the financial services offered by these ethical banks go beyond mere banking to include investment and insurance services. Increasingly, traditional banks are beginning to offer ethical products as well.

Ethical banking

Ethical banks offer customers the ability to open an account and lodge their savings as a basic or time deposit. With basic deposits, customers are able to withdraw their money at any time; with time deposits, they are restricted from withdrawing their funds before a certain date. Most ethical banks have developed special saving products that seek to promote sustainable development. For example, customers may let the interest on their savings be (partially) transferred to environmental or human rights NGOs, or to a specific environmental project.

Ethical banks in turn use the deposits at their bank to make loans to households and companies, like any other bank. However, in contrast to regular banks, the borrowers are usually screened on sustainability indicators. For example, some ethical banks particularly grant mortgage loans to properties that provide an "ecological payback," such as old houses that are being renovated or new eco-friendly homes. So-called "community investment" or "community development" banks direct their funds to borrowers that are neglected by traditional banks, or projects that have a social mission (e.g. affordable housing, women-owned small businesses or educational institutions).

In addition, ethical banks often offer their clients bank cards and credit cards, which may not contain PVC.

Ethical investments

Ethical banks, as well as regular banks and investment companies, have developed all kinds of "ethical funds" [also called "socially responsible investment" (SRI), social or green funds]. These funds invest in financial assets just like a regular mutual fund. But in contrast with a regular fund, ethical funds look very closely at the entities issuing the securities. Different indicators are taken into account to judge a firm or organization's sustainability, including: (1) How it operates in-house: the social and environmental aspects of its own operations such as labour and work conditions, recycling and energy consumption; (2) How its policies, services and products impact society; and (3) how the issuer actively helps promote sustainable development: e.g. by designing new products that favour better social or environmental practices.

On the basis of these data, funds then use different strategies to select the firms or entities to invest in:

- **Exclusion mechanism or negative screening.** Ethical funds can exclude entities with unacceptable policies, practices, or products/services. For example, funds may reject companies on the basis of poor human resource policies or wasteful energy consumption. Some funds have stated NOT to invest in World Bank bonds, and companies involved in arms trade, animal testing (medical and cosmetic), fur, tobacco, pornography, oppressive regimes, environmental destruction, nuclear power and gambling.
- **Positive screening.** Ethical funds also can choose to actively support entities that have the right social and environmental policies in place (employee-friendly working practices, open management, waste management etc.) Moreover, they may actively seek to finance companies that promote environmentally friendly

- products, employee education and training, worker health and safety, and renewable energy.
- **Best of class.** Increasingly, ethical funds are deciding to invest in companies that do well compared to other companies in the same sector.
- **Engagement.** Many ethical funds use their ownership power in companies to advocate for more sustainable corporate practices through dialogue or filing shareholder resolutions.

Ethical insurance

In addition to banking and investment services, some ethical banks also offer 'ethical insurance' services. Clients can purchase insurance against illness, retirement, or car accidents just like at any traditional insurance company. In contrast with regular insurers however, ethical insurers invest their received insurance premiums according to an ethical investment policy. In addition, some insurers and re-insurers are increasingly realizing that environmental phenomena like global warming will pose financial threats to the insurance industry, since insurers will increasingly face claims related to severe weather events such as floods, increased precipitation or drought. Some "ethical insurers" have therefore actively sought to finance more environmentally friendly activities, such as renewable energy or projects that promote the use of bikes and public transport instead of cars.

Trends & Critical Issues:

- **Increase in popularity.** Ethical banking has seen an enormous rise, especially since the 1990s. In particular, ethical funds have been popping up all around the world. According to SiRi, a global network of corporate social research firms, as of June 2004 there were 354 green, social and ethical funds in Europe -- 13% more than in the prior year. Total assets under management of these European SRI funds accounted to EUR 19 billion. Despite this enormous growth, ethical funds still represent only 0.47 % of the total assets managed on the European continent, as well as globally.
- **Government policy** can help promote ethical banking. Government policy can provide incentives for people to use ethical banking services. For example, in the Netherlands, investors are exempt from interest and dividend income tax on certain green funds that fulfil environmental criteria laid down by the government.
- **Truly green?** There are substantial differences in what SRI funds invest in. Standardized criteria for social or green funds do not exist and therefore fund managers, and sometimes governments, are setting their own terms of reference. European green, social and ethical funds often include shares of Vodafone, Pfizer, Johnson & Johnson, GlaxoSmithKline, Microsoft, Royal Dutch Petroleum (Shell), Astrazeneca, BP and Nokia. Many of these companies are subject to NGO protests. Some observers have thus identified the need for clearer standards and supervision to ensure that ethical funds are truly ethical. EuroSIF (European Social Investment Forum) has designed guidelines that fund managers can use to provide more clarity around their SRI funds. For example, EuroSIF encourages funds to be more open as to how they define Socially Responsible Investment in the first place, what exact criteria they use to select their investments, and how they perform their research.

More info

www.triodos.co.uk (UK based ethical bank)
www.bancaetica.com (Italian ethical bank)
www.communityinvest.org
www.siri.org
www.naturesave.co.uk (UK based ethical insurer)
www.eurosif.org
www.socialinvest.org
www.wbbeurope.org/alternatives.php (survey of ethical banks)

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