SIXTH REPORT

Ethical and Value-Based Finance in Europe

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Preface

Teresa Masciopinto, president of Fondazione Finanza Etica

Ethical and value-based finance is distinguished by certain fundamental principles, notably transparency, participation, inclusion, access to credit, and real economy, among others. However, ensuring that ethical finance truly upholds its values in practice remains a challenge. Is there full coherence between the stated principles and the day-to-day operations?
Currently, we are facing a situation where greenwashing and social washing are prevalent, especially in the financial sector. Prominent global banking groups engage in a competitive display of sustainability claims, joining zero-emissions networks, professing commitment to climate and society. However, recent research and reports show that these declarations often lack substance and do not align with the actual actions of these banking entities.
In the realm of ethical and value-based finance, the pivotal distinction rests upon those key principles mentioned earlier, with transparency and participation at the forefront. Let us consider Banca Etica, for instance: it publicly discloses a complete list of financial agreements with legal entities, enabling scrutiny of the allocated funds. Nearly fifty thousand members actively participate in the bank's affairs, thoroughly assessing the environmental and social impact of every financing proposal.

Ethical finance is no longer a niche for a select few, but an ever-growing movement with its own strength

This 6th Report provides concrete figures, demonstrating a deep and consistent alignment between the stated principles and everyday operations. Moreover, when comparing ethical and value-based banks to the broader European banking system, the report emphasises significant and substantial differences.
The data in the report reveals significant differences between apparently similar institutions. Some institutions prioritise solely on maximising profits, while other adopt a more thoughtful approach, considering both the economic and non-economic consequences of their banking operations. The first group refers to significant European banks, while the second group consists of ethical and value-based banks. The data is published in Part 2 - Number, Facts where the two groups are compared in terms of profitability, credit-to-total-assets ratio, and other criteria.
Such differences cover every aspect under consideration. Each year, as the report reaches its sixth edition, it updates statistics and data related to credit accessibility, financing the real economy, and other indicators that reveal a bank's genuine service to the economy and society by collecting savings and providing credit. Additionally, each edition delves into specific themes and aspects of banking activities. Over the years, we've explored topics like climate and divestment from fossil fuels, arms financing, equal opportunities, speculation, and various other areas.
The research is a collaborative effort between Fondazione Finanza Etica in Italy, Fundación Finanzas Éticas in Spain, and the Federation of Ethical and Alternative Banks in Europe (FEBEA). Its primary purpose is to serve as an educational and informative tool for those interested in exploring the realm of ethical finance in Europe. It aims to show how cultural and operational aspects can come together to create a financial system that benefits both society and the planet. The primary aim is to highlight how the finance system is built through the seamless integration of cultural and operational elements, contributing positively to both society and the environment.

This particular edition is designed with the upcoming European elections and the renewal of the European Parliament and Commission in mind. The report provides a database to demonstrate how ethical and value-based finance is no longer a niche for a select few, but an ever-growing movement with its own strength. It aims to inspire and influence the entire financial system. Therefore, we hope that European institutions will support and foster its development. Unfortunately, even today, we often witness rigid, one-size-fits-all rules tailored to the larger financial groups.
In this latest edition, our aim is to clearly show that a crucial factor for the success and credibility of ethical and value-based finance - including when making appeals to European institutions - lies in the alignment between words and actions. Regrettably, such integrity is rare in the current banking and financial landscape.

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Foreword

Anna Fasano, president of Banca Etica

The European and international dimension is fundamental for ethical finance institutions. Banca Etica emerged from the collective experience and dedication of various movements and organisations, including fair trade, microcredit, and fostering solidarity between the global North and South. It can be said that this dimension is ingrained in its DNA.

Today, we are called to think on a European scale for various reasons. Firstly, the rules governing banking and the financial system are primarily shaped in Brussels and Frankfurt.

If the mission of ethical and value-based finance includes influencing and transforming the financial system, it is crucial to seek **dialogue and collaboration** with European institutions and other stakeholders in the social economy, environmentalism, and civil society at large.

The landscape of ethical finance remains relatively small to undertake this task individually. This is why we have been collaborating with FEBEA, the European Federation of Ethical and Alternative Banks, for over twenty years, where Banca Etica stands as one of its founding members, and GABV, the Global Alliance for Banking on Values. Networking with our peers is crucial to amplify the voice of ethical and value-based finance and foster dialogue with European institutions and other social actors. Moreover, it allows for continuous exchange of best practices with other ethical and alternative finance entities, enabling the sharing of proposals and ideas, both in operational choices and cultural perspectives. In summary, one of the strengths of ethical finance lies in its collective endeavour and the ability to collaborate within networks.

Balancing the operational and strategic-cultural aspects is a central challenge. We have recently witnessed the importance of maintaining this dual dimension in the European context, particularly regarding the path embarked upon a few years ago to define and establish **sustainable finance**. This was a path we have welcomed from the very beginning. One of the primary reasons was the opportunity to establish clear and widely agreed criteria for what falls under the umbrella of sustainable finance. Unfortunately, even today, we still observe a significant amount of inconsistency, where each bank can adopt its own definitions of sustainability. These definitions are often tailored to fit specific needs and can open the door to greenwashing.

In terms of content, the European path began with strong foundations. It involved extensive and thorough work to establish an environmental taxonomy, examining the impacts of each activity on climate, biodiversity, oceans, and other areas. For each sector, the analysis focused on identifying positive effects and applying the principle of "do not significantly harm".

At the same time, the process was marked by certain limitations that we highlighted in a document drafted in collaboration with FEBEA a couple of years ago. These limitations encompassed the failure to consider specific impacts of the financial system, ranging from short-term horizons to the potential for instability and crises. Moreover, the approach focused only on individual financial products, failing to consider the overall behaviour of the providers of those products. Unfortunately, in recent months, this approach has become even more weakened, leading to the controversial decision to include gas and nuclear power in the category of financially sustainable products. This decision contradicts the recommendations made by expert committees on sustainable finance appointed by the EU Commission, which had advocated for their exclusion in various cases.

> ***Networking with our peers is crucial to amplify the voice of ethical and value-based finance and foster dialogue with European institutions and other social actors***

On a broader scale, a relentless lobbying campaign has gradually undermined the entire process. We hold a strong belief that for sustainability finance criteria to be effective, they must be both transparent and enforceable.

One of the main criticisms, as mentioned, revolves around the product-centric approach adopted by the EU. In other words, the European framework focuses on assessing the sustainability of individual financial products, without considering the overall sustainability of the providers.

This approach allows companies in the sector to offer a few sustainable products while the majority remain non-sustainable.

This approach seems to contradict the EU's goals of promoting sustainable finance and directing capital flows towards greater sustainability. It is difficult to envision meaningful progress in this direction when banks and financial managers can simply offer a few sustainable products to meet market demand while the majority of their offerings still have significant environmental and social impacts.

The exclusive focus on the environmental dimension, or even the narrow focus just on climate change, represents another significant limitation. While addressing climate change is crucial and urgent, **sustainability must be approached comprehensively**. We strongly support the urgent development of a social taxonomy and the inclusion of governance-related issues alongside the environmental taxonomy. Ensuring coherence across all activities and financial services is crucial for ethical finance.

The need for such a comprehensive approach is not only urgent but also crucial in countering the extensive greenwashing prevalent in the sector. Almost every banking group or financial manager emphasises its commitment to sustainability and environmental responsibility in communication. However, the same institutions continue to finance fossil fuels with billions of euros each year. This inconsistency poses a serious threat to the future of our planet.

The climate crisis is just one of the challenges we are currently facing. We must also address issues such as growing inequalities, gender balance, and access to credit for vulnerable groups, among others. Additionally, the issue of disarmament is of great importance, as the financial system plays a prominent role in supporting a sector with devastating impacts on the planet as a whole. Finance bears immense responsibility for each of these challenges and has the potential to transform from being part of the problem to becoming part of the solution.

It is paradoxical to label the mainstream model as 'significant' finance if the true essence of finance lies in its role as a supportive instrument for the economy and society as a whole

To achieve this goal, a **dual approach** is essential. The first involves a top-down approach, promoting rules and regulations that redefine finance as a tool in service of the economy and the planet. The second approach involves a bottom-up perspective, starting with self-reflection on our individual financial choices and recognizing the potential impact, whether positive or negative, when we entrust our money to a bank or financial manager.

Ethical and value-based finance has consistently embraced these two approaches, and our commitment will continue beyond the upcoming European elections. We will work to urge European institutions to recognize and advocate for a different financial system. In this context, we believe it is crucial for the European Parliament and Commission to prioritise the revision and strengthening of sustainable finance after the 2024 elections.

As highlighted earlier, it is essential to establish regulations that counteract speculation and the short-term focus inherent in a financial system that frequently encounters crises and instability. Interestingly, it is during such crises that we witness massive interventions and bailout plans implemented by public institutions, creating a paradox within a system that simultaneously advocates for continuous deregulation.

Ethical finance stands in direct contrast to the conventional financial system. In recent years, ethical finance institutions have shown their efficacy, not only in terms of their positive social and environmental impact, but also in relation to their economic and financial performance. Previous iterations of this report on ethical finance in Europe have underscored how these institutions not only work 'as banks' but also excel in comparison to traditional counterparts. One significant difference can be observed in loan-to-asset ratio, a proxy of how effectively banks use their resources to support the economy. It highlights a clear divergence between the two models, with ethical finance institutions outperforming their traditional counterparts. Moreover, a range of other indicators consistently reinforce this prevailing trend.

Even in terms of profitability, ethical banks have demonstrated superior performance compared to traditional systemic banks in recent years. The findings of previous versions of this report indicate that ethical banks consistently outperform their counterparts, except in one aspect: Return on Equity (ROE), a measure of shareholder returns. This difference highlights a fundamental distinction between the two models: ethical banks embrace a stakeholder value approach, taking into account the interests of all value bearers, including customers, depositors, borrowers, suppliers, and society as a whole, along with the planet's well-being. This transition signifies a shift from a narrow focus on shareholder value to a broader consideration of the interests of all stakeholders.

Ethical finance goes beyond its reputation for environmental awareness and support for small businesses in the third sector. Extensive research demonstrates that it encompasses a broader scope of activities. Ethical and value-based banks play a crucial role in providing credit, stimulating the real economy, and creating job opportunities, with a particular emphasis on marginalised and underserved individuals who often face limited access to mainstream financial services. Banca Etica, for instance, has experienced consistent growth in loan disbursements, even during periods of credit crunch and financial turbulence, effectively acting as a countercyclical force.

A few years ago, research revealed that nearly half of the organisations seeking financing had been rejected by at least one other bank before turning to Banca Etica. Despite this, Banca Etica consistently maintained lower levels of net non-performing loans compared to the average among Italian banks. This suggests that, contrary to expectations, the bank successfully provided funding to entities often perceived as high-risk by traditional standards. Ethical finance goes beyond its social, environmental, and human rights dimensions. It embraces full transparency, participatory

governance, and a holistic understanding of the bank's role and the societal function of savings, as enshrined in Article 47 of the Italian Constitution. Its success is not limited to these aspects but extends to its economic and financial performance as well.

The research highlights the coexistence of two fundamentally different and often incompatible models. One model perceives finance as an end in itself, driven by an obsessive pursuit of maximum profit in the shortest possible time. The other model, on the other hand, views finance and banking as tools serving society and the common good. It is paradoxical to label the mainstream model as 'significant' finance if the true essence of finance lies in its role as a supportive instrument for the economy and society as a whole. Ethical finance embodies the original ideals that finance should uphold, while a significant portion of the system has lost sight of this social objective.

Regulations often favour the dominant model, imposing 'one-size-fits-all' rules that cater to larger financial institutions, which is a paradox. It underscores the importance of correcting this course at the European level. We believe in promoting what is known as '**banking biodiversity**', advocating for the coexistence of diverse banking models that can effectively support a range of economic and social entities.

To make progress in this regard, a thorough analysis of ethical finance is necessary, accompanied by efforts to promote awareness and to study its distinctive features in comparison to mainstream finance and alternative financial models in Europe. This entails conducting research, providing training, and disseminating information. The ongoing publication of the sixth edition of the Report is aligned with these goals, aiming to establish itself as a trusted point of reference and a valuable source of information for institutions and the general public alike.

Both of these divergent models rely on the savings of individuals. This allows us the opportunity to make a decision. We can choose which model we want to support, and, consequently, which economic, social, and environmental framework we aim to promote. However, the mission of ethical finance extends beyond mere choice; it strives to influence and transform the broader financial system by showcasing, through its everyday operations, the potential for meaningful change. In this regard, the research conducted by FEBEA, Fondazione Finanza Etica, and Fundación Finanzas Éticas serves as a vital tool, providing valuable data and serving as a platform for education and training. By aligning these efforts, we can work towards achieving the twin goals of promoting a sustainable financial model and fostering greater awareness and understanding among institutions and the wider public.

The mission of ethical finance extends beyond mere choice; it strives to influence and transform the broader financial system by showcasing, through its everyday operations, the potential for meaningful change

PART I

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1. The Alternative Finance Ecosystem in Europe: Ethical and Value-Based Banks

Jordi Ibañez, Director, Fundación Finanzas Éticas
Valentina Patetta, Policy Manager, FEBEA

INTRODUCTION

In recent years, the words sustainability, ethics and social responsibility have been increasingly used in the financial sector. A trend that began as early as the 1970s in the United States with the emergence of the first ethical funds (today more commonly known as Socially Responsible Investment Funds) and spread to Europe from the 1990s onwards[1]. Following the financial crisis that erupted in 2007, there have been calls to reshape or even reinvent capitalism in order to avoid new systemic crises. These calls came from global financial actors, academics and politicians alike. But transforming capitalism without replacing its moral and ethical premises is like trying to cage the sea. The big systemic banks have embraced the UN Principles for Responsible Banking but it did not prevent them from excluding the weapons or fossil energy sectors. In Europe, the Sustainable Finance Disclosure Regulation (SFDR) has led to a proliferation of investment funds which, by incorporating sustainability criteria (so-called Article 8 funds and Article 9 funds), address the climate emergency. Nevertheless, the financial lobby has managed to force natural gas or nuclear energy as sustainable investment activities in the Taxonomy Regulation, even though the European Commission has warned some asset managers not to comply with the regulations, as in the recent case of Deutsche Bank. The European Securities and Markets Authority (ESMA) itself published a Progress Report on Greenwashing in which it recognises that greenwashing practices are too accessible under current regulations: it is like trying to put a camel through the eye of a needle.

The transformation of the economic system requires a drastic restructuring of the pattern of ownership, participation and profit distribution in financial companies

The transformation of the economic system requires a drastic restructuring of the patterns of ownership, participation and profit distribution, especially in financial companies, in order to put otherness at the centre of our priorities. Impact, sustainability and responsibility will not fully change a financial institution until its own shareholders stand for it. And this process looks difficult as long as it is possible to distribute dividends without discounting the negative externalities on people and planet. Beyond positive impacts mega-phoned by financial institutions' marketing departments, the transformation we need requires to be aware and prevent negative ones.
This is ethical finance's approach to this challenge. A diverse ecosystem that continues to grow year after year, as this report shows. There is no fine line that delimits exactly what is its identity, though some studies have tried to clarify it over time. What is clear, however, is that its qualitative leap over other financial practices lies in the quality and depth of vision of its people and shareholders, which permeates all its activities and corporate strategies. Inspired by the Charter of the European Federation of Ethical and Alternative Banks and the training and awareness-raising work of the Banca Etica Group, in this chapter we have tried to bring together the five main aspirations that all ethical financial institutions have in common.

ETHICAL BANKING PRINCIPLES

Transparency

Transparency is a **core principle** embraced by ethical finance organisations, which emphasise **openness and accountability**. These organisations recognise the importance of providing clear and accessible information to all stakeholders, including members, clients, providers, strategic partners and the general public. One effective way of promoting transparency by **disclosing the organisations they fund**. By sharing this information, ethical finance organisations increase visibility and enable individuals to make informed decisions about their financial choices. **Transparency goes beyond financial disclosure**, as these organisations aim to be transparent about their governance structures, decision-making processes and the impact of their activities.

1. Camino B. and López J. (1995): "Un análisis de la Inversión Ética en España", Boletin de Estudios Economicos, Vol.L - N.º 156, December 1995.

Participation

By embracing a **people-centred approach**, ethical finance organisations recognise the role played by their members and stakeholders. Through democratic processes, members actively participate in shaping the organisation's strategies, policies, and activities, ensuring that they align with the shared ethical vision.

The democratic and collaborative dialogue among members and stakeholders serves as a **powerful mechanism for maintaining their ethical identity**. It provides a platform for open discussions that helps to reinforce the organisation's ethical principles, ensuring that they are not compromised or diluted over time.

Through their cooperative ownership and control, **members** of ethical finance organisations become key stakeholders in shaping the direction and impact of the institution. They **are not passive participants, but proactive contributors** actively working towards the common goal of promoting the ethical values of the organisation. This participatory approach ensures that the organisation remains true to its principles, as the members themselves are instrumental in maintaining and promoting its ethical identity.

Inter-Cooperation

Ethical finance organisations actively pursue partnerships and alliances with public institutions, social enterprises, community gwroups, and other stakeholders in the financial and social ecosystem. Through inter-cooperation, ethical institutions foster knowledge sharing, resource pooling, and collaboration to drive positive change. Together, these organisations exchange ideas, innovations, and best practices, working towards common goals. They join forces to lobby and advocate for policy changes that promote a fairer and more equitable finance system and society.

Destination of Money

Ethical finance recognises the **transformative power of money** and **intentionally** directs it towards initiatives that foster social, economic, and environmental well-being. By prioritising those sectors little served by traditional banks such as **social economy organisations, real economy and green initiatives** ethical finance plays a pivotal role in **reorienting the economy**. Furthermore, ethical finance institutions prioritise a comprehensive evaluation process for loan applications, considering both financial, social and environmental viability of the initiatives funded. **This dual evaluation ensures that money is used in a way that aligns with ethical values.**

Ethical finance institutions strategically **exclude certain sectors from their operations**, including weapons production, environmentally detrimental projects, human rights violations, exploitative labour practices, non-organic intensive animal breeding, marginalisation of populations, unethical scientific research, commodification of sex, and gambling. By avoiding involvement in these sectors, ethical finance institutions take a stand against harmful activities. This deliberate decision carries significant weight, as it underscores the finance institutions' dedication to creating a positive impact on society.

Integrity

Integrity is a core aspect of ethical finance, permeating every level of the organisation's values and governance. **Ethical finance institutions embody their principles in all aspects of their operations, from strategic decision-making to day-to-day practices**. They prioritise ethical behaviour, transparency and accountability, and ensure that their actions are consistent with their stated values. Integrity is deeply embedded in their governance structures, where checks and balances are in place to ensure adherence to ethical standards.

FURTHER PROPOSALS FOR TARGETED FINANCE

We have elaborated on the main aspirations of ethical and alternative finance. We have also referred to the European Union's Sustainable Finance strategy and will continue to discuss it throughout this report. And we have mentioned the United Nations Programme for Responsible Banking. But there are still other processes that seek to build oriented finance. Let us use this term to put them all under one umbrella if possible. Among them we can point out:

- **Socially Responsible Investments**, which are oriented towards the acquisition of financial assets normally listed by selecting the best securities in each industry sector from an environmental, social and economic point of view.
- **Impact finance**, which is geared towards investing in normally unlisted companies whose *raison d'être* is to generate positive impact and which have a proven track record of doing so.
- And finally, the Banking with Values movement, which brings together banks that focus all their banking activity on the triple bottom line: social, environmental and economic. The **coincidence between ethical and alternative finance and banking with values** is particularly relevant, as both have objectives that go beyond the selection of investments consistent with an ethical investment profile, for example, transparency, the comprehensiveness of their proposal, and many shared values in management. Moreover, in many aspects, for example the positioning with regard to the Sustainable Finance Plan, they are very similar and in fact they have worked together. Therefore, in this report we will often combine the two realities, which show that other forms of finance already exist and are growing year by year.

Ethical finance institutions embody their principles in all aspects of their operations, from strategic decision-making to day-to-day practices

2. What Ethical and Value-Based Finance Demands from Institutions

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INTRODUCTION

The EU will face numerous significant challenges in the upcoming years, ranging from climate change to inequalities, among many others. To tackle these issues effectively, a suitable financial system is essential.
The current financial system has proven largely inadequate in meeting the needs and demands of society. IIt is characterised by short-term objectives, continuous crises, instability, and an unwavering focus on profit maximisation as its sole goal.
To pave the way for a different approach, institutions must play a twofold role. Firstly, public finance plays a crucial part, while secondly, they must take on a regulatory and guiding function.
In recent years, the ethical finance movement has gained prominence, demonstrating both results and a visionary approach. It has put forth numerous requests for a profound overhaul of the financial system.
Looking ahead to the upcoming elections, there are several proposals that we hope to see at the forefront of the European institutions' agenda. Below, we will briefly outline some of them.

THE ETHICAL FOUNDATIONS OF THE REQUESTS OF ETHICAL FINANCE

What claims do ethical finances currently make regarding banking regulations? Before delving into the specific aspects that define the ethical finances' position on the necessary changes to banking regulations, it is crucial to clarify the ethical principles underpinning their proposals. This will provide additional context and a deeper understanding of the proposals' nature and their inherent value.
This value should serve as a counterbalance or compensation for other significant factors present in today's lobbying environment, which ethical finance may lack, such as size or influence. However, these factors do not necessarily indicate a greater moral worth in the propositions but rather a greater capacity to advocate for self-interests. The moral authority of ethical finance proposals is grounded in other values, of which at least four should be emphasised.

Credibility
Decades of ethical finance history demonstrate the undeniable feasibility of crafting financial propositions that adhere to significantly more rigorous ESG criteria than those currently mandated by regulators. The **voluntary self-regulation**, firmly rooted in the essence of ethical finance culture, endows them with substantial credibility to advocate for significant changes in banking regulations. Over the years, ethical finances have been at the forefront of developing viable projects, boasting exceptional credit portfolios and experiencing sustained growth in assets and equity. They have achieved this remarkable progress by embracing self-imposed practices that regulators now seek compliance with. These are not blind transformation proposals that jeopardise the viability of finance by neglecting other factors. Rather, they represent conscientious behaviours, such as refusing to operate in tax havens, abstaining from financing international arms trafficking, not considering nuclear energy as green energy, and adhering to rigorous and measurable socio-environmental accountability. These practices are not only perfectly acceptable but also indisputably contribute to the promotion of the common good.

> ***The EU will face numerous significant challenges in the upcoming years, ranging from climate change to inequalities, among many others. To tackle these issues effectively, a suitable financial system is essential***

The credibility of the proposals can be recognized through the narrative and evidence presented in the history of ethical finance, much of which is documented in these Annual Reports. In this regard, it is noteworthy to recall that during the conference organised by Febea on 10th June 2021 to commemorate the 20th anniversary of its founding, various guest speakers underscored the significance of developing a narrative that helps comprehend the circumstances that led to its inception, understand its present reality, and envision its future. These narratives can be utilised by ethical finance in the ongoing and ever-evolving process of political and social advocacy, promoting a financial system that is much more committed to the common good.

Legitimacy
It is primarily in the **unique governance style** of ethical finance that its legitimacy is grounded. This is attributed to several reasons. First of all, the cooperative essence of ethical finance, based on the principle of decentralised solidarity, fosters organisational cultures with a profound ethical awareness. This awareness is cultivated through the close connection of ethical finances with social realities, enabling them to gain firsthand knowledge of sustainability challenges. As a result, ethical finances have acquired specific competencies that naturally align them as allies for collaborating with diverse public initiatives, especially in sensitive sectors that traditional banks may overlook due to risk assessment, volume, or market conditions.

A second key aspect that underpins the legitimacy of ethical finances is **the centrality of ethics in shaping their strategic frameworks**. In today's world, where society faces various global challenges, organisations' ethical intensity, be it strong or weak, often determines their response. Some organisations may adopt merely reactive measures due to external pressure or new regulations, merely complying with apparent ethical standards as a burden to protect their performance and reputation.

To understand the ethical foundation of sustainability challenges, we must grasp the true meaning of stating that our world is not sustainable

In stark contrast, ethical finances, guided by their purpose and governance style, view these challenges as a societal call aligning with their civic nature, compelling them to respond. They actively seek innovative approaches, recognizing the imperative for change and adopting a proactive stance in response to this call.

Ethical finance's political advocacy differs significantly from traditional banking lobbying. Ethical finance prioritises the interests of vulnerable people and threatened ecosystems, rather than those pursued by the most powerful stakeholders. These interests are rooted in the decentralised solidarity mentioned earlier.

Urgency
To truly understand sustainability challenges, we must go beyond developing taxonomies for market decisions. Likewise, seeing the SDGs as mere puzzle pieces for specific financial products or services falls short of the needed understanding. To understand the ethical foundation of sustainability challenges, we must grasp the true meaning of stating that our world is not sustainable. It involves reconciling the present verdict (is the world sustainable today?) with the assessment of sustainability, which inherently looks towards the future. The challenge is to realise that the world we live in today is no longer sustainable or cannot sustain itself anymore.

Setting the **ethical boundaries for sustainability** entails examining the current situations in which people and ecosystems endure intolerable conditions. Sustainability and justice are interconnected, as neglecting justice could lead to a dangerous form of social Darwinism, where the pursuit of sustainability might favour the powerful over the weak. Depending on how we prioritise the implicit demands of sustainability, this could lead to an unjust social system controlling access to scarce resources through unfair mechanisms, despite sustaining itself in the long term.

To truly grasp the importance of responding to ethical finance proposals for sustainability, we must understand that these issues concern not only ethical finance but society as a whole. Ethical finances embrace sustainability, driven by a purpose rooted in decentralised solidarity, prioritising the common interest over self-interest. They acknowledge that sustainability involves **regeneration**, which is why they assess credit criteria with a strong focus on social and environmental factors. Ethical finance gives priority to projects that aim to heal and regenerate people and ecosystems already affected. This understanding of sustainability emphasises the urgency of addressing present challenges while looking towards the future.

Comprehensiveness
An important outcome of this moral commitment is the unique perspective that ethical finances bring to the ESG approach. While it is crucial to examine ethical finances' claims regarding each dimension of sustainability separately for this report's purpose, we must not forget that **the challenge is interconnected**. To foster a financially sustainable space, ESG must be viewed as an inseparable whole. Emphasising that sustainability cannot be achieved solely through specific products that represent a small part of overall operations, ESG approaches must remain unbiased.

In a way, this holistic approach to ESG brings the focus back to governance-related aspects. That's why it is often emphasised (as we have done in previous Annual Reports) that **good governance** is the fundamental element that defines ethical finance and its practical impact. It serves as a prerequisite for a coherent and comprehensive response to ESG challenges by financial institutions.

That's why, when examining the governance model of ethical finance, our focus goes beyond actions; we delve into the fundamental "how" and "why" behind their decisions. This approach allows us to understand the incentives and motivations that underpin their environmental and social behaviours. Key elements of governance include participation, communication dynamics, and alliances. Structures like Ethics Committees or locally-rooted groups of members committed to the project's development play an important role as well. All of these require **deep and honest transparency**, which fosters proper social accountability and builds trust in the financial system.

OUR REQUESTS

Despite recent achievements and the establishment of principles and values, rules governing banking and financial systems are often promoted based on a "one size fits all"

approach, tailored to the needs and business models of the largest groups.
We must acknowledge the uniqueness of various banking models. However, this doesn't imply creating a regulatory niche for ethical finance. On the contrary, regulatory efforts should address the failures and flaws of the current financial system, as mentioned in the introduction.
Finance is not an end in itself but a tool to serve society and the planet. As such, it must align with our goals and objectives. The needs of transnational corporations differ from those of social economy actors. In a complex society and economic environment, we require various financial tools and models, akin to "banking biodiversity."
To move in these directions, several regulations could be implemented. We will highlight **three proposals**, each focusing on one of the three pillars of the traditional ESG approach. It's important to note that ethical finance emphasises comprehensiveness, viewing ESG as an indivisible whole. For clarity, we've identified one specific proposal for each pillar in the rest of this chapter. These three proposals represent the core of the ethical finance movement's desires for the financial European agenda in the coming years.

Environmental

In the environmental section, several proposals can be put forward. Climate change stands as the most urgent and pressing challenge for humanity.
The financial system has recognized its crucial role to play, with nearly every banking group emphasising their "sustainability" in their communications. However, these same 60 major banking groups have provided around 5.5 trillion dollars to the fossil fuel industry over the last seven years. This enormous discrepancy puts the future of our planet at risk.
Finance must align its actions with its words and genuinely commit to its stated principles. In simpler terms, there is a pressing need to combat the prevalent greenwashing in the financial sector. While the EU has taken promising steps, further action is required. The latest trend in greenwashing is the rush among entities to declare themselves net zero'.
'Net zero' could be a key focus for shaping a legislative proposal. We've witnessed a surge of networks comprising banks, financial managers, insurers, shareholders, and other financial actors aiming to achieve net zero emissions. However, beneath the surface, we often discover that these admirable principles are accompanied by limited commitments. Many cases employ accounting tricks on the path to net zero. It appears that the primary objective is to protect the bank's reputation rather than genuinely saving the planet, while continuing with business as usual.
Various techniques are employed, ranging from considering only direct emissions (Scope 1 and 2) while ignoring those more significantly linked to loans and capital (Scope 3) to delaying heavy commitments until after key decision-makers have left the company. Many net zero declarations focus on offsetting emissions rather than reducing them or rely on optimistic forecasts about currently insignificant technologies (e.g., Carbon Capture and Storage). Unfortunately, the list of accounting tricks for 'net zero washing' is extensive.
In this, as in other areas, **ethical finance has taken a significantly different approach**. It focuses on accurate emissions accounting and transparent reporting, using offsets only when necessary to address unavoidable emissions. It is not a matter of simply calculating economic convenience between pollution costs and compensation. Ethical finance often avoids financial relationships with entire sectors, including coal and oil industries.
As mentioned above, a few years ago, the European Union started the journey to define sustainable finance, despite facing several critiques. Nonetheless, the process aimed to establish a clear and shared understanding of 'sustainable finance'.
Now, we require a similar commitment concerning 'net zero'. We need a strong and transparent framework to address greenwashing in all its forms. A **regulatory structure** should outline how to achieve net zero emissions, apply it to daily operations, and facilitate proper reporting.

In a complex society and economic environment, we require various financial tools and models, akin to "banking biodiversity."

Social

In the social aspect, various proposals can be considered, but the primary focus might be on '**inequality**'. We see increasing disparities in wealth and income, which are becoming more and more unsustainable. Within finance, there are inequalities in access to credit and financial services for vulnerable populations. Gender-related issues like pay gaps in the financial industry are also crucial concerns. Numerous other inequalities could be addressed as well.
For instance, **gender issues** come into play in at least two ways. First, it involves the exclusion of female entrepreneurs from accessing credit. Second, it pertains to the gender wage gap within the banking and financial sector, which can be seen as both a social and governance issue.
Various proposals have been put forward in recent years to address these inequalities. One of them is related to the calculation of capital requirements following the Basel Accords. Many social economy entities are unjustly classified as high-risk by default and subjected to 100% capital absorption. However, this choice lacks foundation, as recent years have demonstrated their solid and resilient nature.
This figure is supported by the analysis of financial statements from ethical banks in Europe. Despite financing social economy entities more than the European banking system average, **ethical banks have lower bad debt rates**. There are no technical reasons justifying why profit companies can have a capital absorption of 50% or 75%, while social economy entities are weighed as high-risk and heavily penalised.
Introducing the social supporting factor, which reduces capital absorption for social economy entities, would be a crucial boost for the sector's development, microfinance, and the fight against financial exclusion. These objectives are considered central by the EU, and this instrument has

proven to be highly effective. Importantly, it comes at no cost to the States, which is especially relevant given the current challenges with public debts.

Governance

The most significant distinction between ethical banks and the mainstream system, regarding the third pillar of governance, is **transparency**. This keyword applies to various aspects, such as loans disbursed, internal payroll and retribution system, impact reports, shareholdings, and more.
A crucial area related to transparency, where progress is essential, is the fight against **tax havens**. Despite being on the European agenda for years, tax havens still thrive, major financial groups in Europe continue to exploit them freely, and there's a concerning race among EU countries to offer advantageous conditions to capitals and financial companies. This situation resembles more of a 'competition' rather than a European 'union'.

In recent years, some progress has been made, like the promotion of **country-by-country reporting**. However, there are limitations, especially concerning public access to information about companies.
Currently, the regulation appears ineffective in countering the significant opacity of the financial system. Financial entities exploit various jurisdictions to avoid taxes, lack transparency, and bypass regulations. This situation results in social injustice, worsens inequality, and creates unfair competition between ethical finance entities that refrain from such practices and others that take advantage of them.

CONCLUSION

The current situation is full of paradoxes and contradictions. Rules are often designed to favour larger groups, penalising those with different approaches, like ethical finance. These rules tend to benefit those already in a strong position.
To highlight this contradiction, we have chosen three keywords: net zero, inequalities, and transparency. The lack of clear rules on net zero allows banks to make impressive claims without real commitments, while those genuinely taking net zero actions face challenges and costs of transitioning. Social economy companies and job creators are burdened with higher regulatory requirements compared to speculative market players.
Additionally, those exploiting tax havens gain an unfair advantage over those who reject any association with such jurisdictions. Many other examples could be provided to highlight this issue.
In the last two decades, European ethical finance has shown its strength by supporting the real economy, creating jobs, and excelling in social, environmental, economic, and financial objectives, outperforming traditional counterparts. Regulators and authorities should acknowledge these accomplishments and recognize the unique features of ethical finance. The regulatory framework should promote its growth instead of penalising it, fostering further development.

3. Assessing and Advancing Impact Management in Ethical Banking: a New Perspective

Tommaso Rondinella, Head of Impact Modeling Department, Banca Etica

Ethical and value-based banks prioritise social and environmental impact alongside financial returns. They employ various strategies to ensure their contributions to sustainable development and positive societal outcomes. In this regard, ethical banks develop tools for continuously monitoring their impact to stay aligned with their set objectives. Banks should align their goals closely with social and environmental objectives. This involves the need to identify a variety of instruments to ensure the process: exclusion criteria, customer due diligence, impact measurement, and continuous aggregated monitoring. Ethical banks establish a clear mission and set of values to guide their operations. When put in practice, these strategies primarily involve the definition of **exclusion criteria**. This approach ensures that banks avoid financing harmful sectors and practices, serving as a fundamental strategy to reassure customers about the ethical use of their savings.

Yet this might not be enough. If there is a possibility to bring about positive change in the economic system, the responsibility profile of financed undertakings need to be assessed. This is a crucial element for the ability to produce positive change.

A transformed economy requires enterprises that prioritise transparency and demonstrate respect for their employees, the environment, and various stakeholders. We need a **CSR due diligence** before assessing positive impacts if consistency should remain a fundamental value of ethical finance. Financing renewable energy companies based in tax havens should be avoided, as should financing non-profit organisations that exploit workers. Impact is indeed fundamental, but not at any cost.

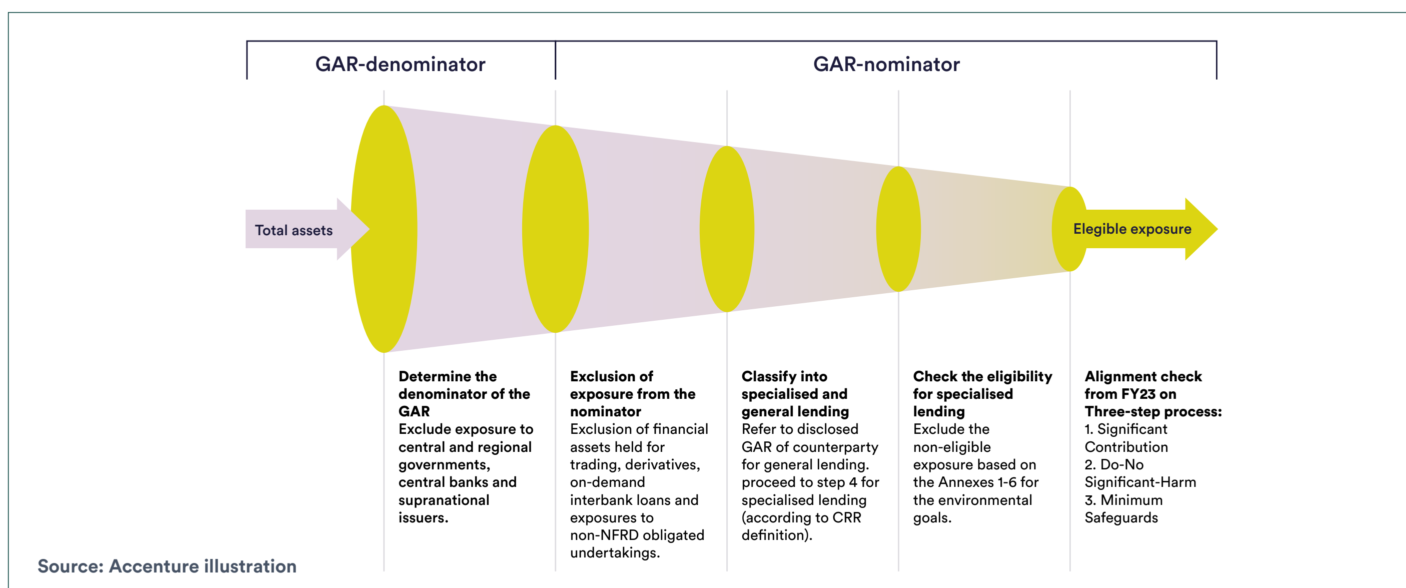
Furthermore, improving the responsibility profile of customer organisations can become an impact objective itself. Engaging with enterprises, providing incentives linked to their business behaviour, represent a strategy to be pursued by value-based banks.

Promoting impact-oriented investments can drive technological advancements, foster entrepreneurship, and catalyse the growth of sustainable industries. In turn, this fosters economic resilience and competitiveness, creating a positive feedback loop that benefits financial activities and the overall economy and society.

Recently, European banking authorities have been advocating for a risk adjusted pricing system that should include ESG factors, which are currently limited to climate related-risks. The approach of ethical banking should transition toward a pricing system based on comprehensive social responsibility.

Impact assessment approach

Assessing the impact of the financial activities is becoming increasingly important for ethical and value-based banks.



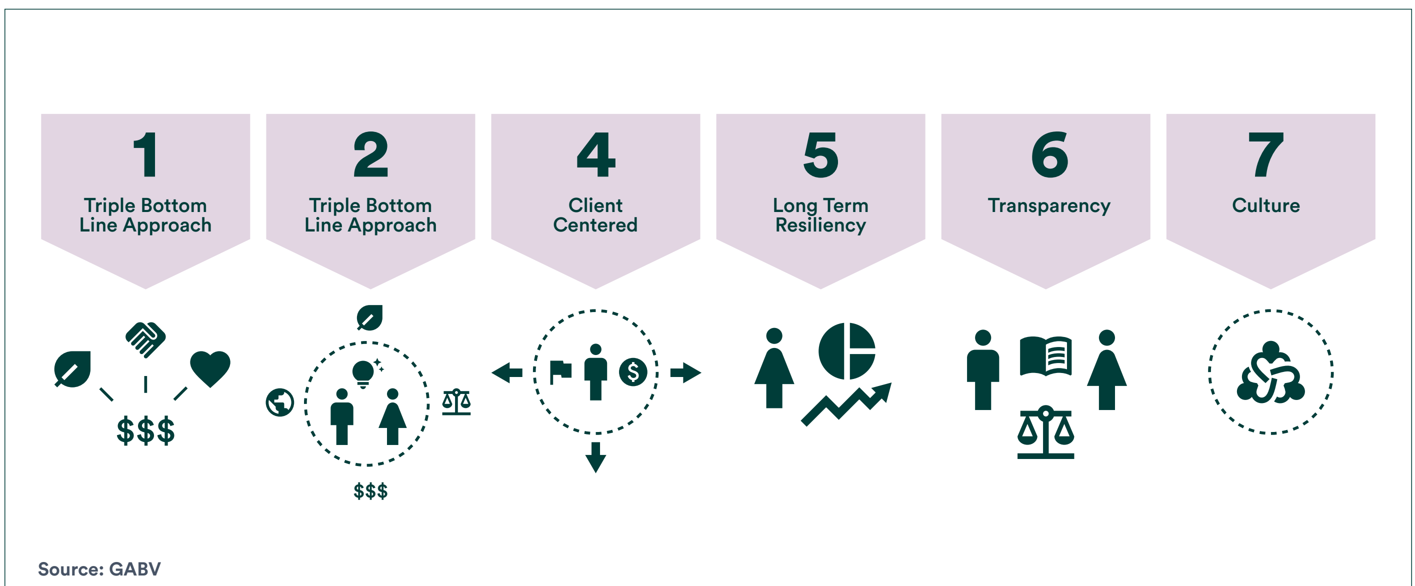
Source: Accenture illustration

However, in an era in which most stakeholders are expected to demonstrate and monitor their impact, ethical banking must emphasise a distinctive approach that paves the way for standards that prevent "impact washing".

The initial step toward transparency involves disclosing the **share of impact assets**.
All financial institutions generate positive impacts, without exception. Any financial entity, even if solely focused on short-term profits, can list several positive impacts that the supported organisations have achieved. What is crucial is not the ability to generate impact but rather the disclosure of the disaggregation of total assets among impactful, neutral and harmful activities. The introduction of the Green Asset Ratio (GAR) within the European taxonomy moves in this direction, although it remains somewhat limited: it only addresses environmental issues and does not distinguish between environmentally neutral and harmful undertakings. In fact, GAR treats a healthcare facility and a coal plant in the same manner.

While showing positive impacts can be important, demonstrating an overall commitment to impact is fundamental.

GABV, for example, asks its members to measure the so called Triple bottom line: to consider financial intermediation to be Triple Bottom Line it must support individuals or enterprises delivering impact in at least one of the following categories: Social Empowerment (People), Environmental Regeneration (Planet), and/or Economic Resiliency (Prosperity). GABV members are able in this way to assess the share of financial assets with a positive impact.
Still, for this to happen, impact assessment tools must be put in practice towards the largest share of financed customers. For example, a distinguishing factor between general entrepreneurship and social entrepreneurship is the ability to generate a positive impact.
To this end, the dissemination of metrics and measurement models that can substantiate the existence and magnitude of such impacts is essential.



Source: GABV

Impact assessment methodologies

Impact assessment methodologies can vary depending on the specific goals and priorities of value-based banks. The selection of an appropriate methodology depends on the nature of the initiatives, available resources, and the desired level of rigour in measuring impact.
In general, the tools used by banks differ from those generally used due to the specificity of financing a broad range of very different projects.
This may not be the case for project financing, private equities or venture capital funds, which can allocate time and resources to an in-depth assessment of every single intermediation. However, traditional credit activities require impact assessment methodologies that can be easily applied to the entire economic sector.
There are dozens of possible alternative approaches to measurement. In general, we can identify three main methodological areas in which impact measurement techniques can be grouped:

- **Logical models** (such as Logical Framework, Impact Value Chain, Theory of Change, Storytelling)
- **Key Performance Indicators** or analytical frameworks (such as GIIN-IRIS, Cost-effectiveness analysis, Banca Etica's VSA), possibly aggregated into composite indicators (B analytics - GIIRS, multicriteria)
- **Monetary evaluations** (such as Cost-benefit analysis, Social Return on Investment-SROI).

On one extreme, we have **qualitative analyses** that outline the causal relationships between the activities of the bank and the intended social or environmental outcomes. They identify the key inputs, activities, outputs, outcomes, and impacts of the bank's initiatives. These methodologies help stakeholders understand how their actions contribute to desired changes and enable them to assess their impact accordingly.
While this approach is valuable for describing how impact is generated by a specific project, it becomes challenging to apply logical models when aggregating the many different

impacts generated by banks. They can be used to evaluate the actual ability of a project to generate impact, but they cannot describe the overall impact generated by the financial activity.
A similar problem arises with **monetary evaluations**, such as Social Return on Investment (SROI). SROI involves mapping out the inputs, activities, outputs, and outcomes of the bank's initiatives and assigning financial values to them. It assesses the social return in relation to the resources invested and provides a ratio indicating the social value generated per unit of investment. However, it also requires making numerous assumptions to translate social and environmental impacts into corresponding monetary values. This exercise involves complex analysis of the financed project, which is challenging to be conducted within loan assessments.
The methodology typically used for assessing the impact of credit activity is, therefore, based on sets of **Key Performance Indicators**. Thay may refer to existing frameworks, but there is no standardised one for loan activities. So, even when referring to SDGs or GIIN, a subjective choice of the actual indicators used has to be made.
The number of potential different indicators may be extremely high, but the higher the **number of different indicators**, the less the bank's ability to report an aggregated impact of its credit activity. There must be a balance between the capacity to cover the diversity of clients and sectors served and the risk of having fragmented information.
Simplicity in the number of indicators is also relevant in terms of disclosure and in impact management. When reporting the generated impacts, we must select only a few relevant measures. There may be up to 20 indicators, but higher numbers become progressively more challenging to communicate.
Even more binding is the activity of impact management, which involves defining monitoring processes and impact objectives, as we will see later. Impact targets need to focus on just a few measures if we expect credit officers to concentrate on achieving them.

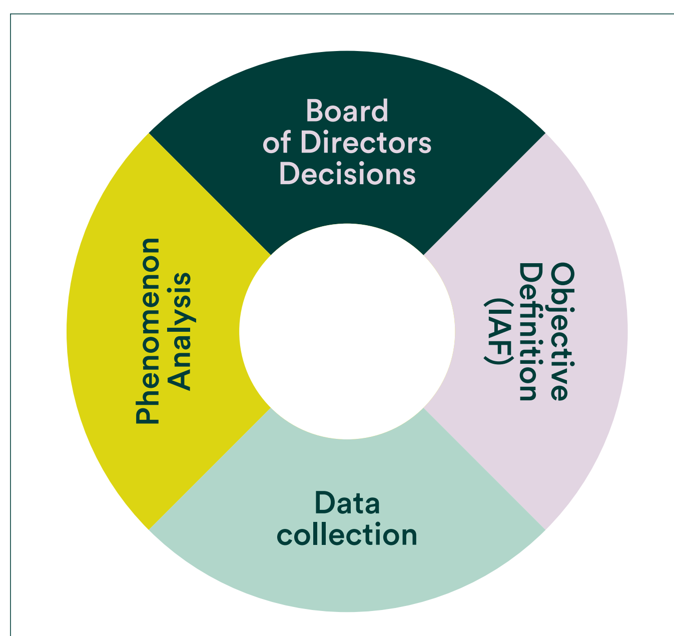
Indicators also need to be **easily quantified by clients**. If they rely on data collected for management purposes, most clients active in each specific sector will be able to provide data.
On the contrary, if they require a specific impact assessment activity, only more socially responsible clients will be able to provide them.

The deadweight issue

A further element that is commonly considered crucial when assessing impact is the evaluation of deadweight.
Deadweight, in the context of impact assessment, refers to the extent to which the observed outcomes or impacts would have occurred even without the intervention or program being evaluated. It is an important consideration when assessing the effectiveness and efficiency of an intervention, as it helps determine the net contribution of the intervention toward achieving desired outcomes. This information is crucial for decision-makers to allocate resources effectively, improve program design, and maximise the overall impact of interventions.
To evaluate deadweight, analysts employ various methodologies such as control groups, statistical regression, and counterfactual analysis. These techniques help isolate the specific impact of the intervention by comparing outcomes between the intervention group and a comparable group that did not receive the intervention.
However, these techniques are costly and time consuming, and require a tailored approach for different types of initiatives. They may be applied for specific project financing but are less suitable for business loans.

Impact management

The development of an impact finance model cannot be limited to providing annual reports on the expected effects of actions and strategies. This is why ethical banks have implemented continuous monitoring tools for their activities regarding social and environmental impact, made available to the Boards and other stakeholders. In the case of Banca Etica, such a tool is called the Impact Appetite Framework (IAF), while GLS has its 'Wirkziele', and others have integrated impact measures into their annual budgeting.
These systems aim to ensure that the primary social impact objectives established by the bank are achieved, and if they are not, they do not pose a reputational risk to the bank. This is why the IAF is integrated with the Risk Appetite Framework (RAF), a parameter required by banking regulations to establish and monitor risk appetite. The IAF is also presented quarterly and has drawn inspiration from the RAF to create a conceptual monitoring system based on the thresholds of Appetite, Early Warning, and Tolerance.



The thresholds are defined as follows:
Appetite: the objective set by the Board of Directors that indicates what the bank aims to achieve in each socio-environmental indicator.
Early Warning: a threshold that indicates a possible worsening of the results of an indicator and requires corrective action.

Tolerance: the minimum level of data below which there is a risk of not achieving the set objectives, leading to an unacceptable impact and potential reputational risk.

Unlike the RAF, the IAF is not subject to any regulations issued by European or national banking supervision. It is an internal tool defined within the corporate governance of Banca Etica.

The selection of indicators for impact management systems should be based on some general criteria:
- **Relevance** of the measures.
- **Feasibility** of timely and regular calculation.
- **Robustness** (ensuring that the measures are not excessively variable) and **reliability**.
- **Lack of ambiguity** (clearly interpretable improvement or decrease in the data).
- **Parsimony**: having too many targets may be challenging to clarify for credit officers who ultimately need to work towards their achievement.

Targets are then aligned with Strategic Plans, Budget, and RAF, with circularity and interdependence among the different documents that sometimes address the same phenomena from different perspectives.
The monitoring of risk objectives serves to identify any critical issues in planning and managing reputational risks and provides a basis for implementing timely corrective actions. Therefore, the monitoring of objectives is structured by developing:
- an effective system for reporting recorded deviations.
- escalation procedures and realignment interventions.

The monitoring of deviations between actual positions and desired positions is based on specific predefined thresholds (e.g., appetite, early warning, tolerance) that measure the degree of goal achievement. Failure to meet the objectives is reported during the periodic monitoring and reporting to the relevant corporate bodies.

If any of the thresholds are exceeded, the process owner's office, in consultation with relevant offices in different areas, proposes an analysis of the issues that led to the deviations and the actions that can be taken to bring them back within the established parameters. The specificity of these actions may vary depending on which threshold has been exceeded.

Conclusion

Impact management plays a pivotal role in the financial sector by ensuring that financial institutions take into account the broader social and environmental implications of their actions. In an increasingly interconnected and interdependent world, the significance of integrating impact management practices with traditional ones cannot be overstated.
Impact management enhances risk assessment and risk management practices. By monitoring social impact factors, institutions can identify potential risks and opportunities that financial analysis may overlook.
This comprehensive approach enables more informed decision-making, reducing the likelihood of reputational damage and financial losses. Impact management serves as a safeguard, empowering ethical and value-based banks to navigate a rapidly changing landscape and sustain their long-term viability.

PART II

Numbers, Facts

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1. Ethical and Value-Based Banks compared to significant European Banks

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with the contribution of
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Ethical and value-based banks perform the traditional role of financial institutions, with one key difference: savings gathered from customers are exclusively invested in productive and financial activities generating a positive impact on society and the environment. In this Sixth Report, our aim is to compare the main indices of profitability, capital adequacy, and financial performance of European ethical and value-based banks with the so-called "significant banks" in Europe, under the direct supervision of the ECB.

WHAT MAKES A BANK SIGNIFICANT

Source ECB

Significance criteria
Size
the total value of its assets exceeds €30 billion
Economic importance
for the specific country or the EU economy as a whole
Cross-border activities
the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%
Direct public financial assistance
it has requested or received funding from the European Stability Mechanism or the European Financial Stability Facility

We have examined European ethical and value-based banks that are members of the Global Alliance for Banking Values (GABV) and the European Federation of Ethical and Alternative Banks (FEBEA), for a total of 22 ethical and value-based banks, for which data from the last 10 years is available.
With regard to "significant" European banks, we have considered those included in the list of banks directly supervised by the ECB, totaling 60 banks, for which data from the last 10 years is available.
The comparison between the two groups of banks goes beyond studying their performance solely to determine which one is more profitable and financially stable. It also helps us understand how ethical and value-based banks, which do not primarily focus on profit but prioritise social well-being and environmental protection in their decision-making, are compatible (in terms of financial results) with the European banking system, especially its larger and interconnected components.
The comparison covers a 10-year period, from 2012 to 2021, a year marked by a significant impact due to the Covid-19 pandemic, whose initial effects were analysed in the Fifth Report.
The methodology used to compare the two groups of bank relies on calculating a series of indices that form the basis of the CAMELS rating system, covering six main areas: **C**apital Adequacy, **A**sset Quality, **M**anagement Quality, **E**arnings, **L**iquidity, and **S**ensitivity to market risk.
It was not possible to perform a comparison that included all the elements required by a CAMELS model, due to the limited availability of data publicly provided by ethical and value-based banks. We conducted the analysis by focusing on the essential indicators, for which calculations were feasible throughout the entire period. To conduct a thorough and truthful analysis, we thus calculated the most important indices. These indices were evaluated in a way that comprehensively covers all the key areas subject to assessment in banking institutions.
We started with **Capital Adequacy,** obtained by dividing equity by total assets. Unfortunately, not all ethical and value-based banks provide information about the capitalisation indices required by the Basel Accords in their publicly available financial reports[2].
The calculated index still provides relevant information about the adequacy of the banks' capital:

Equity to Assets ratio = Equity / Total assets

Secondly, we examined profitability, which is a topic of significant interest and discussion. Profitability was assessed using two indices, Return on Equity (ROE) and Return on Assets (ROA). ROE is a measure of economic performance calculated by dividing net profit by net equity. It measures the return on the capital invested in a company at risk (and thus the profitability of the shareholders' investment):

ROE = Net Income/Equity

ROE (Return on Equity) is expressed as a percentage and can

2. Guidelines regarding the capital and prudential requirements for credit institutions, internationally agreed upon by the Basel Committee on Banking Supervision (BCBS). The Basel indices, concerning capital requirements, encompass the three levels of capital quality, known as core Tier capital, Tier 1, and Tier 2.

be calculated for any company if both the net income and net equity are positive. The assessment of the ROE level will also depend on the industry being evaluated. Often, ROE cannot be used to compare different companies in different sectors. ROE varies across sectors, primarily because companies have different operating margins and financing structures. Moreover, established companies with higher efficiency may not be comparable to younger companies.
It is also important to consider how an excessively high ROE could be indicative of a particularly modest level of capitalisation. Therefore, it is necessary to evaluate this indicator in combination with capitalisation indices.
The term 'Return on Assets' (**ROA**) refers to a financial ratio that indicates the profitability of a company relative to its total assets.

ROA = Net Income/Total assets

Both ROA and ROE measure the degree of resource utilisation by a company. However, one of the main differences between the two is how a company's capitalisation level is considered. ROA takes into account the total company assets, regardless of the financial funding source. On the other hand, ROE only measures the return on a company's equity, excluding liabilities (and thus debt).
Certain characteristics of company management were then evaluated using two further financial indicators. These include the 'business model,' which measures the ratio of loans to total assets, and the 'Deposits to Total Assets Ratio,' an indicator of total deposits divided by total assets.

Business Model = Total loans/Total assets
Deposits to total assets ratio = Total deposits/Total assets

The first shows the percentage of a bank's loans compared to its total assets, thereby measuring the relative amount of loans granted. The second measures the percentage of bank deposits compared to the total funds gathered by the bank and subsequently invested in its activities.

Finally, we examined **liquidity** by comparing loans to deposits.

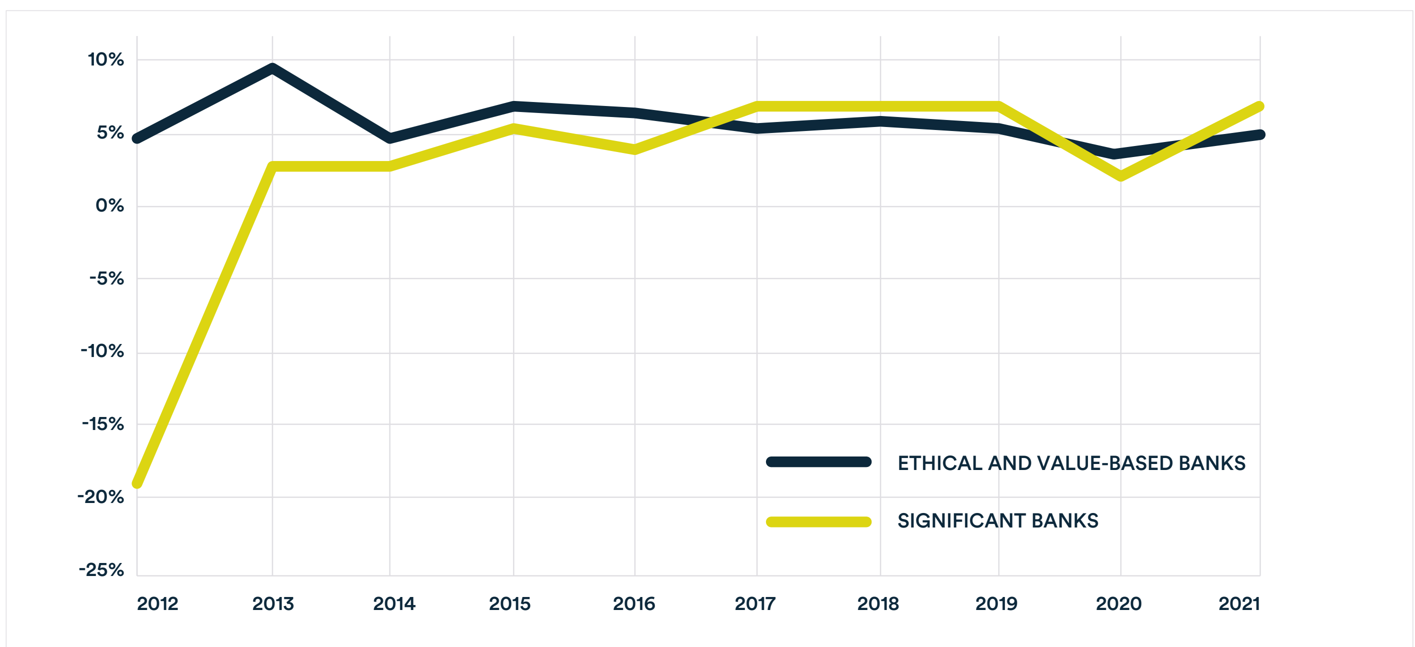
LDR = Total loans/Total deposits

The Loans-to-Deposits Ratio (Loans to Deposits Ratio - **LDR**) is used to assess a bank's liquidity by comparing its total loans and total deposits within the same period. The index is expressed as a percentage and provides insights into the bank's risk level. A high indicator level may hint at a higher-risk situation, as the bank holds a significant amount of assets tied-up in loans and might face greater difficulty in covering unexpected losses and cash outflows.

THE RESULTS

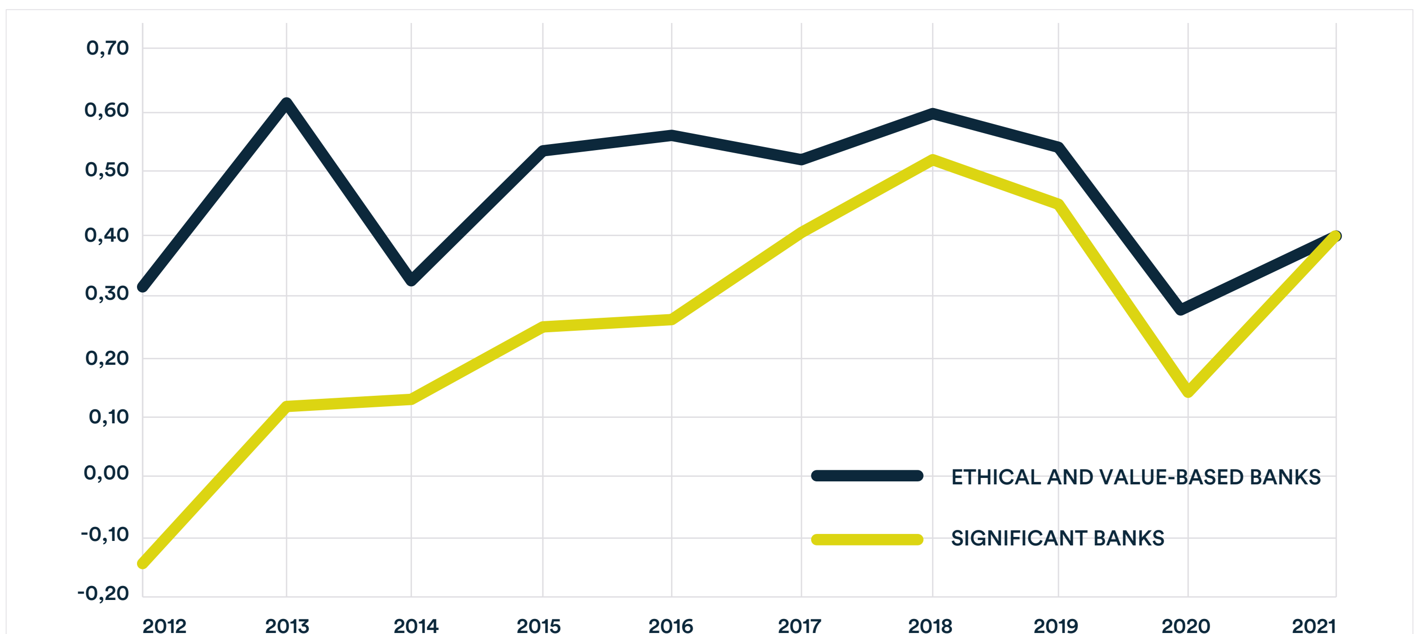
Profitability

We analysed the profitability by comparing the financial ratios, ROA and ROE, of European ethical and value-based banks with those of European 'significant' banks directly supervised by the ECB. From 2012 to 2021, ethical banks maintained a steady average **ROE** of 5.23%, whereas significant banks had an average value of 2.21%. In this regard, ethical banks show significantly higher profitability compared to that of 'significant' banks. Taking a closer look, we can attribute this significant difference to the high volatility in the results of traditional banks. Despite the 'significant banks' having a favourable starting position in 2008, with an average ROE of 8.20%, they were more affected by the consequences of the 2007-2008 crisis in the following years. As shown in the table, the 'significant banks' experienced significant losses, resulting in a severely negative ROE of -18.94% in 2012. In the following years, 'significant' banks staged a recovery until 2020, when they recorded a larger drop in profitability compared to ethical banks (due to the Covid-19 pandemic). However, in 2021, they experienced a rapid surge, outpacing the performance of ethical banks. This can be attributed, in part, to the highly expansionary monetary policy, alongside a notably positive year for major international stock markets, and an enhancement in the quality of granted credit.



Graph 1 - ROE. Comparison between ethical and value-based banks and significant banks.

ROA (Return on Assets) represents the ratio of net income to total assets and shows how profitable a company's assets are. The table shows that ethical banks consistently maintained a higher and stable **ROA** compared to the European 'significant' banks over the last decade, with an average of 0.46% versus 0.25% for 'significant' banks. In terms of volatility, measured by the standard deviation of yearly averages, ethical banks demonstrate stability with relatively low volatility at 0.64%, compared to 0.84% for the 60 'significant' banks.
Between 2019 and 2020, both groups experienced a substantial decline, with ethical banks decreasing by -0.25 percentage points and 'significant' banks by -0.30 percentage points. This is due to the impact of the Covid-19 pandemic.
From 2020 to 2021, despite the challenging economic environment, banks rebounded, recording an average increase in return on assets (ROA) of 0.12% for ethical banks and 0.30% for significant banks. In 2021, ROA values essentially converged: 0.399% for ethical banks and 0.396% for significant banks.
In summary, the analysis of ROA from 2012 to 2021 reveals a higher stability in results for ethical banks, consistently maintaining positive index values even during crises. However, 'significant' banks have faced prolonged effects from the 2007-2008 financial crisis, but they bounced back strongly from 2013 and caught up with ethical banks' performances by 2021. Starting from 2018, the two groups of banks display a similar trend, experiencing a decline in profitability until 2020, followed by a recovery in 2021.

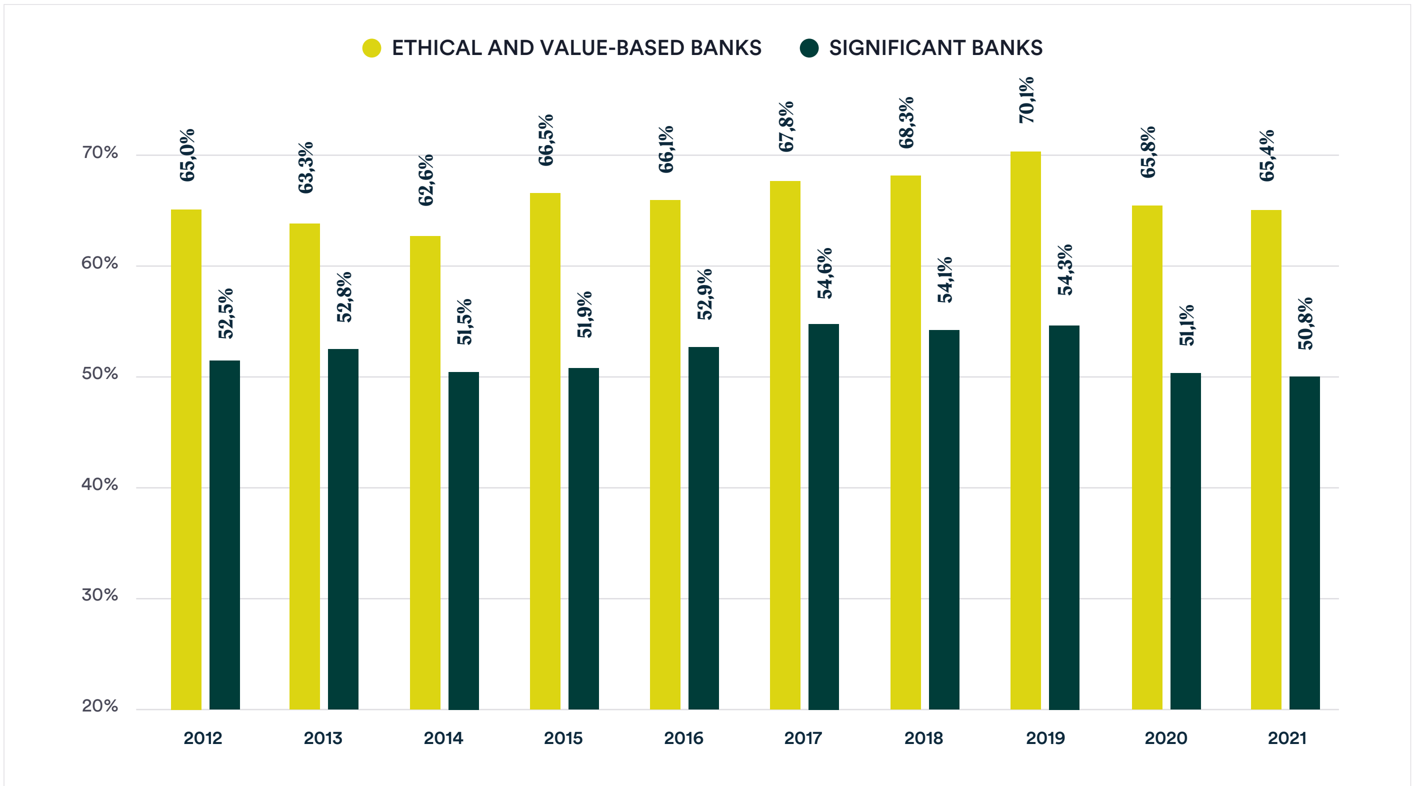


Graph 2 - ROA. Comparison between ethical and value-based banks and significant banks.

Total loans to total assets

Next, we analyse the management characteristics for the two samples. Initially, we compared the weight of credit activity as a percentage of total assets. Credit activities (i.e. loans) remain the primary focus for ethical banks, although we sawa slight decrease compared to previous years. In 2021, total loans accounted for 67.58% of total assets on average. This value is obtained by calculating the business model index based on the aggregated total values of ethical banks.
For more representative results, the indicator was also calculated as the average of the single percentage indices for each ethical bank in the sample (rather than just at an aggregate level, as the ratio of the sums of data for individual banks). The same method was applied to the significant banks sample.
Graph 3 displays data collected for the given period. Results under this second methodology show an index of 65.4% for ethical banks and 50.8% for significant banks in 2021. Throughout the entire period, ethical banks consistently had a much higher percentage of loans to total assets compared to 'significant' banks.
Clearly, ethical banks are more focused on traditional banking activities, like collecting savings and granting loans. On the other hand, 'significant' banks associate traditional banking activities with other financial activities such as investments, financial services or placement of funds and securities.
In both analysed samples, credit activity shows a similar pattern, declining from 2008 to 2014, then growing from 2015 to 2019, and slightly decreasing in the last two years. The recent downturn is due to the impact of the pandemic crisis that started at the end of 2019.
Although credit activity has slightly decreased in recent years, it is evident that ethical banks primarily focus on providing credit, directly supporting businesses and households, which we consider synonymous with the 'real economy' in this and previous versions of the report. On the other hand, 'significant' banks have reduced their credit activity by 2% from 2012 to 2021.

> ***Ethical and value-based banks primarily focus on providing credit, directly supporting the real economy***

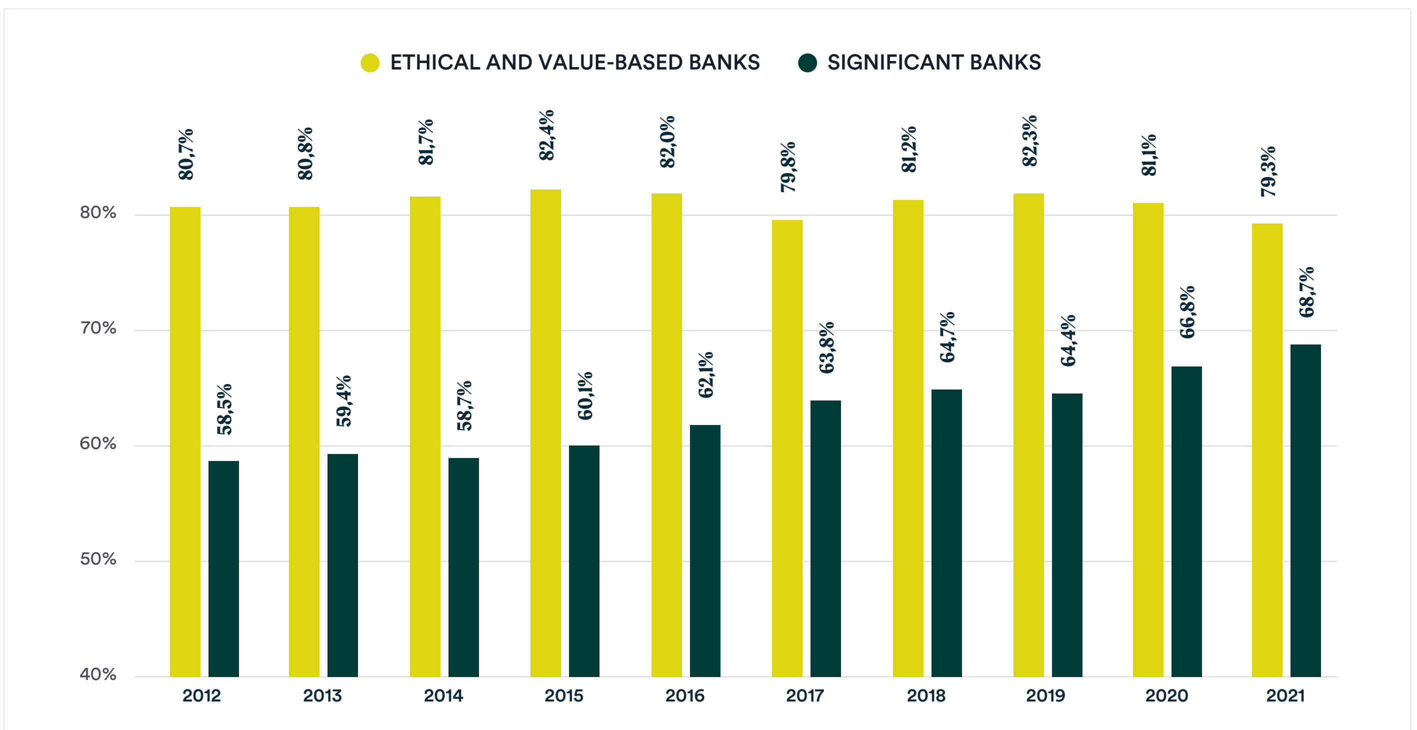


Graph 3 - Total loans to total assets.

Total deposits to total assets

The difference between the two groups of banks is also evident in the percentage of deposits to total assets. As depicted in Graph 4 and Table 1, ethical banks mainly rely on customer deposits, averaging 81.1% of total assets, while 'significant' banks have an average of 62.7%.

The lower ratio for the latter is due to the importance of additional sources of liquidity (compared to ethical banks), such as bonds or financing from other banks. Over the 2012-2021 period 'significant' banks experienced a 10.2% increase in deposits to total assets, whereas ethical banks saw a 1.4% decrease.



Graph 4 -Total deposits to total assets.

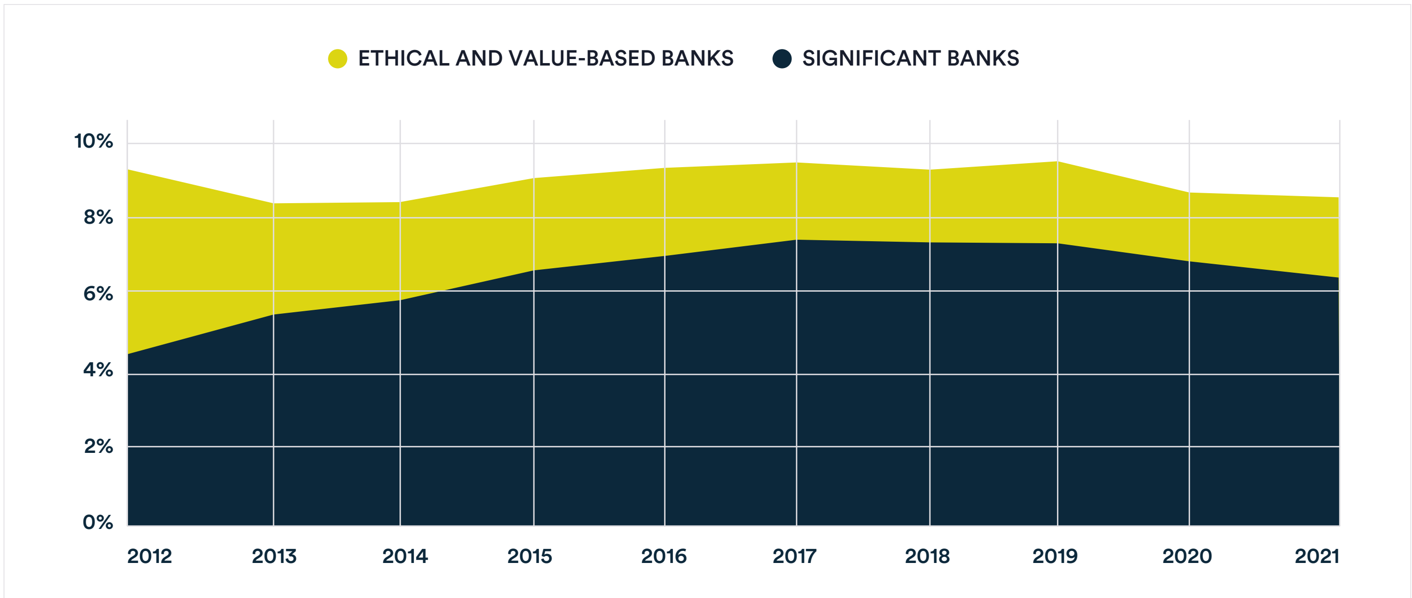
	2021/2020			2020/2019		
Ethical and value-based	**Change in Assets**	**Change in Credits**	**Change in Deposits**	**Change in Assets**	**Change in Credits**	**Change in Deposits**
Credit Cooperatif	8%	11%	7%	13%	9%	22%
Triodos	19%	11%	13%	15%	12%	10%
GLS Bank	15%	5%	16%	20%	-26%	19%
Umweltbank	20%	8%	4%	21%	8%	7%
Banca Etica	8%	3%	3%	28%	10%	17%
APS Bank	15%	14%	15%	12%	16%	10%
ABS	16%	14%	-1%	12%	3%	13%
La Nef	32%	40%	31%	23%	54%	40%

Table 1 - Growth of major European ethical and value-based banks

Table 1 shows the increases in total assets, loans, and deposits for the main European ethical banks in 2021 and 2020. We focused on the eight largest ethical and value-based banks with assets exceeding 1 billion euros, as they have the most significant impact on the overall results.
Similar to 2020, Crédit Coopératif remained a key player in 2021, representing 37% of the total assets of all European ethical banks. However, this year, Crédit Coopératif saw a higher increase in loans at 11% (compared to 9% in the previous year), while deposit growth was lower than 2020 (7% vs. 22%).
Compared to 2020, there was a higher average loan growth for the eight major ethical banks (+13% compared to +11% in the previous year). French bank La Nef stood out once again, showing significant increases of 40% in loans and 31% in deposits (compared to 54% and 40% respectively in the previous year).
In general, the eight largest ethical banks experienced a double-digit growth rate in deposits, with an average of 11%. It's worth noting that all the major ethical banks saw substantial growth in total assets, with La Nef leading the way once more with a growth rate of 32%.
To conclude, 2021 showed positive growth in the analysed metrics, especially in loans and total assets, albeit at a slightly lower rate compared to 2020.

Capital Adequacy

Capital adequacy was measured as the ratio of net equity to total liabilities. Graph 5 shows that over the years, this ratio slightly decreased for ethical banks, starting at 9% in 2012 and reaching 8.2% in 2021. However, for 'significant' banks, it followed the opposite trend, though at notably lower levels, rising from 4.3% in 2012 to 6.20% in 2021.
Compared to 2020, the pandemic crisis caused a further decline in the ratio, with a decrease of 0.2% for ethical banks and 0.4% for 'significant' banks.
Ethical banks have consistently maintained a strong financial position, although it has decreased from 2012 to 2021, confirming a level of capitalisation consistently above that of 'significant' banks. The latter, despite starting from a weaker position, have gradually closed the gap with ethical banks.
After the 2008 crisis, regulators have focused more on the quality and quantity of capital banks must hold, as a fundamental pillar of prudential supervision of financial intermediaries.
Unlike ethical banks, which always maintained relatively high net equity compared to total liabilities, traditional banks have been required to set aside larger capital reserves due to new regulatory interventions in banking supervision.

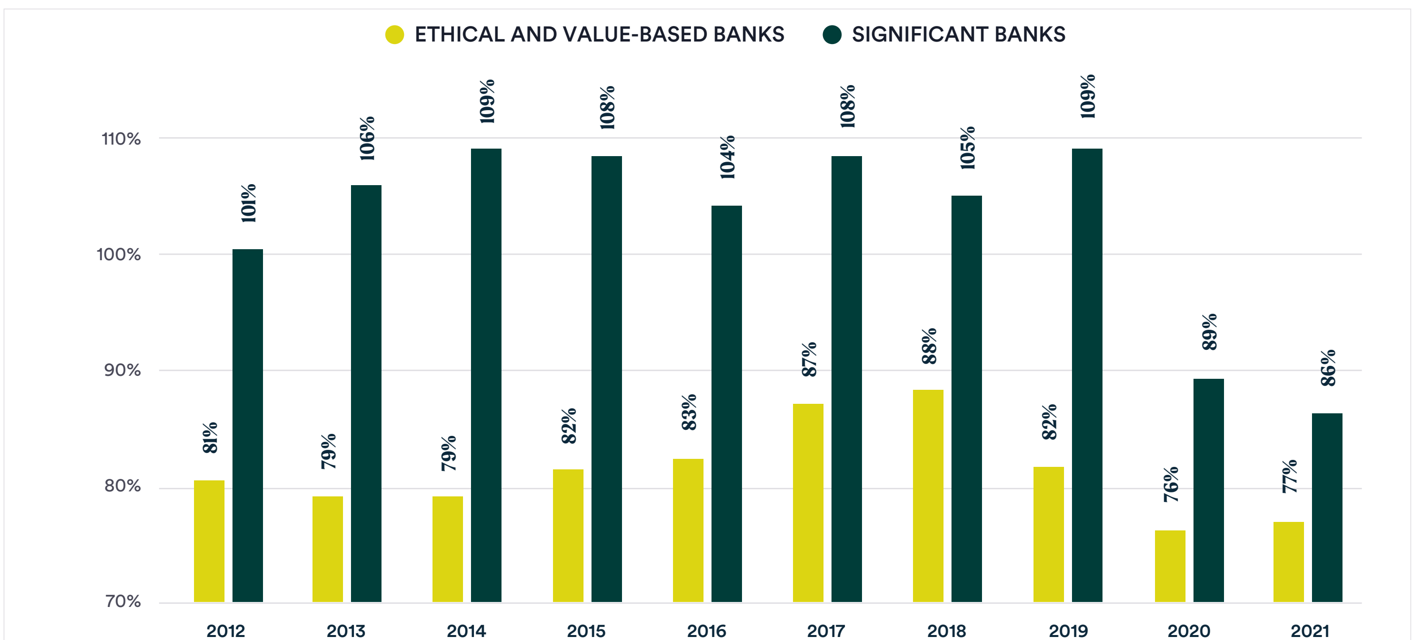


Graph 5 - Capital adequacy.

Liquidity: Loan-to-Deposit Ratio (LDR)

According to Graph 6, ethical banks consistently maintained a strong liquidity index throughout the period from 2012 to 2021, with an average LDR of 81.5%. On the other hand, 'significant' banks had a much higher average LDR of 102.5%, especially in recent years, peaking at 109% in 2019. It's important to note that a very high ratio suggests the bank may not have enough liquidity to meet unexpected withdrawal demands from depositors or other unexpected cash outflows.

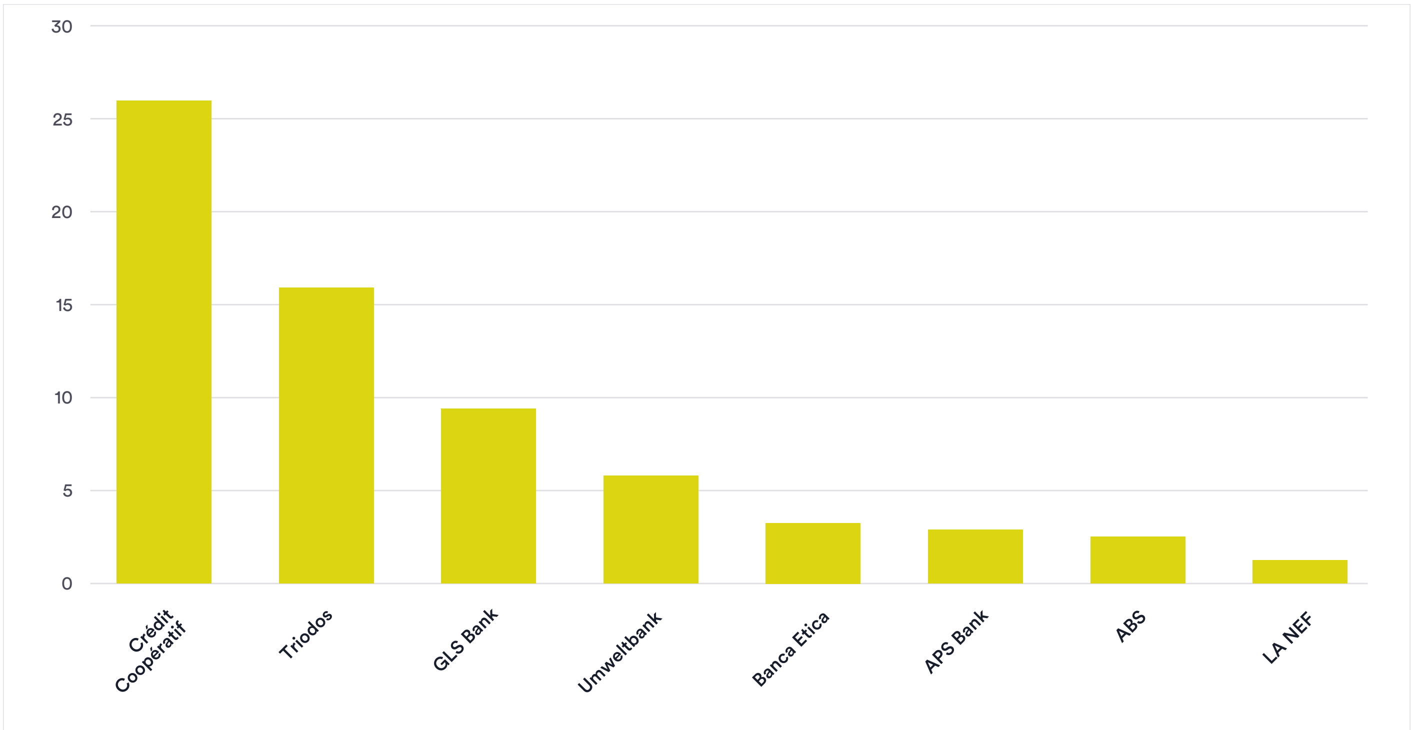
In 2021, both groups of banks experienced a decrease in the LDR compared to the previous year, mainly due to the pandemic emergency and reduced credit issuance. Ethical banks reported an average LDR of 77% in 2021, while traditional banks had an average of 86%.



Graph 6 - Liquidity: Loan-to-Deposit Ratio (LDR).

In general, 'significant' banks often maintain a high LDR due to their tendency to extend loans in proportion to total deposits, aiming to leverage interest margins. Ethical banks, in contrast, exhibit much less performance fluctuation, suggesting the 'significant' banks' greater emphasis on speculative or high-risk activities.

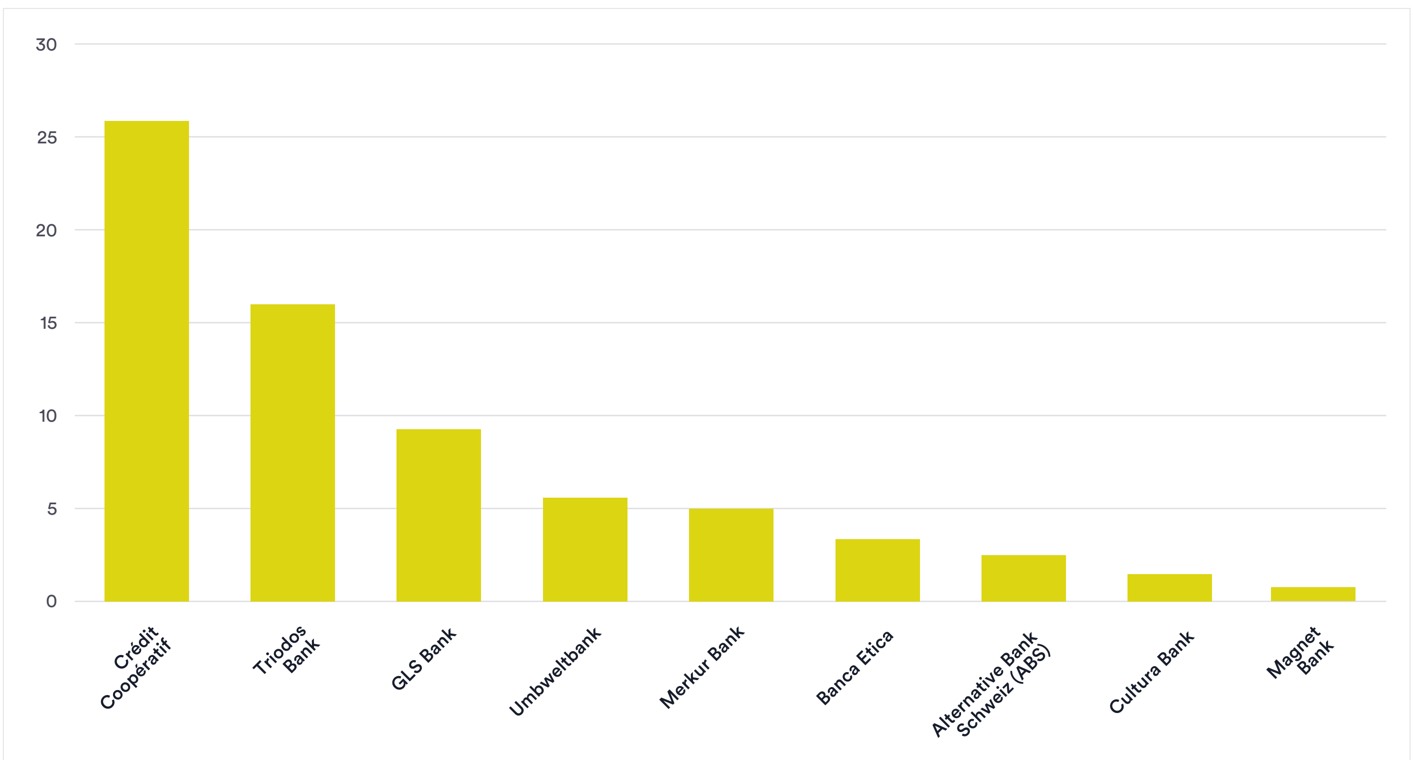
This analysis is supported by the notable volatility in the profitability of 'significant' banks, which shows high values during periods of economic recovery and low or negative values during crises. In contrast, ethical banks have exhibited less pronounced volatility. In recent years, stricter regulations have contributed to narrowing this discrepancy. However, the recent sharp rise in interest rates has increased market risks, especially for 'significant' banks, particularly in terms of interest rate risk, further increasing volatility in the banks' balance sheets.



Graph 7 - Total assets of the 8 largest ethical and value-based banks (in billion euros).

CONCLUSIONS

In conclusion, the comparison between European ethical banks and 'significant' banks shows that ethical banks are more focused on serving the real economy. Furthermore, ethical banks experienced much less fluctuation in profitability compared to significant banks.
During the first year of the Covid-19 pandemic, both groups experienced a decrease in profitability, but ethical banks were affected to a lesser extent. However, in 2021, both groups saw a significant recovery, narrowing the gap between the two, especially in terms of ROA.
Furthermore, in terms of capitalisation, ethical banks consistently maintained a higher capital coefficient than 'significant' banks, despite the latter undergoing a capital adjustment process due to regulatory interventions, leading to



Graph 8 - The eight largest European ethical banks by asset volume (in billion euros).

an increasing trend in banks' capitalization levels.
Regarding liquidity, 'significant' banks had higher average LDR, surpassing 100%, indicating a greater exposure to liquidity risk. In contrast, ethical banks maintained a stable loan-to-deposit ratio, with an average ranging from 80% to 90%.

During the first two years of the pandemic LDR ratio decreased mainly due to a more significant reduction in loans compared to deposits.
However, by the end of 2021, ethical banks showed improvement in the indicator.

Aggregated numbers of European ethical and value-based banks (2021)

Assets **71.09** **billion euros**
+11.77% compared to 2020

Loans **47.83** **billion euros**
+8.98% compared to 2020

Deposits **51.30** **billion euros**
+9.98% compared to 2020

The data for 2021 includes the financial statements of the 23 ethical banks analysed in the research, along with the 2021 data of Coop57 (Spain), Femu Qui (Corsica, France), Etika (Luxembourg), Ucit (Great Britain), Sidi (France), and Sifa (France). While these entities do not engage in mainstream banking activities, they provide credits following the principles of ethical banks.

Methodological note
The calculation methodology used for all indicators is the simple average of the single indices calculated for each bank, extended to all years in the historical series. For the overall comparison, the average of the aggregated means for each year has been applied.

Appendix I. European Ethical and Value-Based Banks

BELGIUM
Credal
Hefboom

DENMARK
Merkur Cooperative Bank

FRANCE
Caisse Solidaire - until 2018
Group Crédit Coopératif
La Nef

GERMANY
GLS Bank
UmweltBank

GREECE
Cooperative Bank of Karditsa

HUNGARY
Magnet Bank

ITALY
Banca Popolare Etica

MALTA
APS Bank

THE NETHERLANDS
Triodos Bank

NORWAY
Cultura Bank

POLAND
Tise

SERBIA
3Bank (formerly Opportunity Bank Serbia)

SPAIN
Caixa de Pollença

SWEDEN
Ekobanken

SWITZERLAND
Alternative Bank Schweiz
Freie Gemeinschaftsbank

UNITED KINGDOM
Charity Bank
Ecology Building Society

Appendix II. ‘Significant Banks’

AUSTRIA
Addiko Bank AG
BAWAG Group AG
Erste Group Bank AG
Raiffeisen Bank International AG

BELGIUM
KBC Group NV

CYPRUS
Bank of Cyprus Holdings Public Limited Company
Hellenic Bank Public Company Limited

FINLAND
Kuntarahoitus Oyj
Nordea Bank Abp

FRANCE
BNP Paribas S.A.
BPCE S.A.
Crédit Agricole S.A.
HSBC Continental Europe
RCI Banque SA
Société Générale S.A.

GERMANY
Aareal Bank AG
Bayerische Landesbank
Commerzbank Aktiengesellschaft
DekaBank Deutsche Girozentrale
Deutsche Bank AG
Deutsche Pfandbriefbank AG
DZ BANK AG Deutsche Zentral-Genossenschaftsbank
Goldman Sachs Bank Europe SE
Landesbank Baden-Württemberg
Münchener Hypothekenbank eG
Morgan Stanley Europe Holding SE
Norddeutsche Landesbank -Girozentrale-

GREECE
Alpha Services and Holdings S.A
Eurobank Ergasias Services and Holdings S.A
National Bank of Greece S.A.
Piraeus Financial Holdings S.A.

IRELAND
AIB Group plc
Bank of Ireland Group plc

ITALY
Banca Mediolanum S.p.A.
Banca Monte dei Paschi di Siena S.P.A.
Banca Popolare di Sondrio, Società per Azioni (S.p.A.)
Banco BPM S.p.A.
BPER Banca S.p.A.
Credito Emiliano Holding S.p.A.
FinecoBank S.p.A.
Intesa Sanpaolo S.p.A.
Mediobanca - Banca di Credito Finanziario S.p.A.
UniCredit S.p.A.

LATVIA
AS “Citadele banka”

LITHUANIA
Akcinė bendrovė Šiaulių bankas

MALTA
Bank of Valletta plc
HSBC Bank Malta p.l.c.

the NETHERLANDS
ABN AMRO Bank N.V.
BNG Bank N.V.
Coöperatieve Rabobank U.A.
ING Groep N.V.
Nederlandse Waterschapsbank N.V.

PORTUGAL
Banco Comercial Português, S.A.

SLOVENIA
Nova Ljubljanska banka d.d., Ljubljana

SPAIN
Banco Bilbao Vizcaya Argentaria, S.A.
Banco de Sabadell, S.A.
Banco Santander, S.A.
Bankinter, S.A.
CaixaBank, S.A.
Unicaja Banco, S.A.

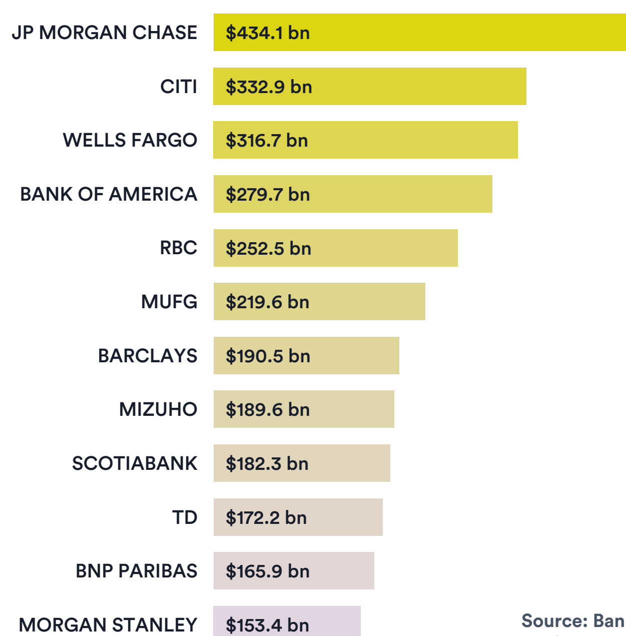
2. Finance for Climate

Mauro Meggiolaro, Senior Data Analyst, Fondazione Finanza Etica
Valentina Neri, Reporter, Valori.it

The fight against climate change, the greatest challenge of our time, is based on two main approaches: mitigation and adaptation. The term "**mitigation umbrella**" refers to all initiatives aimed at reducing the emission of greenhouse gases into the atmosphere, primarily by phasing out the use of fossil fuels, and increasing both quantity and quality of carbon sinks, which are natural reservoirs of greenhouse gases (such as oceans, forests, and soil).
On the other hand, **adaptation** acknowledges the inevitability of the climate crisis's effects, now and in the future. Therefore, it aims to make territories and populations less vulnerable to these damages. Typical adaptation measures involving the use of heat and drought-resistant crops, implementing early warning systems for hurricanes, and building barriers to protect coastal cities from sea-level rise.
These two priorities are expected to have a game-changing impact on the structure of the global economic system as a whole. Over the years, many efforts have been made to quantify their costs, resulting in widely divergent and inherently incomplete estimates. However, these estimates are still useful in understanding the scope of the ongoing transition.
Investments in mitigation have experienced a significant increase, reaching $571 billion per year in 2019-2020. However, further action is required. In order to limit the increase in the global average temperature to within 1.5 degrees Celsius above pre-industrial levels, as committed by the international community through the Paris Agreement and later the Glasgow Pact, financial flows need to increase by three to six times by 2030. Developing countries, in particular, have a greater need for resources, according to the **Sixth Assessment Report** (AR6) of the Intergovernmental Panel on Climate Change (IPCC).
In terms of adaptation, the **2022 Adaptation Gap Report** published by the United Nations Environment Programme (UNEP) underscores a substantial gap between international financial flows and the actual requirements of developing countries. The report affirms that the financial support provided falls considerably short, being 5-10 times lower than what is truly needed, and this gap persists and expands over time. Overall, an amount ranging from $160 billion to $340 billion will be needed by 2030, rising to $315 billion to $565 billion by 2050. The challenges faced thus far can be overcome, as **stated** by the International Monetary Fund (IMF) among others, but it demands "coordinated and determined action in both the public and private sectors."

WHAT DOES CLIMATE ACTION MEAN FOR CONVENTIONAL BANKS?

«*In recent years, starting with the launch of the EU Action Plan on Sustainable Finance in 2018, a growing number of banks and financial actors have started to develop public climate strategies, targets and various green financial instruments, claiming to reduce or eliminate their contributions to climate change. Despite these claims to be 'sustainable', 'green' or 'earth friendly', there is a growing gap between political intentions and reality*», as stated in the position paper **"Beyond the 'Green Approach' to Tackle Greenwashing"** by Febea, the European network of ethical and alternative banks.
The assertion is backed by **Banking on Climate Chaos** 2023. Since 2016, after the signing of the Paris Climate Agreement, the sixty largest international banking giants have collectively financed fossil fuels with a staggering sum of $5.5 trillion. In 2022 alone, they contributed $673 billion to this financing. Based on data from a report published by various NGOs including Rainforest Action Network, BankTrack, Urgewald, and Reclaim Finance, these figures have led to the creation of a ranking known as "The Dirty Dozen". This ranking specifically identifies the twelve banks that provide the highest financing for fossil fuel sources.



Source: Banking on Climate Chaos

Another report, published in early 2023, discloses that, during the period of 2016-2022, only 7% of the total energy sector financing was directed towards renewable energies.
It is paradoxical that, among the 60 banks examined by Banking on Climate Chaos, a notable 49 banks aspire to achieve net-zero emissions by 2050. Additionally, 43 banks are affiliated with the (controversial) Net-Zero Banking Alliance, an initiative promoted by the United Nations but led by the banking system itself. The report aims to uncover the reasons behind this apparent contradiction, exposing significant shortcomings in their climate action strategies.
For instance, 27 institutions explicitly mention carbon capture and storage technologies. However, these technologies are still in developmental stages, far from commercialization, expensive, and, based on initial testing, yield less impact than desired[3].
Many conventional banks, in addition, evaluate their climate progress using metrics that are, at the very least, subject to debate. These metrics can be either based on absolute values or linked to economic factors. The former sets a net target, such as reducing a specific amount of greenhouse gas emissions in the atmosphere (whether it is CO_2, methane, or other gases). On the other hand, intensity emissions arise from the ratio between tons of CO_2 reduced and the amount of money invested (or revenue).
Naturally, what matters for real-world impact is the change in absolute emissions. Most of the banks under scrutiny opt for intensity metrics, which were designed to 'normalise' emissions and enable comparisons across companies and investors of different sizes. Furthermore, the entire economy is gradually shifting towards lower-emission technologies. As a result, it is expected that the emission intensity per unit of revenue (or bank financing) will decrease over time, even in the absence of specific commitments. This could potentially create a counterintuitive scenario where certain banks formally assert the achievement of their emission reduction targets based on intensity per unit of financing, even though their absolute emissions have actually increased. These and other techniques are discussed in Chapter 2, Part one.

UNLEASHING CLIMATE ACTION: THE ETHICAL BANKS' PERSPECTIVE

According to Daniel Sorrosal, Secretary General of Febea, this occurs because many financial institutions solely focus on climate, the 'E' in ESG, neglecting the other two dimensions, society and governance. This action creates a separation between their overarching mission, centred around profit pursuit, and the specific objective of allocating resources, portfolios, and financing to climate-positive activities. This approach, he argues, paves the way for greenwashing, a marketing practice that highlights individual products or strategies with positive performance without addressing the bigger picture of their overall activities.
Instead, Febea embraces a comprehensive perspective where the environment, society, and governance form an interconnected whole. They highlight the significance of the institution's commitment to its mission and the allocation of a substantial portion, if not all, of its resources towards fostering positive impacts for both climate and society. Febea believes that simply focusing on individual products, strategies, or sectors with higher investments, or adopting a 'best-in-class' approach that selects the 'least bad' option within a specific sector, is not enough.

HOW ARE EMISSIONS REPORTED?

The Greenhouse Gas (GHG) Protocol **sets** internationally recognized standards that banks and other organisations use to measure their greenhouse gas emissions.
These emissions are categorised into three scopes:

- Scope 1: Direct emissions produced by the bank, such as heating the office and using transportation for business travel.
- Scope 2: Indirect emissions resulting from the bank's electricity consumption.
- Scope 3: Indirect emissions generated throughout the supply chain. These emissions include upstream sources like non-owned vehicle transportation, employee commuting, and energy consumption related to remote work, as well as downstream emissions influenced by the bank's investments.

One of the most internationally recognized models for calculating emissions from financing and investments, specifically within Scope 3, is the model **proposed** by PACF (Partnership for Carbon Accounting Financials). It was launched in 2015, and ethical banks were among the pioneers in its adoption, followed by many mainstream banks starting in 2019. PACF is not the only existing methodology, but it is considered one of the most reliable. By following a standardised approach, financial institutions lay the groundwork for setting science-based targets and aligning their investment portfolios with the Paris Agreement on climate change.

3. Listed below, a selection of articles that take a highly critical stance towards carbon capture and storage systems:
https://www.nytimes.com/interactive/2023/03/19/us/carbon-capture.html
https://www.bloomberg.com/news/articles/2023-05-16/big-money-rushes-into-carbon-capture-can-it-deliver-this-time
https://www.theguardian.com/environment/2022/sep/01/carbon-capture-is-not-a-solution-to-net-zero-emissions-plans-report-says

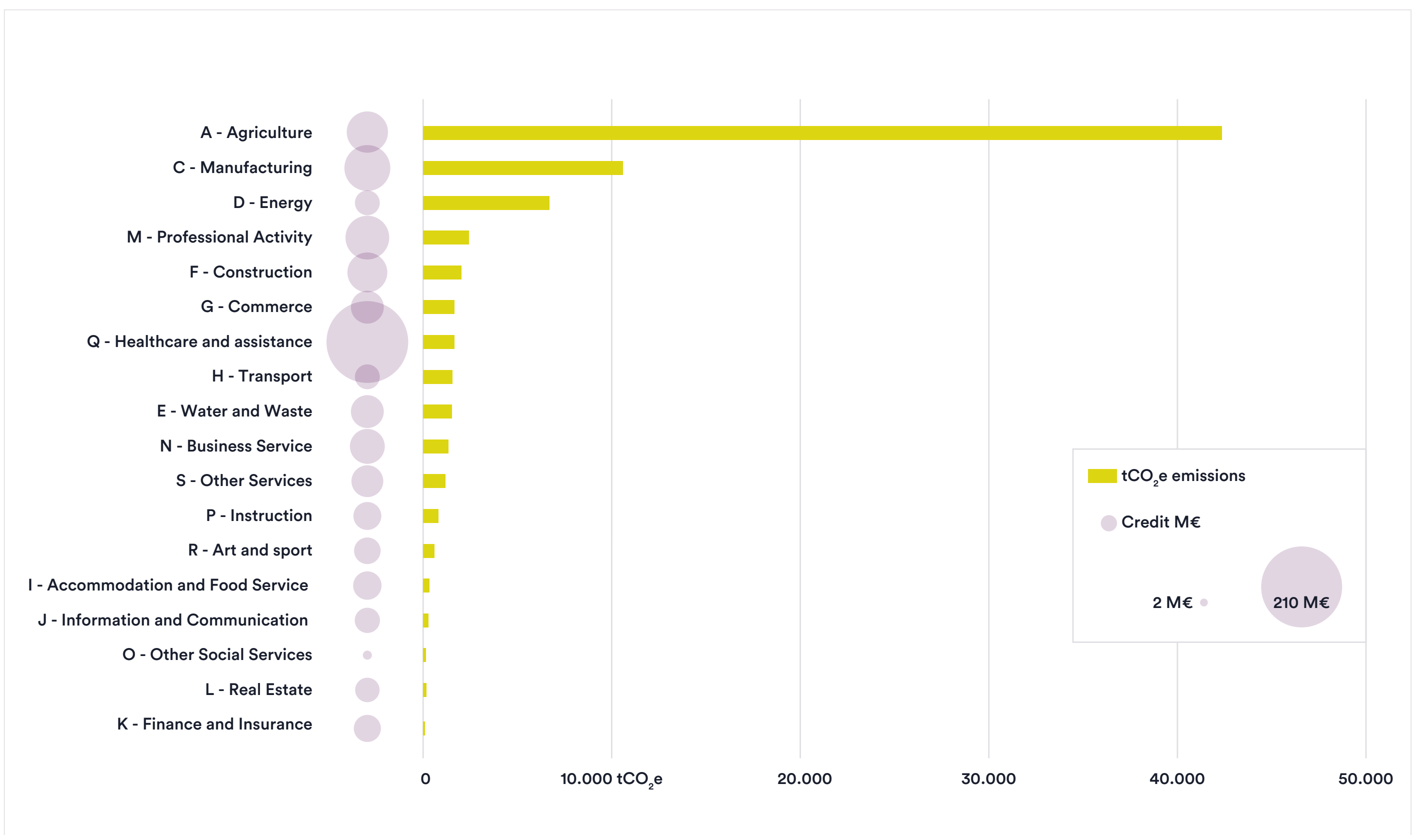
GLOBAL ALLIANCE FOR BANKING ON VALUES (GABV) CLIMATE CHANGE COMMITMENT (CCC)

During its annual summit in 2019, held in Vancouver, the Global Alliance for Banking on Values (GABV) announced the **Climate Change Commitment**, also known as CCC. As of May 2023, GABV consists of 34 member banks. These banks voluntarily undertake the responsibility of measuring and reporting the carbon footprint of their loans and investments for a period of three years, aligning with the goals of the Paris Agreement. Significantly, this commitment specifically addresses Scope 3 emissions, which hold significant importance for financial institutions. However, these emissions are often overlooked by methodologies used by other net-zero alliances.

CASE STUDIES

Banca Etica - Italy

In 2022, the European Banking Authority (EBA) implemented new **Guidelines on credit origination and monitoring** (LOM). These guidelines urge banks to incorporate environmental, social, and governance (ESG) considerations into credit risk assessment.
Ethical banks have been pioneers in this field. Banca Etica was the first in Italy to adopt a Socio-Environmental Assessment (VSA-*Valutazione Socio-Ambientale*) since the early 2000s. A questionnaire is sent to companies applying for financing. Based on the answers, the bank calculates an index called ESG credit score, which assesses the impact of the company's social and environmental choices on the risk of loan default. In 2015, 53.4% of corporate financing resolutions were covered by VSA. By 2022, the percentage had increased to 95.8% out of a total of 1,044 resolutions.
The Socio-Environmental Assessment is just as important as the economic and financial analysis in determining creditworthiness. Moreover, companies with a better ESG profile also enjoy more favourable conditions, owing to their greater resilience to future shocks.
Banca Etica was also the first Italian bank to **disclose** the emissions of its financial activities (Scope 3) based on the PACF protocol, as recommended by the Climate Change Commitment of GABV. In 2022, Banca Etica's overall activities generated 313,000 metric tons of CO2 equivalent. This amount significantly increased compared to previous years due to the new standards introduced by PCAF for emissions resulting from the ownership of sovereign bonds. More specifically, the loans granted to organisations and businesses resulted in the emission of 74,000 metric tons of CO2 equivalent. Out of this amount, nearly 9,000 metric tons were directly measured by the clients, while calculations for the remaining emissions were based on sector-specific averages provided by PCAF. The three sectors that contributed to the largest share of total emissions were Agriculture, Forestry, and Fishing, accounting for 57%, Manufacturing activities for 14%, and Energy for 9%. At the same time, Banca Etica financed energy-saving initiatives and the installation of renewable energy production facilities, helping to avoid nearly 70,000 metric tons of greenhouse gas emissions annually.

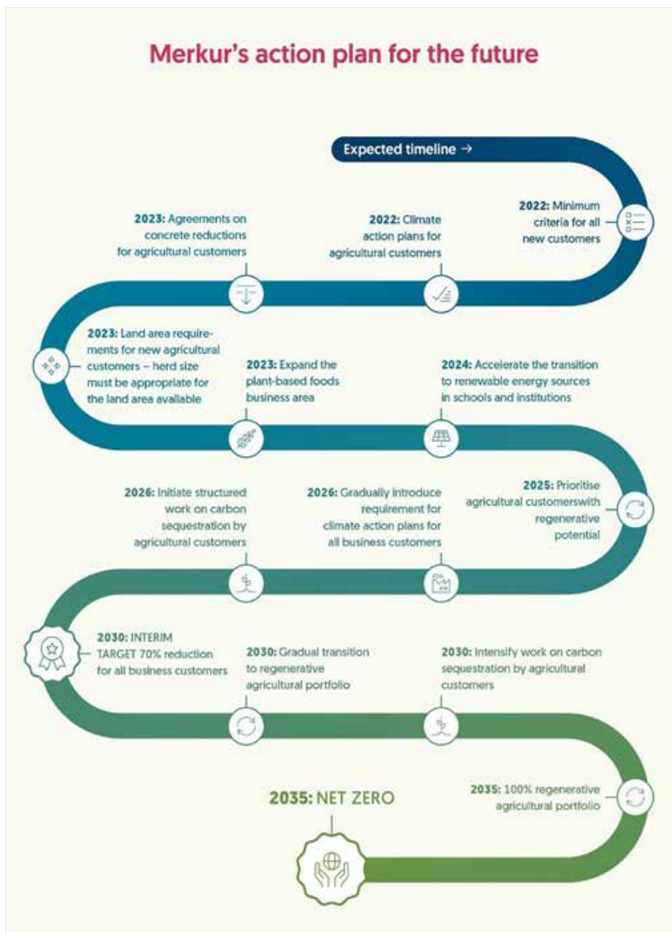


Graph 8 - Banca Etica. Business loan emissions.

The next step will be to take targeted actions for customers with significantly higher emissions compared to the sector average or revenue class.
Indeed, Banca Etica is currently collaborating with an external provider to develop software that will enable customers to calculate their Scope 1 and Scope 2 emissions. Currently, the bank itself performs these calculations using the PCAF protocol.
As this report is being drafted, a pilot phase is currently underway. Following this phase, the tool will be made available to approximately 6,000 entities that have already undergone a Socio-Environmental Assessment.
This initiative will provide a more detailed overview of each customer's emissions, allowing for a comprehensive analysis of their individual environmental impact.
Moreover, the bank can play a facilitating role in climate transition. Presently, the pricing model takes into account ESG scoring in addition to economic and financial variables. In the future, the bank may also introduce environmental covenants.
Customers will have the opportunity to submit their decarbonization plans, and upon validation by the dedicated office, they can enjoy favourable interest rates by meeting their annual emission reduction commitments.

Merkur - Denmark

In its journey to reduce emissions from its financed activities, the Danish bank Merkur has devised a specialised strategy for the sector that generates the highest emissions: agriculture.
Agriculture represents 26% of the loan volume granted to businesses but contributes to 84% of the emissions financed (resulting in an estimated total of 6,589 metric tons of CO2 equivalent in 2022).
This approach also stems from dialogue with customers. In 2022, the bank reached out to customers individually to collect data on each agricultural company.
In addition to enabling more refined measurements of carbon intensity, this customer engagement also played a crucial role in developing targeted climate action plans. Building upon this progress, the institution will collaborate with its customers to assess agricultural methods with the highest carbon storage capacity, including regenerative agriculture and land fallowing. In 2022, Merkur launched a strategic project called "the Plant Journey", aiming to gradually allocate more space (and resources) to agricultural businesses primarily focused on plant-based production, while scaling down livestock farming.



Graph 9 - Merkur's action plan for the future.

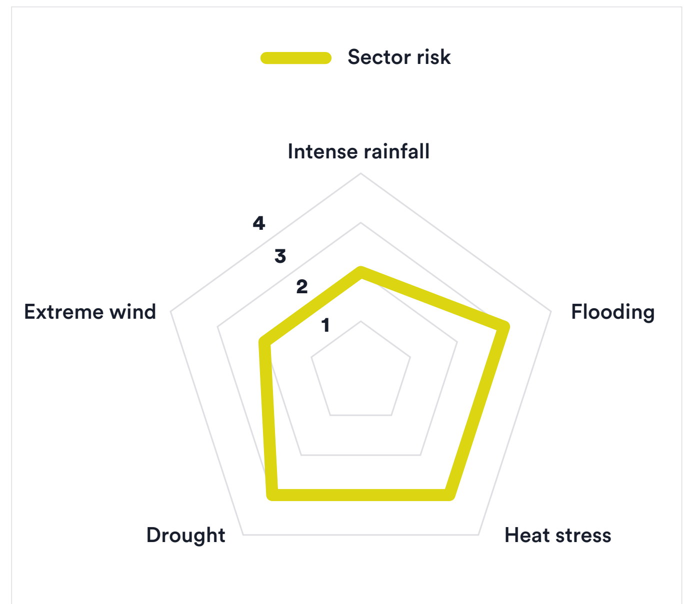
GLS Bank - Germany

Despite their inherent limitations, methodologies for accounting emissions from financing and investments have become widely adopted, empowering banks to take more effective measures for mitigation.
However, when it comes to adaptation, there is still a significant need for raising awareness and building understanding.
The German GLS Bank is actively engaged in addressing this issue through the KlimAnKo project. In collaboration with the Institute for Ecological Economy Research (IÖW), Liminalytics GmbH, and funded by the Federal Ministry for the Environment (BMUV), this initiative focuses on climate risks and adaptation. It encompasses the bank itself and client companies in three key sectors: construction and real estate, food and agriculture, and renewable energies. These sectors collectively account for around 70% of the total.
In practice, a dedicated platform called the Impact Measurement Portal collects all available data related to each customer. This includes basic information such as industry sector and geographic location, as well as more advanced details like the characteristics of the premises, supply chain, and any existing physical risk protection measures. All of this data is cross-referenced with climate risk information provided by the specialised partner Liminalytics GmbH, which covers factors like heat stress, drought, and flooding.
This comprehensive approach enables the bank to assess the specific customer's profile in the short, medium, and long term.

Graph 10 -GLS Bank illustrates the process by using the example of a farmer named X.

Agriculture faces diverse physical risks, with different crops being affected by excessive or insufficient water, heat stress being a significant concern for livestock farmers, and strong winds and hail posing threats to plants. GLS Bank develops individual estimations of climate impacts for each client based on their geographical coordinates and the nature of their agricultural activities. In the case of farmer X, for instance, there is a high susceptibility to drought, considerable exposure to floods and extreme winds, and limited vulnerability to heavy rainfall and heat stress. Estimations are made for each specific physical risk in both the short and long term (2050), taking into account the location of each client.

While compiling this report, GLS Bank's Strategy and Development team was in the process of developing the model. The next phase will focus on implementing tailored adaptation measures. The aim is to integrate the concept of adaptation into GLS Bank's business and sustainability strategy, while also fostering awareness among customers and other banks through educational and outreach initiatives.



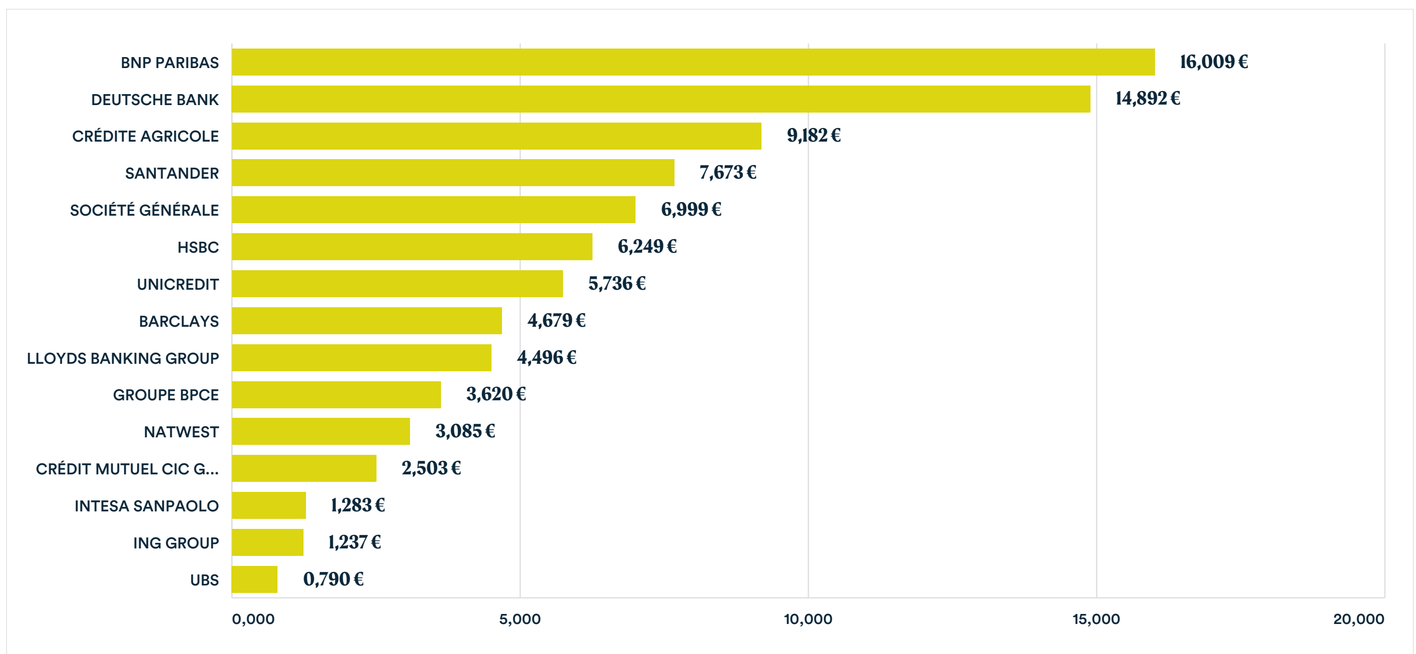
Graph 11 - Sector risk: agriculture

3. Finance for Peace

Mauro Meggiolaro, Senior Data Analyst, Fondazione Finanza Etica
Valentina Neri, Reporter, Valori.it

Due to the conflict in Ukraine, 2022 witnessed the resurgence of war as a central topic of debate and people's lives, even within Europe. It is, therefore, unsurprising that there has been a surge in global military spending. The Stockholm International Peace Research Institute (SIPRI) reported a real increase of 3.7% in 2022, bringing the total to a record high of £2.24 trillion. In Europe, the increase was even higher, reaching 13%. This analysis refers to government spending, but the banking system also plays a role. This is evident from the fact that, in the aftermath of the Russian invasion, several European conventional banks have considered reintroducing investments in weapons, despite having prohibited such practices for years or even decades.

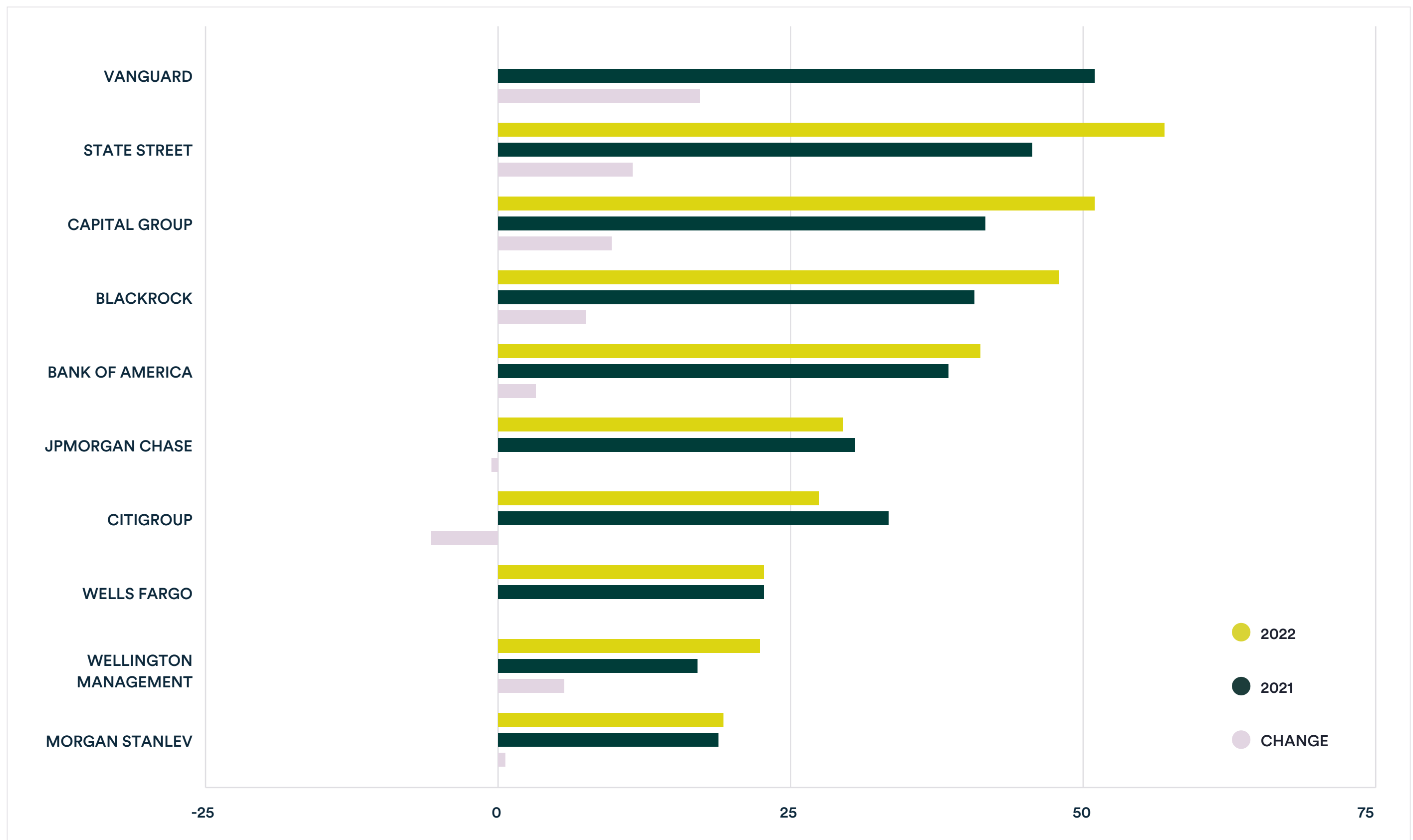
Reestablishing the links between the banking sector and the arms industry is not simple. The Dutch organisation PAX reports that all 15 major European banks provide financial services to manufacturers supplying weapons to countries where there is a high risk of their use against civilians. The report, published in the summer of 2022, highlights a total value of loans and underwriting amounting to €87.7 billion. Among the beneficiaries are companies such as Airbus, which has sold fighter jets and anti-ship missiles to the United Arab Emirates, and General Electric, which supplies jet engines to Saudi Arabia, involved in the bloody war in Yemen for over seven years.



Graph 1 - Total value of financial services to arms companies exporting to countries at risk (in million euros).

As indicated in the table extracted from PAX's report, the prominent banks involved in Europe include BNP Paribas, Deutsche Bank, Crédit Agricole, Santander and Société Générale. However, as mentioned above, all 15 major European banks provide financing to arms manufacturers that export to high-risk countries.
The nuclear weapons sector remains a subject of contention and is annually monitored by the 'Don't bank on the bomb' report (on page 68). Between January 2020 and July 2022, the report identifies 306 banks and financial companies linked to 24 'heavily involved' companies in nuclear weapons production. Their financial support, through loans and investments, totals $746 billion, $61.5 billion more than the previous 2021 report. The top ten rankings are all U.S. banks, with BNP Paribas being the first European bank with $12.7 billion (as seen in the following figures). The next edition of the report, published in 2023, highlights some signs of improvement by examining the policies of 109 banks and

financial companies: 55 exclude any financial relationship with nuclear weapons-producing companies (the only Italian one being Banca Etica), while the other 54 have adopted policies that move in this direction, albeit with some exceptions.



Graph 2 - Top 10 investors in nuclear weapons producers compared. All figures in USD millions.

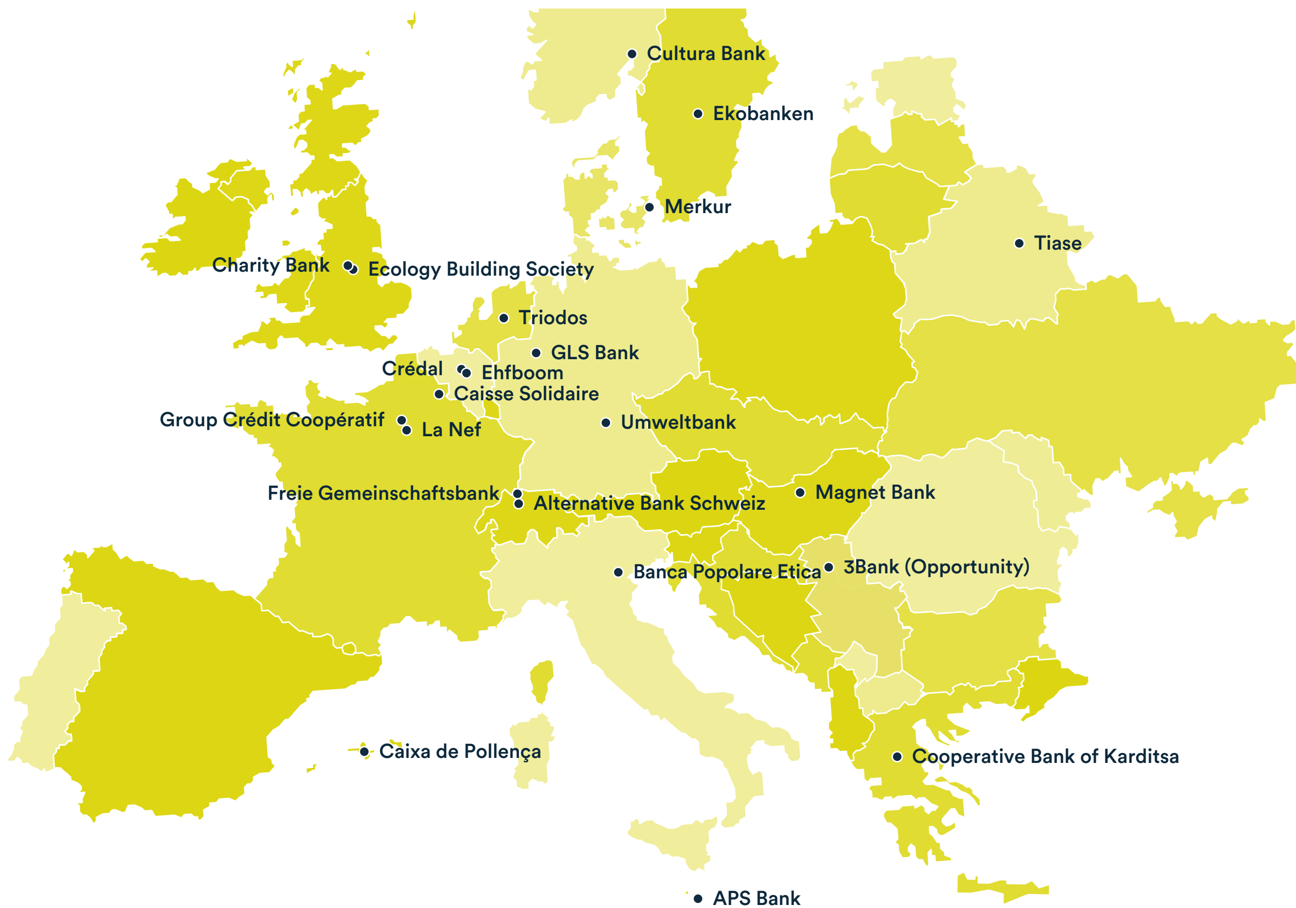
TOP 10 INVESTORS

Bank	Country	Investment (in million $)
Mizuho Financial	Japan	$12,900
BNP Paribas	France	$12,701
Mitsubishi UFJ Financial	Japan	$11,452
Deutsche Bank	Germany	$11,448
SMBC Group	Japan	$10,308
Crédit Agricole	France	$9,141
Sun Life Financial	Canada	$8,630
Royaò Bank of Canada	Canada	$7,989
Société Générale	France	$6,736
Japan Mutual Aid Association of Public School Teachers	Japan	$5,528
GRAND TOTAL		$96,833

Table 1 - Top 10 investors, not including US based investors, hold a combined investment of $96,833 million.

In 2018, there was still $8.7 billion invested by 88 banks in seven companies producing cluster bombs, which pose a significant threat to civilians as they often remain partially buried. This amount reflects a considerable decrease compared to the $31 billion reported in the previous year's study. However, it is still a substantial figure, especially considering that cluster bombs are prohibited by the United Nations Convention, which has been signed by over a hundred countries. Out of these 88 banks, only 7 are based in a signatory country. The next edition of the report is expected to be released in 2023.

EXCLUSION CRITERIA OF MAJOR EUROPEAN ETHICAL BANKS



Credit Cooperative - France

Companies whose core business involves the production or trade of weapons of war, ammunition for weapons of war, or combat vehicles are excluded from financing.

Triodos Bank - Netherlands

Triodos Bank excludes companies from financing and investments that:

- Produce or sell weapons, components specifically designed for weapons, and/or provide services related to weapons. 'Weapons' include both conventional and unconventional weapons such as nuclear, chemical, and biological weapons, as well as complete weapon systems.
- Offer financial services to companies that produce or sell weapons or services related to weapons (e.g., maintenance, repair, training for their use).
- Have holdings, equity investments, bonds, and/or provide loans to companies involved in anti-personnel mines, cluster bombs, biological weapons, chemical weapons, and/or nuclear weapons.
- Conducts an ad hoc evaluation of companies involved in the production or sale of technologies that can be used for both civilian and military purposes, to ensure that they are not designed to cause harm to people or animals.

«*Investing in weapons contradicts the foundations of our mission: the use of weapons, anywhere and at any time, undermines the physical and psychological integrity of human beings and fuels a culture of conflict and violence*», reads a statement published after the Russian invasion of Ukraine. The statement also warns against the revival of investments in weapons due to the war itself. «*Banks that start financing the production and/or trade of weapons today will continue to do so even when the conflict in Ukraine is over. This means normalising this type of financial activity and diverting funds (and attention) not only from conflict prevention, capacity development, and reconstruction but also, importantly, from other activities in the real economy that can truly contribute to social progress*».

GLS Bank - Germany

GLS Bank excludes from financing and investments the production and/or trade of weapons and armaments, specific components, and services for the military industry. This includes weapons prohibited by the Rome Statute of the International Criminal Court (e.g., weapons of mass destruction, landmines, cluster munitions), weapon systems (e.g., platforms and combat vehicles), and other military equipment (e.g., radar systems and military transporters). «*I firmly believe that weapons cannot be sustainable because they are destructive. There is nothing more destructive than weapons. War follows a certain logic. And it seems convincing. The convincing thing, so to speak, is that violence always begets more violence. You can only get out of it if you rise above it.* [...] *You see the infinite pain and infinite brutality that result from it, and you immediately ask yourself: why? Does all this improve anything? War can never be won*», says GLS CEO

Thomas Jorberg. «*GLS was founded in 1974, during the pacifist movement. The choice not to finance weapons is really in its genes*».

Umweltbank - Germany

Weapons and military articles are excluded from both financing (loans) and investments (funds) by Umweltbank. Umweltbank's investment funds exclude any company that generates revenue, regardless of the extent, from the production or distribution of weapons or from services related to weapons.
The bank excludes from investments states that have a military budget exceeding 2% of the Gross Domestic Product, possess nuclear weapons, or have not signed the Treaty on the Non-Proliferation of Nuclear Weapons.
On 1st March 2022, Umweltbank joined a group of church and ethical banks based in Germany (including Triodos) to condemn the Russian aggression in Ukraine.
The **statement** reads:
«*We call on all actors in the financial market to take responsibility and set an example. We condemn all direct and indirect financing in this war of aggression. All economic actors must now question their business relationships and carefully examine what is truly sustainable* [...] *We also urge investors to consider what is being financed with their money and which bank they want to work with*».

Banca Etica - Italy

The rejection of weapons is fundamental for Banca Etica. Its establishment, which began between 1999 and 2000, is intertwined and draws strength from the "Campaign to Pressure Armed Banks," promoted by the missionary magazines Nigrizia, Missione Oggi, and Mosaico di Pace, to "promote active citizen control over banks' support operations in the arms trade" and to "provide information to associations and individuals for a reconsideration of criteria for managing their savings." As a result of the pressure campaign, hundreds of citizens and religious entities began seeking explanations from their banks and, in the absence of satisfactory answers, decided to move their accounts to Banca Etica.
Since then, and up to the present day, a necessary condition to apply for financing from Banca Etica is not being involved in activities that involve the production and commercialization of weapons.
Etica Funds have never invested in companies involved in the production, use, maintenance, distribution, and storage of controversial weapons or their key components (such as anti-personnel mines, cluster bombs, or nuclear devices). They also do not invest in companies involved in the production of conventional weapons, their key components, and other products or services intended for military use.
Fondazione Finanza Etica, a cultural foundation established in 2003 with the aim of promoting the principles of ethical finance, is among the founding members of **Rete italiana Pace e Disarmo** (Italian Network for Peace and Disarmament), with which it also carries out activities of critical shareholder engagement. In 2023, Fondazione Finanza Etica launched **Finanza Disarmata** (Disarmed Finance), an information and mobilisation hub whose activities are focused on three areas: countering an armed economy, promoting peace finance, and divestment.

Ekobanken - Sweden

Swedish Ekobanken adheres to all international policies and conventions regarding weapons and excludes all types of weapons (conventional, cluster bombs, mines, nuclear weapons, chemical, and biological weapons) from its investments.

Merkur - Denmark

The Danish ethical bank Merkur, through its main investment partners (Triodos Investment Management and SDG Invest), maintains a zero-tolerance policy towards companies involved in the production or distribution of weapons, as well as related services. In a **statement**, the bank clarifies: «*Financing the arms industry is far from investing in security and defence. The arms trade lacks structural transparency, is poorly monitored, and is highly susceptible to corruption. Governments rarely provide comprehensive lists of countries excluded from their business activities, and even when expressly banning arms sales to conflict zones, these criteria are often compromised due to a lack of transparency. Even when weapons and military equipment are sold and traded for defence and security purposes, it is impossible to determine in advance how, where, and by whom the weapons will be used, as even outdated weapons can find their way into the 'black markets'. Ultimately, banks and asset managers channelling money to weapons producers have little to no formal control over – or limited control over – the entities to which the weapons are sold*».

Cultura Bank - Norway

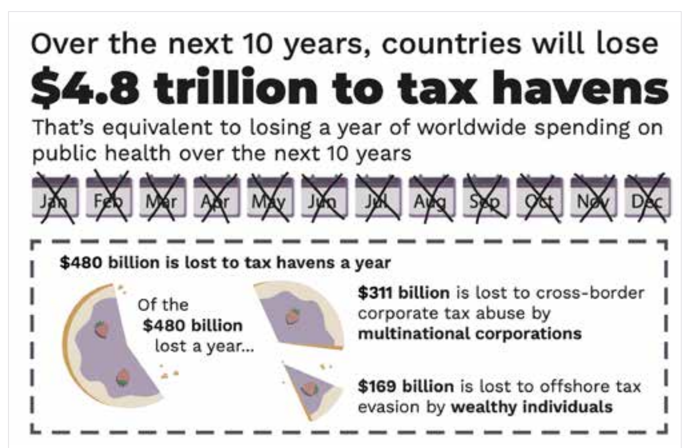
Cultura Bank **does not finance** companies and projects that are «*harmful to the environment or have a negative impact on people's lives and health*», including the arms industry.

4. Finance for Tax Justice

Federica Ielasi, professor in Economics and Finance, University of Florence

Sustainable and Responsible Investment (SRI) represents a long-term approach that integrates Environmental, Social, and Governance (ESG) factors into the research, analysis, and selection process of securities in the investment portfolio. This approach combines financial analysis with the evaluation of ESG factors and also involves engagement activities like participating in shareholder meetings, voting, dialogue, and pressure campaigns towards issuers.
The definition of SRI involves a selection and management process of securities based not solely on financial criteria. Various screening and analysis strategies can be employed, varying in complexity and relying on different underlying criteria. For instance, negative criteria can be applied, leading to the exclusion of specific securities from the investment portfolio. Positive criteria can also be employed to assess issuers' ESG performance and include them in the investable universe solely if they meet predefined parameters. Additionally, investment strategies can be driven by interaction criteria, where shareholders actively engage in dialogue with issuers and participate in their respective shareholder meetings.
In recent years, there has been significant growth in funds managed under an SRI approach. Alongside the increasing assets allocated to this sector and managers incorporating sustainable products, there has also been a qualitative improvement in the adopted strategies and indicators within individual approaches.

One notable addition among the recently introduced indicators is those related to "**Tax Justice**."
In a context where environmental concerns and growing social inequality are dominant, the issue of tax transparency and fair tax rates becomes crucial. Aggressive tax planning leads not only to market distortions but also significant social impacts and substantial public costs. Controversial tax practices should be a factor in evaluating companies and governments to promote greater social justice and corporate tax responsibility.
In this context, Tax Justice Network (TJN) was established in 2003 as a global think tank focusing on the relationship between inequality and taxation. According to a study published by the Network in July 2023, the public money losses that states will face in the next ten years due to the activities of individuals and corporations in tax havens amount to $4.7 trillion.



Source - State of Tax Justice 2023. Tax Justice Network

The United Nations' Sustainable Development Goals include the improvement of countries' tax collection capacity as one of the financial means to achieve those goals.

To promote a progressive transition towards fairer and more responsible tax practices, a key driver is **transparency** in this area. Tax reporting, therefore, becomes an essential factor in raising awareness among investors and various corporate stakeholders. For this reason, the Global Sustainability Standards Board has released a new set of GRI indicators titled 'Tax and Payments to Governments' (GRI 207 or GRI Tax Standard), which serves as the primary market standard for companies' ESG reporting. This standard defines the reporting requirements related to taxation and the impact of organisations in this context.
The Principles for Responsible Investments (PRI), a United Nations-supported network of investors aiming to promote sustainable investment and corporate responsibility, have also recognized the importance of integrating tax considerations into investment evaluation. According to a survey conducted by the PRI among supplementary pension holders, in some countries, over 75% of beneficiaries consider it very or somewhat important that the companies in which their pension funds are invested refrain from engaging in unethical tax practices, including evasion or avoidance.
Furthermore, the PRI has published documents on Corporate Tax Responsibility and a report on Tax Fairness. These resources aim to assist investors in assessing companies'

tax-related practices, provide insights into warning signs of potential tax risks, and guide investor-company dialogues. PRI recommends best practices for tax transparency to ensure responsible corporate tax behaviour.
Drawing from the earlier discussions, models for selecting and managing securities within SRI financial portfolios have started to include the assessment of issuers' tax behaviours in certain cases. Etica Funds stands out as one of the most advanced examples, seamlessly integrating evaluations of tax transparency and aggressive tax planning by companies into various aspects of its portfolio selection and management policy. Indeed, tax-related considerations are applied at various stages throughout the process of constructing and managing investment portfolios for funds managed by Etica Funds.
Firstly, the company **excludes firms** from its portfolios whose parent company is registered in a country identified as a tax haven (negative selection criterion). Moreover, Etica Funds evaluates the level of **reputational risk** and excludes issuers if the risk is deemed excessively high, both in absolute terms and compared to the trend of the last two years. The evaluation of reputational risk encompasses various aspects, including tax evasion, tax optimization, and the use of tax havens.
Furthermore, Etica Funds has incorporated dedicated **tax-related indicators** into its models used to assess the ESG scores assigned to companies and governments (positive selection criteria or best in class).
Here are the criteria used for assessing companies in tax-related matters:

- *Level of transparency on payment of taxes*. Indicator qualitatively assesses the transparency concerning income tax payments in all regions and countries of the company's operations. It also evaluates the disclosure of any other types of taxes, such as property taxes or royalties.
- *Social and economic development - policies*: The indicator assesses policies implemented to promote the social and economic development of local communities where a company operates. This evaluation includes promoting responsible tax strategies and commitments to avoid operations in offshore or OECD non-compliant countries.
- *Social and economic development - implementation*: The indicator assesses how processes are implemented to fulfil the commitments made for the social and economic development of local communities where a company operates, including tax responsibility.
- *Social and economic development - results*: The indicator evaluates the trends in key performance indicators related to social and economic development, including tax reporting transparency. It assesses various indicators, such as the disclosure of taxes paid by activity country, the ratio of taxes paid to the nominal corporate tax rate by activity country, the explanation of differences between the actual and expected effective tax rates, and the presence in offshore or OECD non-compliant countries.

Regarding the assessment of countries, Etica Funds completes its ESG analysis by evaluating data from Tax Justice Network concerning:

- *Financial Secrecy Score*: This indicator assesses jurisdictions based on a score that combines their financial secrecy and the extent of offshore financial activities they host.
- *Corporate Tax Haven Index*: This indicator ranks jurisdictions according to a score that combines their facilitation of harmful tax practices for multinational corporations and the scale of economic activities they host.

Taxation is particularly relevant within Etica Funds's engagement activities, aimed at promoting more responsible behaviours among entities included in their fund portfolios. Specifically, Etica Funds's Engagement Policy includes a specific point on issuers' tax responsibility, outlining potential dialogue and voting activities during shareholders' meetings on the subject. Within Etica Funds's Engagement Plan, the taxation domain is divided into three themes, with specific expectations provided to guide the company's dialogues with issuers included in their portfolios.

1) *Tax Policy*: Companies are required to publish a tax policy or highlight the principles adopted for tax planning.
2) *Tax Governance and Risk Management*: Companies are required to formally include taxation in the mandate of the Board of Directors' oversight. Additionally, issuers must define tax risk and develop a related management mechanism.
3) *Tax Reporting*: Companies are required to publish a Country by Country Report, which highlights relevant tax information for all countries where they operate, including data on taxes paid and explanations for any gap between the effective tax rate and statutory tax rate.

Etica Funds's voting guidelines specify that in case of significant tax-related disputes, votes should be cast against the Chairman of the Sustainability Committee, or alternatively, or alternatively, against the Chairman of the Board of Directors or the CEO. The Engagement Policy also entails voting in favour of any shareholder resolution, such as those requesting the disclosure of tax policy and historical tax data, as well as defining the company's tax risk.
Apart from individual dialogues and voting in individual shareholders' meetings, Etica Funds also engages in collaborative dialogue on tax-related issues within international networks it is associated with, such as PRI and Shareholders for Change.
Etica Funds has also engaged in national and international initiatives and campaigns related to corporate tax responsibility. Notably, in 2019, they participated in consultations for the development of the new set of GRI 207 indicators, and in 2021, they endorsed a letter prepared by PRI and addressed to the European Parliament. The letter advocated for regulations mandating European-based

multinational corporations to publish a Country by Country Reporting and included some recommendations to improve the existing proposal.
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Lastly, it is worth noting that since its establishment in 2022, Etica Funds has been a part of the PRI's Tax Reference Group, a working group leadingPRI's activities on taxation and aids in the development of related programs on the subject.

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