BARRIERS TO GROWING THE PURPOSE-DRIVEN BANKING SECTOR IN THE UK

GROW
PURPOSE
DRIVEN FINANCE

DISCUSSION PAPER

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PURPOSE

Pronunciation /ˈpəːpəs/

1. The reason for which something is done or created or for which something exists.
2. [mass noun] A person's sense of resolve or determination.

SYNONYMS
intention, aim, object, objective, goal, end, plan, scheme, target, ambition, aspiration, desire, wish, hope

THE FINANCE INNOVATION LAB

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BACKGROUND

The Finance Innovation Lab's vision is a financial system that is democratic, sustainable, just and resilient. Central to achieving this vision will be the growth of purpose-driven finance institutions. By purpose-driven finance, we mean institutions that have a social and/or environmental purpose embedded within them.

This means the purpose is hard-wired into the organisation, for example in its ownership, governance or mandate. While strong leadership from owners or managers can be the basis for aligning institutions to a deeper purpose, this depends on the leadership remaining in place. If owners or managers change, or external or internal factors put pressure on the commitment to purpose, things can shift. We may call institutions where the commitment to purpose is derived from the leaders in place at the time *purpose-led* institutions. *Purpose-driven* institutions in contrast have purpose embedded in their structure, so whilst they also need good leadership to contribute effectively to social and environmental goals, their commitment to the purpose is much stronger and not dependent on who is in charge at any particular time.

A budding ecosystem of alternative, purpose-driven finance institutions exists in the UK, including in banking (the focus of this paper) and investment (organisations such as Abundance have been leading the way), but this UK ecosystem is much smaller than that of other European countries. This report focuses on purpose-driven banking in the UK, and sets out the size, composition and drivers of this ecosystem, alongside an analysis of the current opportunities and barriers to growth.

What fits into the realm of banking is not just alternative 'ethical' banks. Because barriers to entry into the banking sector are so high, we have included institutions that provide retail services centred on the three main services in banking – deposits (bank accounts and savings), lending (mortgages and loans) and payments. There are five types of purpose-driven institutions we investigate here: credit unions; community development financial institutions; building societies; ethical banks; and mutual banks.

PURPOSE-DRIVEN BANKING SECTOR

There are five key types of institution which make up the current UK purpose-driven banking ecosystem: credit unions; community development finance initiatives (CDFIs); building societies; ethical banks; and mutual banks (which are not yet trading). Table 1 below sets out brief descriptions of these types, with an assessment of their current size. Direct comparisons between purpose-driven banking and mainstream banking is not straightforward, but where comparisons can be made, they will be included in the table.

TABLE 1. UK PURPOSE-DRIVEN BANKING OVERVIEW

TYPE OF INSTITUTION	SIZE	LEGISLATION
CREDIT UNIONS There are over 400 credit unions across the UK. Traditionally, credit unions have been small, not-for-profit providers of savings services and loans for members. However, many now offer additional products such as prepaid debit cards, insurance products, cash ISAs and in some cases even mortgages. The sector has a small number of large and many smaller credit unions. Membership of a credit union is based on a common bond. This can be working for a particular employer or in a particular industry, or simply living or working in a specified geographical area. This could be as small as a village, or as large as several local authority areas. **Trade associations**: there is a great diversity of trade organisations for credit unions, with several in the UK, including: • The Association of British Credit Unions Limited (represents over 70% of credit unions) • UK Credit Unions Ltd • The Irish League of Credit Unions • The Scottish League of Credit Unions • Credit Unions of Wales.	Total UK assets at 30 September 2019 stood at a record £3.5 billion. At the end of the financial year, there were just under 582,000 loans outstanding, with an average loan amount of £2,806. Northern Irish credit unions accounted for 29% of all credit union loans, with an average loan amount of £3,767. Welsh firms accounted for only 3% of the loans, with the smallest average amount outstanding – just £1,460 per loan. English credit unions had 48% of the loans, with an average amount outstanding of £2,184.[1]	In Great Britain, credit unions are registered under the Co-operative and Community Benefit Societies Act 2014, and as a credit union under the Credit Unions Act 1979 ('society legislation'). In Northern Ireland, The Credit Unions (Northern Ireland) Order 1985 is the principal legislation. Credit unions require authorisation by both the PRA and FCA.

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1 Bank of England (2020) 'Credit Union Annual Statistics 2019'

<table>
<tr><th>TYPE OF INSTITUTION</th><th>SIZE</th><th>LEGISLATION</th></tr>
<tr><td>COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS (CDFI)

CDFIs are not-for-profit social enterprises. There are two types of CDFIs (although some CDFIs do both):

Personal CDFIs: provide affordable credit to low-income consumers as an alternative to high-cost credit. Because personal lending CDFIs serve a segment of the market which is outside the risk appetite of mainstream lenders and some high-cost lenders, their target customer market is relatively high-risk, with a corresponding risk of default. There are currently around 50 CDFIs in the UK, of which nine offer personal loans to consumers.

Business (or enterprise) CDFIs: most CDFIs focus on lending to small businesses to improve local employment. They focus on providing loans to SME busiesses (often regionally-based).

Trade associations: the main trade body is Responsible Finance, and Fair4All Finance and Big Society Capital both have CDFIs in their remit.</td><td>In 2018, the personal lending CDFI sector gave out 46,000 loans with a value of £26 million. Yet, this still barely registers in relation to the need. The commercial high-cost credit sector provided £4.5 billion in personal lending during the same period.[2]

In 2019, business CDFIs lent £78 million to 4,200 businesses, and £93 million went to almost 400 social enterprises.[3]

Outstanding bank lending to SMEs from large and small banks totalled £160 billion in 2020.[4] Bank lending to SMEs between December 2017 and December 2018 was £30.5 billion,[5] which makes CDFI lending less than 0.25% of the entire SME market.</td><td>Some CDFIs can take the form of companies, but many are Registered Community Benefit Societies, which are an alternative form of corporate vehicle.

CDFIs are eligible for Community Investment Tax Relief. This is a significant advantage for CDFIs that other categories of purpose-driven banks do not have access to.

A CDFI may not need to be authorised and regulated if its activities fall outside the scope of regulated activities under the Financial Services and Markets Act 2000, but this will depend on the exact scope and nature of those activities.

CDFIs are not subject to any interest rate cap, so they reflect risk in the cost of the credit they provide.

Loans are often offered at rates above 100% APR and, in some cases, over 200% APR.

Although these rates are high, many products offered by high-cost lenders have interest rates which frequently exceed 1000% APR. This means CDFI loans are lower cost options for some consumers.</td></tr>
<tr><td>BUILDING SOCIETIES

Building societies (of which there are 43 in the UK) are mutual institutions whose statutory ‘principal purpose’ must be to make loans which are secured on residential property and funded substantially by their members.

Building societies can carry out a wide range of other activities, including other types of lending, investment advice and insurance mediation services.

Trade association: the Building Societies Association is the trade body for all 43 building societies. It also includes six credit unions in its membership.</td><td>Total building society assets were £406 billion at the end of March 2019.

Building societies had outstanding mortgage balances of £336.6 billion at the end of March 2019, a 23% market share[6] of the total mortgage market.

Savings

Household savings balances outstanding at building societies in Q2 2020 stands at £297.3 billion, an 18% market share of the total £1,609.2 billion[7] across the market.</td><td>Building societies are subject to certain statutory provisions, such as: 75% of their lending must be secured on residential property; at least 50% of their funding must be raised in the form of shares held by individual members (retail deposits); and there are some restrictions on their treasury activities.

Building societies require authorisation by both the PRA and FCA, however the last new one to form was Ecology in 1981.</td></tr>
</table>

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2 Dayson et al. (2020) ‘Scaling up the UK Personal CDFI Sector’
3 Responsible Finance (2020) ‘Responsible Finance: The Industry in 2019’
4 Bank of England (2020) ‘Open Data for SME Finance’ p8
5 UK Finance ‘SME update 04 2018’
6 Building Society Association (2020) ‘Latest BSA Statistics’
7 The Money Charity, (2020) ‘Monthly Statistics’

TYPE OF INSTITUTION	SIZE	LEGISLATION
ETHICAL BANKS These banks provide a range of retail banking services including current accounts, loans and savings. There are two UK banks that are members of the Global Alliance for Banking on Values – Triodos and Charity Bank. Triodos Bank serves individuals, organisations and businesses with current accounts, lending and saving. Charity Bank offers savings accounts for retail customers, and loans to the social and charity sector. Unity Trust Bank serves organisations with current and savings accounts and loans. They work with organisations that aim to have a positive impact on society through economic, community or social change. Reliance Bank (formerly Salvation Army Bank) is a full service bank, offering current accounts, savings accounts, mortgages and loans. Up to 75% of its profits are given to the Salvation Army International to fund their charitable and evangelical work. The Co-operative Bank is a full service bank for personal and business accounts. It is not a co-operative bank in structure. **Trade association**: there is no formal trade association for ethical banks, but both Triodos and Charity Bank are B Corporations, and members of the Global Alliance for Banking on Values. This is an independent network of banks and banking co-operatives that use finance to deliver sustainable economic, social and environmental development.	Triodos had assets of 16 billion Euros (£14.5 billion) in 2019. Their 2020 half-year results show that they had loans of 1.1 billion Euros (£998 million). They had 1.4 billion Euros (£1.27 billion) of deposits across 76,000 accounts. In terms of current accounts, Triodos has 76,878 accounts in the UK.[8] There are around 70 million current accounts in the UK, giving Triodos around a 0.01% market share. Charity Bank In 2019, Charity Bank lent £49.9 million to 67 different charities and social enterprises.	As banks, they require the normal authorisation by both the PRA and FCA.
MUTUAL BANKING MOVEMENT The mutual banking movement has roots in the Community Savings Bank Association (CSBA), which was set up to call for the creation of 18 regional mutual banks across the UK. Some regions have begun the process of setting up their own independent banks and, as of October 2020, South West Mutual and Avon Mutual have submitted their Regulatory Business Plans to the regulators. Fully owned by their members (every customer will be a member), these banks aim to provide full service retail banking for individuals and SMEs including bank accounts, savings, loans and mortgages. Their aim is to provide a local offer with new technology to serve the communities they are part of, in order to contribute to economic development and local resilience. Trade association: the CSBA mutual organisation supports banks up until their banking licence application. The Regional Finance Network has been established as a trade association for regional mutual banks that have commenced the application process, and for when they are licenced.	No regional mutual banks are trading, but there are several at various stages of development. Avon Mutual and South West Mutual are in the pre-application process. The underlying business model assumes around 4% share of personal current accounts and 5% of SME current accounts, as well as a share of lending across loans and mortgages.	As banks, they require the normal authorisation by both the PRA and FCA.

It is clear from an assessment of market shares that, whilst local and individual benefit may be transformational for those who engage with the organisations above, the purpose-driven ecosystem is very small in comparison to mainstream banking services. The competitive challenge of regional mutual banks and ethical banks should provide additional motivation to mainstream banks to improve their performance, and so the impact should be wider than that measured by market share. The challenge of growing this sector goes hand-in-hand with the challenge of transforming mainstream banking to better serve a social and environmental purpose.

8 Triodos Bank, Half Year Results 2020 p20

AN EXPLORATION OF PURPOSE

Our initial definition of purpose-driven finance going into this research, refers to *institutions that have a social and/or environmental purpose embedded within them.* This means that purpose must be in some way hard-wired into the organisation, for example in its ownership, governance or mission.

We sought to explore the concept of purpose with our participants, with one remarking:

> **"all finance is for a purpose, what that purpose is however, differs"**

The point being made here is that the vast majority of banks are conceived as being driven solely or principally by balance sheet growth and the need to deliver shareholder profit. Much has been written on this, and a useful distinction can be found in the analysis of the difference between shareholder and stakeholder banks:

- **Shareholder banks:** the most common type of bank in the UK, i.e. most commercial banks – the main objective being the maximisation of shareholder value.
- **Stakeholder banks:** a much rarer type of bank in the UK (but common in Europe and other countries), where the main objective is to maximise stakeholder value.[9]

Purpose-driven banking institutions can be understood as fitting the stakeholder model, in that they are driven by both social and/or environmental and financial objectives. Although profit is clearly an important factor, particularly for sustainability (and to become a bank in the first place), it is often not the primary objective. Growth and profit are means to another end, be that supporting the financial wellbeing of local people (credit unions), providing resource to local businesses (CDFIs), contributing to local wealth creation and circulation (mutual banks), providing for sustainable housing (building societies), or making positive investments for a sustainable world (ethical banks).

Why is purpose important? Purpose gives an inbuilt direction to these institutions that is lacking in mainstream banking. Embedding a social and environmental purpose changes the outputs and what is created and supported by finance and banking. As RSA Fellows David Pitt-Watson and Dr Harinder Mann put it:

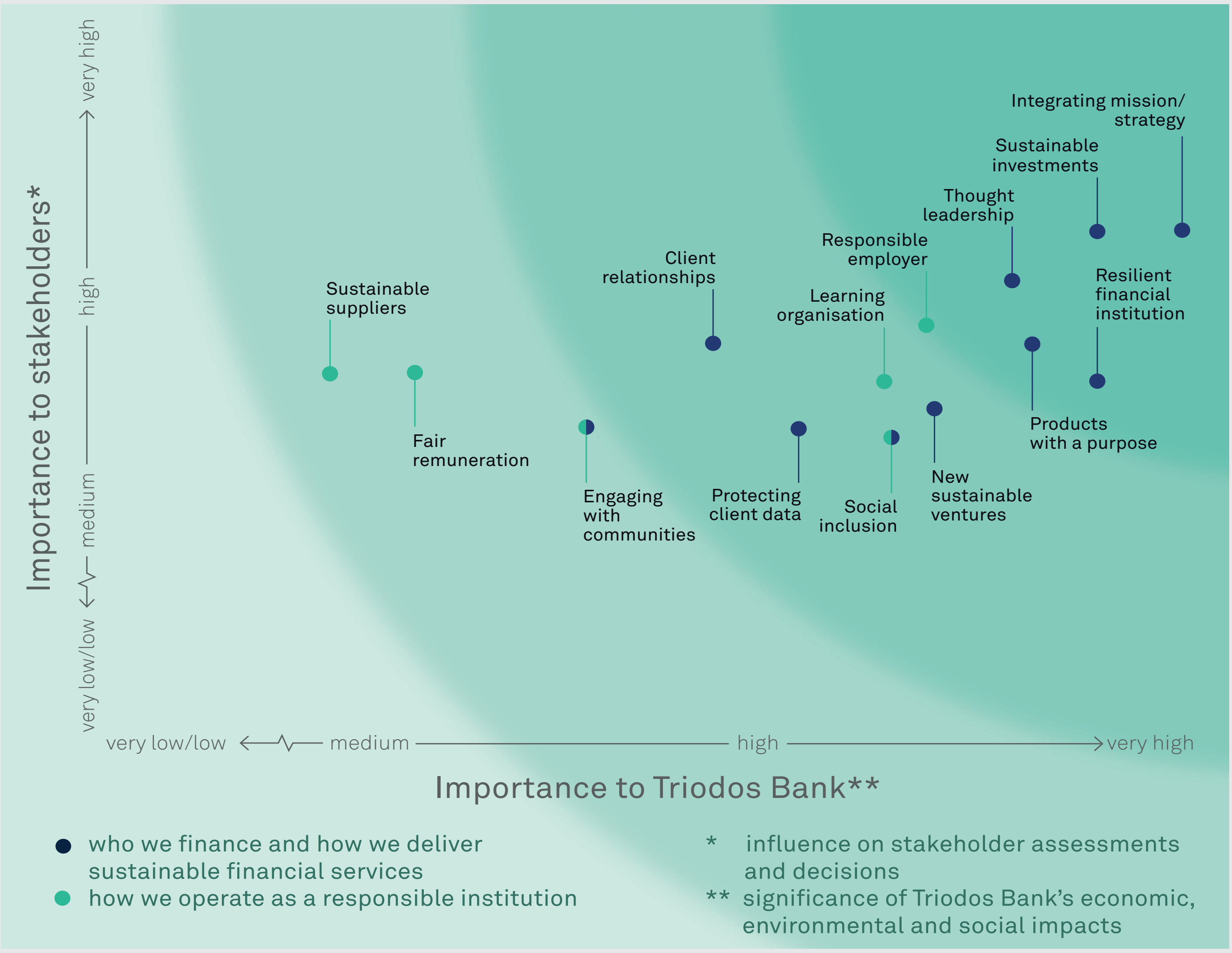
> **"No regulator has tried to define purpose and to measure whether or not it is being fulfilled. If you only get what you measure, then it is scant wonder that regulators have failed to encourage a purposeful industry. Instead they have focused on micro-regulation, believing this to be the best way to protect customers.**
>
> **If regulators take this approach, and if the boards of banks believe their only purpose is to profit while the regulator has sole responsibility for financial stability, we must anticipate trouble ahead."[10]**

This is an apt reminder that finance, and banking, is not neutral, even when it is often treated as such. Our previous work, The Regulatory Compass, sought to create space for UK regulators and the policymakers who instruct them to develop a more explicit and holistic concept of what social purpose means in the context of financial services. We found that rather than being 'purpose-neutral', regulation is often designed around the large, shareholder-focused firms that dominate the market.

9 Prieg, L. and Greenham, T. (2012) New Economics Foundation, 'Stakeholder Banks: The Benefits of Banking Diversity'
10 Singh, A. Toner, E. and Hall, M. (2020) 'The Road to Resilience: how community financial institutions can level up Britain' p.20

BOX 1. TRIODOS' 'MATERIALITY MATRIX'

Triodos Bank regularly engages with its stakeholders to understand their needs and interest in the bank. It identifies three categories of stakeholders: those who engage in an economic relationship with the business; those who do not have an economic relationship, but who have a close interest in Triodos Bank from a societal perspective; and stakeholders who can provide new knowledge and insights. Figure 1 shows the latest results of its stakeholder engagement on topics that are material to the business, with regard to how the business operates, who it finances and how it delivers this.



Source: Triodos Bank Annual Results 2019

When asked, interview participants on the whole agreed that the term purpose-driven finance fitted with the work they do; however it is worth noting that there are a number of other established terms they use to describe themselves, including ethical, mission-driven and values-based. For some, values-based banking was a more established term because of their participation in the Global Alliance for Banking on Values (GABV), but for all banks their choice of descriptor is very much influenced by the audience they are tailoring their message to.

So, if purpose is important to the financial system overall, what do we know about the drivers of those institutions that are purpose-driven, and how can we understand what the potential is to incubate and grow purpose-driven institutions for systemic benefit?

THE DRIVERS OF PURPOSE

A principal aim of this project was to explore what it is that sets the purpose-driven banking sector apart from mainstream banking. We found that, whilst mission is at the core of what sets an organisation on a path to become purpose-driven, there are three other principal drivers that impact on an organisation's ability to drive forward its mission. These are: ownership; governance; and culture and leadership.

FIGURE 1. THE FOUR KEY DRIVERS OF PURPOSE

Each of these drivers plays a role in the implementation of purpose for the organisations we looked at, but they do so in different ways and with different levels of emphasis on each. Some institutions were strong across all four drivers, others were stronger in one or two, but less strong in others. This means that these drivers can be used to further support purpose growth within existing institutions, but also to give some shape to what mainstream institutions or start-ups should be aware of if they would like to move towards greater social and environmental purpose.

MISSION

The principal driver of purpose that was consistent across all organisations we looked at is found in their underlying, ethical or values-based 'purpose' – most often expressed as a mission or mandate. The mission must be 'more than' financial.

For our participants, the missions that drive their organisations were diverse. Themes included economic development/resilience in communities, delivering benefit for members and contributing to sustainability. Table 2 below gives an example of some of the mission statements across our five purpose-driven banking sectors.

TABLE 2. MISSIONS OF PURPOSE-DRIVEN BANKING INSTITUTIONS

FIVE LAMPS (CDFI)
Mission: to transform lives, raise aspirations and remove barriers to social, economic and financial inclusion
ECOLOGY BUILDING SOCIETY
What we stand for: we're dedicated to building a greener society by providing mortgages for properties and projects that respect the environment and support sustainable communities, funded through our range of simple, transparent savings accounts.
SOUTH WEST MUTUAL
Our purpose: to promote inclusive and sustainable prosperity in the south west of England.
SCOTWEST (CREDIT UNION)
Vision: delivering better financial lives through caring about individual members and their happiness: growing together to become the leading credit union in Britain.
TRIODOS BANK
Mission: to help create a society that protects and promotes quality of life and human dignity for all. Since 1980, our sustainable financial products have enabled individuals and organisations to use their money in ways that benefit people and the environment.
AVON MUTUAL
Our vision: is to help repair a broken banking system in our community; which has seen branches and cash points closed, various scandals and low levels of lending to businesses.

The relative strength of the mission has an impact. Ecology is the most environmentally-driven of all the building societies. The relative strength of its mission, which embeds sustainability, sets it apart. Its mission drives the products and services offered, as well as the sequencing of decision-making.

It describes how it always starts with the individual transaction; taking an interest in the outcome, understanding whether the proposition fits with its mission, and if applicants have the right motivations. Only after these criteria are met, will return on investment be calculated. Its mission means that the values and outcome of the project comes first. This was felt to be a significant differentiator from other banks' attempts to provide green mortgages, where return on investment comes first, which leads to a preference for simple and easy projects, leaving potentially more innovative or impactful complex projects unfunded. This example shows how a mission can lead the organisation to greater impact.

Mainstream financial institutions also state a purpose and mission. For example, the Natwest Group's report, 'Our Purpose in Action', states they have three purpose areas: enterprise – to be the biggest champion of UK businesses; learning – to be a learning organisation; and climate – leading on addressing the climate challenge. These are indeed valuable missions for the banks in Natwest's group, however as you will see from Table 2 below, one of the group, Royal Bank of Scotland (RBS), sits bottom in a rating on ethical banks.

This shows us that a mission is not enough; necessary, but not sufficient. A mission needs to be embedded in the structure of purpose-driven finance for it to be meaningful, and if Natwest wants to truly advance its mission, then we suggest it could look at exploring how to do this through the other key drivers of purpose – ownership, governance, and leadership and culture.

OWNERSHIP

Most of the organisations we consider to be purpose-driven have different ownership models, with the majority taking a co-operative or mutual structure. Mutuals are organisations that are owned by their members, who then have a say (via the principle of one member one vote) in the decision-making structure of the organisation. Credit unions, building societies and mutual banks are all built on this foundation.

As you can see from Table 3 below, three of the top five rated ethical banks are mutuals. When we compare their scores with the top five UK banks (by market share), knowing that these all have traditional shareholder ownership models, we can infer that ownership is important.

TABLE 3. TOP AND BOTTOM ETHICAL BANKS

TOP 5 ETHICAL UK BANKS AND BUILDING SOCIETIES	SCORE
Charity Bank	100
Ecology Building Society	94
Triodos	94
Leeds Building Society	83
Nationwide Building Society	83
THE TOP 5 UK BANKS BY SIZE AND RANKED BEST TO WORST	**SCORE**
Santander	39
Lloyds	33
Barclays	22
HSBC	22
Royal Bank of Scotland/Natwest	22

Source: Ethical Company 'Ethical Banks & Building Societies Ethical Comparison Table 2020'

Whilst important, co-operative or mutual ownership is not the end of the story. Two of our top five ethical banks have something closer to a shareholder-led ownership model. Charity Bank issues shares, but only to trusts, charities or foundations for a "modest return, but with a central purpose to see your money do good".

Triodos differs, in that it is an independent bank, and has set up its ownership structure in such a way that the principles, values and objectives of the bank are protected. To ensure this, its shares are held in a dedicated Foundation, which issues depository receipts to anyone who wishes to buy them, and crucially exercises all the voting rights from those receipts – unlike in shareholder-owned banks, individual receipt-holders cannot exercise any control over Triodos. Depository receipts are not listed on the stock exchange, but traded on its own platform. The price of depository receipts is not market determined, but decided by Triodos based on its net asset value.[11] As of 2018, Triodos has over 42,000 depository receipt holders.

11 Triodos Bank, 'Triodos Bank. Important information about Depository Receipts in Triodos Bank N.V.'

Building societies are the most well-known mutual organisations, with over 25 million UK customers and covering 23% of all mortgages provided.[12] Despite often having local names, building societies are no longer exclusive to an area, with most operating over the whole of Great Britain (Northern Ireland has a separate jurisdiction). They are therefore no longer tied to specific regions in the way they once were. Credit unions and the emerging mutual banks' ownership are/will be rooted in locally-bound geographic areas, so ownership is/will be through members who live and work in the regions where the banks operate. This geographical dimension adds a specific character to the members, giving the potential for meaningful engagement amongst people who have a shared interest in their area.

Ownership is important because it provides an opportunity for different conceptions of who the organisations are set up to serve, and embeds this within their legal structure. It also provides for a level of democratic input into decision-making, although as we will see when we discuss governance, meaningful democracy is not a given, even under a mutual model of ownership.

GOVERNANCE

The importance of governance is perhaps best illustrated through an example. The Co-operative Bank is often considered to be the UK's most well-known purpose-driven bank, due to its ethical lending policies and historical association with the Co-operative Group. However, as co-operative banks were not legal in the UK before 2014, the Co-operative Bank was always structured as a private bank in terms of business model and, amongst other things, problems with its governance were seen as one of the key factors leading up to its crisis point.

In 2013, the bank came close to failure due to a capital shortfall. An independent review into the causes of the failure concluded that:

> **"The capital shortfall is rooted in a number of specific events. Poor commercial lending, a failed IT project, and mis-selling of PPI accounted for the bulk of it in numerical terms. But the severity of the problem was magnified by failures of management, lack of capability, a fallible culture and weak governance."[13]**

In terms of bank failures, it is worth remembering that the Co-operative Bank a) was not a true co-operative, and b) its problems were small in comparison to the spectacular governance failures of mainstream banks, such as those of RBS, Northern Rock and Barclays. However, a study (see box 2 below) found that governance that doesn't properly take account of the strength of co-operative structures serves as a warning to others that the ways in which purpose, ownership, culture and governance interact is important.

BOX 2. CO-OPERATIVE GOVERNANCE PROBLEMS

All governance structures can cause problems. A study by co-operative practitioner Peter Couchman and academic Murray Fulton examined the failure of large co-ops, and found five consistent features:

- seeing the co-operative structure as a weakness, not a strength;
- having the wrong people in charge;
- lack of board oversight;
- overconfidence;
- and a 'final roll of the dice', to achieve a big bang merger solution to a problem built-up over a long period.

Couchman & Fulton, (2016) 'When Big Co-Ops fail'

Today the Co-operative Bank is no longer owned – either in whole or in part – by the Co-operative Group, as it was rescued by international hedge funds. Thanks to ethical policies embedded in its Articles of Association,[14] it does still rate highly in ethical comparisons for its ethical investment policies. This underscores the importance

12 See Fintechtalents Building Soceties (2020)

13 Sir Christopher Kelly (2014) Failings in management and governance. Report of the independent review into the events leading to the Co-operative Bank's capital shortfall

14 The Co-operative Bank: Our Customer-led Ethical Policy

of mission in delivering purpose-driven outcomes, but the bank's near collapse serves as a warning to other purpose-driven finance organisations to understand the critical role of governance.

Governance and democracy are intertwined, and although only explicitly remarked on by one interviewee, economic democracy can play an important role in delivering purpose. It is not insignificant that the vast majority of purpose-driven organisations are mutually based. The exceptions to this are Charity Bank, which only accepts shareholding from trusts, foundations and charities, and Triodos, which holds shares on its own platform and not the stock market. Triodos, not being a mutual organisation, has set a structure to ensure good governance as seen in Box 3 below:

BOX 3. TRIODOS' GOVERNANCE STRUCTURE

SAAT

The Foundation for the Administration of Triodos Bank Shares (SAAT) manages all Triodos Bank shares. To finance the shares, SAAT issues depository receipts. The board of SAAT, Triodos Bank and its depository receipt-holders communicate, and meet, regularly. This happens informally and formally in meetings such as the AGM, and in meetings for depository receipt-holders in countries where the bank is active.

SUPERVISORY BOARD

The supervisory board oversees and reviews the activities and decisions of the executive board, and the development of Triodos Bank's operations, strategy development and the bank's overall mission. The supervisory board also provides advice and guidance to the executive board. Members of the supervisory board are independent; from each other, from the executive board, and from any other party or interest that might affect the board's operation.

Source: Triodos (2020) 'About Us'

Purpose-driven banking institutions need to embrace forms of governance that help them achieve their underlying missions and that fit with their particular ownership model. For example, governance for co-operatively owned institutions has to take into account how democratic processes and meaningful engagement with members can strengthen and drive forward purpose, sustainably, in the long-term.

CULTURE AND LEADERSHIP

The final driver of finance that we must attend to is that of culture and leadership. Many decisions in banking, and indeed all sectors and industries, are led by policies, regulations and other operational drivers, but the landscape on which these are created is shaped by culture, and culture is in turn shaped and driven by leadership.

But what is culture? Dr Hugh McCarney explains it like this:[15]

> **Academic accounts tell us that a corporation's culture refers to the beliefs and actions of its employees. Culture drives behaviours and strategies. It is what employees of an organisation live and breathe daily. Neoclassical economics usually assumes that behaviours stem from financial incentives: offer an employee a big enough bonus and he or she will sell life insurance to a corpse. Behavioural economics shows that status and approval are equally important: getting the biggest bonus is often more important than the actual financial sum itself. Some studies have therefore concluded that culture may even be the determining factor behind the long-term success and sustainability of a firm. As the financial crisis showed however, the opposite can also be true.**

What of positive banking cultures? How do purpose-driven banking institutions create cultures that are supportive of the mission?

If we return to the Co-operative Bank, it is interesting that it has not abandoned its ethical policy, and continues to be highly rated as an ethical bank. Its ethical policy is clearly a driving force, but I would argue that organisational culture plays a role in the assumptions and expectations that people have of the bank – so, despite the change in ownership and

15 McCartney, H. (2019) 'What's wrong with bank culture?' LSE

the failings of governance, the Co-operative Bank is still progressing its mission to be an organisation that recognises the social, economic and environmental impacts of its activities, and seeks to shape those impacts in pursuit of shared ethical goals.[16] It is also likely that the Co-operative Bank attracts staff with an affinity to its values, and this will create sustainability in an ethical culture.

Leadership is related to governance, and bold and purpose-driven leaders can help shape purpose in organisations, but as we can see from the Co-operative Bank's customer-led ethical policy – there is also a role for participatory leadership. There are some interesting debates around democratising finance, and how meaningful the democracy within organisations is. Some building societies have a mutual structure, but without widespread participation by their members this can be seen as light touch, without a great deal of potential for deeper engagement, challenge and scrutiny. This perhaps explains why remuneration for building society senior staff is broadly comparable with banking sector pay.[17]

A counterpoint is provided by challenges from Ecology members who played a role in scrutinising the building society when it raised its potential maximum pay ratio between the lowest and highest paid staff. Good leadership can shape culture by using wider stakeholders to ensure that organisations account for their principles and missions, and this has a clear overlap with governance.

But whilst culture and leadership is an important driver, it, like the other drivers, is often not enough without some form of alignment between them all.

16 Co-operative Bank (2019) 'Our customer-led ethical policy'
17 Farthing, D and Hatter, L. (n.d) Building Society Association 'Remuneration at building societies: the remuneration committees perspective'

SECTOR-SPECIFIC BARRIERS AND OPPORTUNITIES

Having outlined the drivers of purpose through mission, ownership, governance, and culture and leadership, this final section draws together some of the key barriers faced by the purpose-driven finance sector as of September 2020, with some suggestions for realising the opportunities that exist to support and grow this sector.[18]

MUTUAL BANKING MOVEMENT

The mutual banking movement has grown out of the model developed by the Community Savings Bank Association (CSBA). These banks will be the first full service mutual banks in the UK. They were made possible by the Co-operative and Community Benefit Societies Act 2014 and the creation of the New Bank Start Up Unit, which has made it easier for new banks to be established.

Of those in development, Avon Mutual and South West Mutual have recently submitted their draft Regulatory Business Plan. Banc Cambria is progressing plans which may accelerate its entry into the market. The only other region with a registered mutual organisation is North West Mutual. Other areas in development include the North East, Manchester, Northern Ireland, and the West of Scotland.

The success of the first of these will be game-changing in proving that there is a model of banking that is socially responsible and driven. There is much at stake in ensuring that Avon and South West Mutual are supported to be able to launch. As with all innovations, there are some challenges to be solved, but with some political will there are also clear opportunities to be realised.

Access to capital

Access to capital is the single biggest challenge for the emerging banks. In Wales, they have the support of the Development Bank for Wales and of the Welsh Government, and this has clearly helped Banc Cambria's quick development. For all those in England however, there is little in the way of financial backing, and creating these banks from scratch takes a significant amount of time before you can get to market and start becoming financially viable.

There is effectively a market failure for mutual bank capital in the UK, which arises from a combination of history and structure. Co-operatives need to minimise their dependence on external capital, ideally building capital reserves up from retained surpluses from trading with their members. This is how UK building societies and European co-operative banks accumulated capital over decades and centuries. They were able to do so because they were established in an era before modern banking regulations, when institutions could start small and build up slowly. This approach is impossible under modern banking regulations, which require sufficient scale and capital to be in place before any trading among members – a catch 22 situation. Venture capital is not suitable because it demands too high a return and too much control. Social impact investors often require an asset lock, which would prevent distribution of surpluses among members – and hence excludes co-operatives.

It should also be noted that for Avon and South West Mutual to reach the banking licence application stage, the cost of development will be considerably higher than for the banks that follow, particularly for the fourth or fifth mutual bank to be established. The first movers always take the biggest risks by creating a path that others can follow.

There are also different challenges with different kinds of funders:

- There are concerns that social investors find it difficult to understand the potential systemic impact of local mutual banks. It is thought that they would fund interventions that help vulnerable people access bank accounts, but the long-term nature of the intervention means that they would be unlikely to see returns in a shorter time frame (at least until after the banks have received their licence and are operational).
- Traditional investors want returns that are incompatible with the (lower) returns of purpose-driven businesses, and most don't have the appetite for the patient capital requested.

18 I am indebted to my interviewees for sharing their knowledge and insight, and any errors or omissions are mine alone.

- Local authorities and Local Enterprise Partnerships do not have a wealth of resources available to them, and there are no tax or lending incentives to encourage investment for this kind of economic development.
- Systemic funders will often fund papers and reports focused on identifying systemic levers for change, but there was felt to be less appetite in supporting specific practical innovations.

What is needed is access to patient capital that understands purpose-driven businesses. There is an opportunity to drive strategic thinking amongst funders to help shape their thinking and appetite for investing in systemic challengers. There are several elements to this which could be explored:

- Support to work with funders to provide longer time horizons, specifically 5-10 years, to understand and see the emerging impact.
- Central government could create a fund that Local Economic Partnerships (in England) could apply to specifically, to help seed the creation of regional mutual banks, and that devolved nations could also draw down.
- Match funding could be released from the dormant bank account money held in trust by organisations such as Big Society Capital and Fair for All Finance. It would be appropriate to reinvest some of these funds in purpose-driven banking.
- Regional Growth Funds may have unspent money and may be another source of capital, if the political leadership is there.
- The Treasury/The Department for Business Energy and Industrial Strategy could provide a start-up fund for mutuals focused on long-term SME business support in economic recovery planning.
- A change could be made to the Public Works Loan Board regime to allow councils to invest for a profit, as an incentive to borrow for public good (like those that exist for social housing).
- Tax breaks for economic development investments could be offered.

Purpose-driven finance ecosystem

Purpose-driven banking is much less developed in the UK than in other countries, and so misunderstandings about values-based banking is common. One participant described this as a significant challenge, because nearly everyone's understanding of banks is led by the mainstream. This leads to confusion with regulators, other purpose-driven institutions (specifically credit unions who may see mutual banks as competitive) and customers, who may struggle to recognise the difference and uniqueness of the proposition.

There is a need to better understand and define the ecosystem that all five types of institutions identified above are part of, both for the organisations themselves to enable better co-operation, and to make the current ecosystem more visible to regulators and potential customers. There may not be extensive choice for where and how we manage our money, but there is *some* choice, and there is something to be said for shouting about this with a common voice.

There are some significant challenges in bringing together all the sectors involved in purpose-driven finance, principal among which is a feeling of competition between organisations who essentially are all trying to survive in a harsh environment. These dynamics include, but are not limited to:

- Credit unions and CDFIs have potential differences in approach to each other (often around the problem of very divergent interest rates).
- Some in the ecosystem can be sceptical of the emerging mutual banks, fearing that they will take custom away from their market share, rather than from mainstream banks, particularly for the small number of 'conscientious customers' – i.e. the ethical consumer market.
- Mutual banks believe that, whilst CDFIs get the majority share of the dormant bank money, there is enough to share more widely in the ecosystem. This could be a source of potential competition.

That being said, every participant said that although most collaboration is needed between people who are in the same regulatory regime, they are interested in cross-sector collaboration. There is the opportunity to convene a roundtable discussion centred around something pertinent to all sectors. This could be any of the above-mentioned ideas, or around the concept of really digging into and understanding the broader purpose-driven ecosystem.

There have been instances where credit unions have worked collaboratively and, for example, referred customers to CDFIs, and vice versa. There are also examples of credit unions exploring partnerships with the emerging mutuals. If we could understand better where each sector lies, to be clear about the aims and targets of market share, where each industry stops and begins, then perhaps it would work to encourage greater collaboration, particularly if that ecosystem was used to drive conversations with government, regulators and funders. A united front would be useful in the service of the social and environmental purposes that are shared across purpose-driven finance.

BUILDING SOCIETIES

Ecology was the only building society we were able to talk to during the period of research, so the discussion below is tentative and would need to be expanded to test the barriers and opportunities suggested here.

Rediscovering purpose

Building societies, which until the 1950s were seen as a social movement, had somewhat forgotten their purpose after the reforms in the 1980s. This is evidenced by the fact that none of the building societies, despite their name, are limited to working in their area or region. This matters, because if building societies get a lot of their business through mortgage brokers from outside their area, there is a concern that their connection to their local stakeholders may be diluted.

In recent years, the drive towards purpose is back in building societies, partly due to a change in societal attitudes towards the banking sector and a renewal of interest in the green finance agenda, and partly due to the advocacy of the Building Society Association[19] and the success of Ecology Building Society.

There is a role for building societies in the Green Finance Taskforce, and the Building Society Association is hoping to grow and deepen the purpose within existing institutions. Some, including Newcastle Building Society, have been expanding their branches[20] to deepen their relationships with local communities.

Tax incentives

There are opportunities to push for tax incentives for green investments. For example, lowering the rate of tax on the profits of green activities would support re-investment in green financial products.

CREDIT UNIONS

There are a number of barriers and opportunities in the credit union sector.

Archaic IT

This is a core and widespread problem. Some smaller credit unions do not even use technology, relying instead on paper records and old IT systems that are not fit for purpose and the requirements of modern-day customers, thus hugely limiting the unions' ability to grow. The costs of replacing these without economies of scale are substantial, and outside the scope of possibility for those credit unions who need it most.

Leadership

Because credit unions are very diverse, with a wide range of credit unions all with a unique set up and several different membership bodies, there is no single united voice (although the Association of British Credit Unions represents 70% of British credit unions). A great deal depends on individual management teams and directors' and volunteers' capacity at each institution, so naturally there is a big disparity in leadership, skills, knowledge and abilities across the sector, which has an impact on the sustainability and growth potential of some (but not all) credit unions. It was felt by some that, whilst there are some amazing and dynamic individuals in the credit union sector, there can be a lack of support to build the capacities needed to develop future leaders.

Growth and marketing

It was remarked on by many interviewees that 'most people have never heard of a credit union'. As with IT budgets, marketing is a key challenge for a cash-strapped sector. Some credit unions have sought to invest substantially in growing their business to help with growth and sustainability, but this is not common and is linked to leadership. It could be that wider development of the purpose-driven ecosystem, of which credit unions are part may be one opportunity to counteract this dynamic.

19 For example see this keynote speech from the CEO of Nationwide from 2018.
20 Newcastle Building Society (2020) 'Our Branch Investment Programme'

CDFIS

CDFIs feel that there are a number of challenges, but Fair for All Finance is seen as a hugely positive development for the sector. The range of research and pilot programmes underway (led by Fair for All Finance) is felt to be making progress on the barriers and issues that CDFIs have faced. Access to dormant bank account capital has been a significant boost to the sector.

Raising finance

Business lender CDFIs are eligible for tax relief, but personal lenders are not. This is a barrier to raising investment. The lower the cost of capital for CDFIs, the lower the rate they can pass on to the customer.

Awareness-raising

Like credit unions, CDFIs struggle with awareness-raising. It was felt that compelling mainstream banks to partner with CDFIs as part of their social remit would compensate for the banks' reluctance to serve SMEs who do not meet their size or risk requirements.

ETHICAL BANKS

Most of the specific barriers and opportunities for the ethical banks (of which we were only able to access Triodos) centred around some of the themes raised by others above, in relation to tax incentives for ethical and green investments, having regulators that appreciate social purpose, and the strength of the status quo.

Like most of the sectors, ethical banks have good working relationships with regulators, but there was a concern that (understandably) regulators are often in the mode of trying to constrain 'bad' finance. Because the purpose-driven finance sector is very small in comparison, this can lead to unintended detrimental consequences for socially and environmentally focused financial organisations.

The Finance Innovation Lab's Regulatory Compass work from 2018 was felt to have made a difference to the relationships between some purpose-driven finance organisations and regulators. Recent changes of leadership at the regulators has meant that revisiting the Regulatory Compass with new teams and leadership would be productive, to refocus on the overall vision and purpose for the financial system. There could also be scope for a bolder approach to regulation.

This work should link into conversations around the government's Green Finance Strategy. Whilst recognising how this work is producing necessary discussions, some respondents felt that there was a greater need to understand how green finance is needed to transform the wider economy. A broader purpose and vision of finance is needed to raise the ambition (to do more than that required by law) and to scale up more quickly, to give us a chance at meeting our climate targets.

CONCLUSION

This report is a snapshot of the purpose-driven banking industry as of Autumn 2020. There are many alternatives available for those who want to bank with more purpose – to be able to have your financial needs met without compromising your values or principles. There are also many practical and impactful suggestions from this community about what can be done to grow the sector further, which this report has outlined.

We should all look at where our money is, and support all the initiatives that already exist, and we should also follow and support the emerging mutual banks because as they grow, they will provide a new and distinct offer that both challenges mainstream banks and contributes to regional economic development, both of which will be sorely needed in the economic recovery to come.

However, we know that many people do not actively seek out change in their own financial lives, and so a collective challenge moving forward is to understand how purpose-driven banking can become the norm. When it comes to the deep and pressing needs of society and the environment, it should not be the case that the 'ethical' choice is the niche option, instead it should be the default.

Why is it that the mainstream offer is one that is incompatible with our values? Why should conscientious customers hold the burden of working out if their bank account, mortgage or savings are contributing to regenerating or destroying the planet – surely, like the organisations investigated here, the onus should be on *all* banks to do the right thing, and strive for a purpose greater than this year's profits. This is the future that is the burden of *all of us* to create, wherever we can.

CONTACT US

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