SUSTAINABLE BANKING & FINANCE

FINANCIAL TIMES SPECIAL REPORT | Thursday June 14 2012

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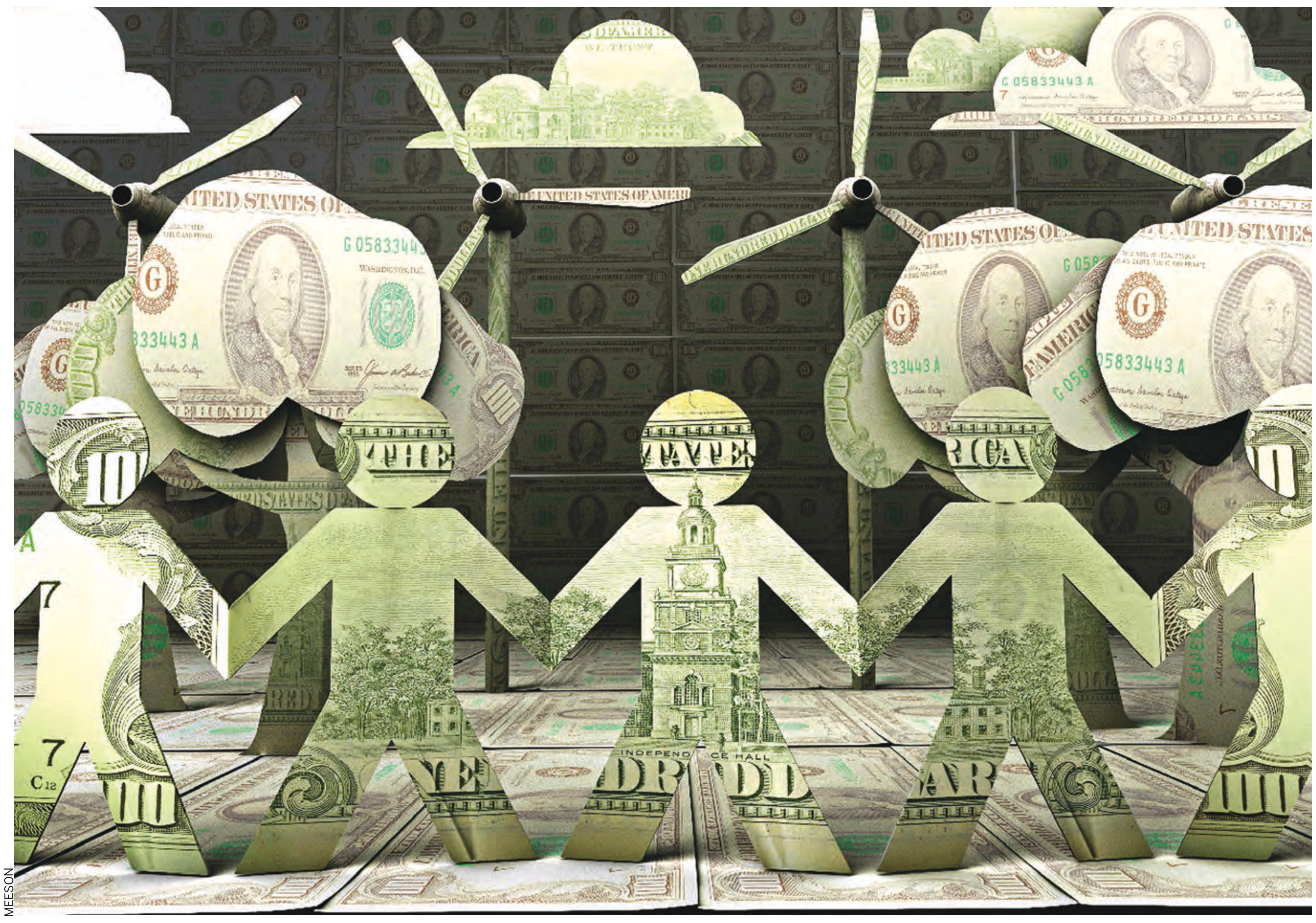
Sector takes steps to reform its behaviour

Scepticism remains but there are signs financial institutions view their responsibilities seriously, writes **Patrick Jenkins**


MEESON

At a time when several eurozone governments are battling to restructure their budgets and make their debt burdens more manageable, the topic of sustainable finance could hardly be more pertinent.

But, if the sustainability of many government accounts still looks precarious, at least there are encouraging signs that the world's financial services companies, some of whose excesses contributed to today's macroeconomic woes, are reforming themselves.

As much of the developed world struggles to drag itself out of economic torpor, banks and other financial services companies are ditching some of their hard-charging growth mentality and adapting to a new reality in which responsible business and long-term focus are watchwords.

Britain's Barclays has even put "citizenship" at the heart of its public image, stressing its "clear sense of business purpose: to help individuals, communities, businesses and economies progress and grow".

Scepticism over such rhetoric persists, as tax wheezes continue to emerge, bankers' pay levels continue to ride high and customers complain of a lack of affordable credit. But, at the urging of politicians, regulators and shareholders, there are signs of genuine reform in banks' behaviour.

This is reflected in the 2012 FT Sustainable Banking Awards, sponsored by the Financial Times and the International Finance Corporation, a member of the World Bank Group *(see shortlist below)*. The awards recognise achievements across four categories that reward banks, asset owners and asset managers as well as their non-financial partners.

A new award this year acknowledges initiatives in financial services that harness information technology and communications to address the scarcity of essential goods in the world's poorest communities. Award winners will be announced at a dinner in London tonight after the FT/IFC Sustainable Finance Conference.

The vexed topic of boardroom pay has dominated many companies' annual meetings recently. But at banks – from Citigroup in the US to Credit Suisse and UBS in Switzerland and Barclays in the UK – the shareholder rebellion over the broader topic of bankers' remuneration has been particularly virulent.

In particular, there has been a new focus on the extent to which there should be a rebalancing between the amounts paid out in staff costs and the amounts distributed in dividends to shareholders.

A recent Financial Times analysis, examining the distribution of net profits and staff pay, found that the world's big international banks had sharply increased the proportion given to staff while slashing dividends – the tally accounted for by staff pay jumped from 58 per cent immediately before the financial crisis in 2006 to 81 per cent last year, while dividends slumped by two-thirds to just 4.5 per cent of the total.

Anecdotal evidence suggests investor complaints about that shift are paying off, with some banks' remuneration committees indicating a new preparedness to think about the share of the spoils in that way.

Regulators and policy makers – principally at an EU level – believe they are underpinning the trend with new ideas to limit the generosity of senior bankers' bonuses to the level of basic pay, though many bankers and analysts argue that such efforts could backfire by encouraging sharp inflation of basic pay levels and thus of fixed costs – unhelpful in cyclical downturns.

Shareholders are also concerned about other reforms in bank regulation and their side-effects.

Colin Melvin, chief executive of Hermes Equity Ownership Services, which advises pension fund investors, says banks "need to engage with regulators" on the issue of small business lending costs. In countries across the world, there has been persistent tension between politicians and banks over a dearth of lending to small and medium-sized enterprises (SMEs) in recent years, with SMEs accusing the banks of a lack of affordable credit and banks blaming a lack of demand.

SME lending is widely seen as a key potential generator of economic growth when it is badly needed in so much of the world.

The truth, Mr Melvin says, is that both sides are right – there is a lack of demand for credit at current prices, but that comes back to the costs being imposed through tough new regulatory capital requirements.

Though politicians of all hues continue to berate the banks over their behaviour in the run-up to the crisis and since, some investors at least are convinced banks are changing their mentality away from the short-termism of the pre-crisis years towards a more sustainable focus on long-term business. "On lending, banks are now more focused on supporting the economy. We need this sort of thing," says Mr Melvin. There are two schools of thought, too, on the evolution of a new breed of "shadow banks" – entities expanding into previously core areas of bank lending, for example.

There has been widespread scepticism, for example, about the recent move of UK payday lender Wonga into the area of small business lending. Peter Ewen, managing director of Dutch bank ABN Amro commercial finance – reincarnated from the remnants of the business bought in 2008 by Royal Bank of Scotland and Santander and Fortis – warns businesses against rushing into short-term loan deals.

"While short-term loans can certainly plug funding gaps, they can also be unsustainable and expensive," he says. Wonga's price structure means a business borrowing the maximum £10,000 over the maximum term of a year could be faced with interest and fees of almost £11,000.

Peer-to-peer business lending has also moved into a new league in several countries around the world in an effort to sustain SME financing at a time when banks are seen to be pulling back from the area.

In the UK a new breed of "peer-to-peer" lenders that allow individual savers to supply funds to small businesses are preparing to compete for up to £100m of UK government money and build on their already rapid growth.

Similar operations are growing fast in Germany, China and the US, where former Morgan Stanley chairman and chief executive John Mack recently joined the board of peer-to-peer operation Lending Club.

As with payday lending, the peer-to-peer market is praised by some for meeting a financial need and criticised by others for being built on shaky ill-regulated foundations

In further flung locations, microfinance – the funding of very small businesses in developing economies – continues to grow rapidly.

"Microfinance is a valuable tool because it often goes to places where there are no banks," says Scott Brown, head of Visionfund, the financing arm of Christian charity World Vision.

But here, too, there can be problems. Mr Brown, whose business has $360m out on loan to nearly 700,000 micro-enterprises largely in rural areas, says banks are undermining the model in towns and cities.

"As banks move more into microfinance, particularly in urban and peri-urban areas, there is tremendous competition," he explains.

"There are higher losses and over-indebtedness of customers. As the market expands, it's important for the sustainability of the sector that everyone puts in place client protection mechanisms. There needs to be a greater sharing of data on loans through credit houses."

It is in the larger-scale conventionally defined area of sustainable or ethical banking, though, that one of the most encouraging signs of the sector's growth has emerged, as the UK's Co-operative Bank doggedly pursues its ambition to acquire 630 branches from Lloyds Banking Group. As this report went to press, the ethically focused Co-op was still hoping to seal a deal that would triple its branch network, despite a fraught negotiation process encumbered by regulatory hurdles.

Overall, it appears advocates of sustainable finance have good reason to be optimistic. The effects of growth in specialist ethical banking and microfinance are being buttressed by conventional banks adopting more sustainable business models, nudged along by a like-minded troika of investors, regulators and politicians.

"The whole sustainability argument applies to the basic principles of banks' interaction with customers," says Mr Melvin at Hermes Equity Ownership Services. "As they emerge from the financial crisis, banks have the opportunity to be responsible stewards of the economy."

Inside this issue

Shortlist Nominees for the 2012 FT Sustainable Banking Awards

Sustainable Bank

Africa-Middle East
Bank of Palestine
BMCE Bank, Morocco
Nedbank, South Africa

Americas
Banco de Galicia y Buenos Aires, Argentina
Itaú Unibanco, Brazil
Santander Brasil, Brazil

Asia-Pacific
Sumitomo Mitsui Banking, Japan
XacBank, Mongolia
Yes Bank, India

Europe
Bank Sarasin & Co, Switzerland
The Co-operative Banking Group, UK
Sekerbank, Turkey

Sustainable Global Bank
Banco Santander, Spain
Bank of America, US
BNP Paribas, France
Citi, US
Crédit Agricole, France
Credit Suisse, Switzerland
Morgan Stanley, US
Standard Chartered, UK

Sustainable Investor
Bridges Ventures, UK
Dragon Capital Group, Vietnam
Environment Agency, UK
LeapFrog Investments, Australia
SAM, Switzerland
Storebrand, Norway
VantagePoint Capital Partners, US

Sustainable Investment
CleanStar Mozambique & Bank of America Merrill Lynch, Mozambique-UK
Embraport & Inter-American Development Bank, Brazil-US
Korean Recycling Plant & ZincOx Resources, South Korea-UK
Optima Energía & Acapulco Municipality, Mexico
PerPETual Global & Aloe Private Equity, India-UK
VINTE Viviendas Integrales & IIC & Banamex, Mexico-US

Technology In Sustainable Finance
Credit Suisse with Opportunity International, Switzerland
Itaú Unibanco, Brazil
Kilimo Salama, Kenya
Sustainability Accounting Standards Board, US
YellowPepper, US

Branching out: supporting activities such as sustainable forest management in the Brazilian Amazon is good for the finance sector Alamy

Risk assessment skills can produce dividend for nature

Environment

Banks have a big role to play by designing products that take into account the value of natural resources, writes **Sarah Murray**

With many banks struggling for their own survival, they could be forgiven for putting saving the environment lower on the agenda.

However, some argue that because of the need for companies to manage growing constraints on natural resources, now is the time for the financial sector to play a bigger role in supporting a green economy.

"A bank that's fighting for survival cannot focus as much on environmental issues," says Lars Thunell, chief executive of the International Finance Corporation (IFC), the private sector arm of the World Bank Group.

"But with the higher price on commodities and resources in general, and the scarcity we're seeing in water, using resources effectively is coming to the forefront. That will drive a lot of sustainability work."

In one signal of this, 20 financial institutions recently signed a new pledge – the Natural Capital Declaration. The declaration, which will be announced at this month's Rio+20 summit, is a commitment by financial sector institutions to integrate natural resource considerations into the development of financial products and services.

Signatories include National Australia Bank, Netherlands-based Rabobank, the UK's Standard Chartered Bank, Nedbank of South Africa and the IFC.

But while it is one thing to sign up to a declaration to protect natural resources, it is another to integrate environmental considerations into all banking operations

Nor does signing a declaration protect banks from criticism – those that signed up to the Equator Principles, the voluntary set of social and environmental standards launched in 2003, have in the past been accused of lack of transparency and continuing to lend to environmentally damaging projects.

Mr Thunell points out that the Equator Principles have done much to help financial institutions manage social and environmental risks.

"The Equator Principles today include 80 banks, including Chinese and other banks from the developing world – and the same standards are used by other international finance institutions around the world," he says. "That's an example of how voluntary standards are becoming global standards."

However, the principles cover mainly loans to large-scale projects and demand long-term assessment and monitorin so are not easily applicable to all types of financial products.

"The Equator Principles have not really been able to advance the environmental cause in the financial sector because of the project finance focus," says Ray Dhirani, finance policy officer at WWF UK, the campaign group.

He argues that banks have a bigger role to play by designing financial products that take into account the value of natural resources.

He cites the example of forests: "If you can monetise things like Brazil nuts, sustainable timber and rubber, you can use those multiple revenue streams to back something like a bond.

"Then you also value the ecosystems underlying all that, and you use that valuation to attract investment."

To promote this idea, WWF is working with the Global Canopy Programme, a UK non-governmental organisation, to pilot a multi-revenue forest finance mechanism in Acre, Brazil.

The project involves designing a forest-backed security, such as a bond, to raise capital for sustainable forest management that would be asset backed or asset linked.

The revenue generated from forest products could be used to pay securities holders' interest and final principle.

Some of the capital raised will be invested locally in programmes promoting sustainable livelihoods and in conservation monitoring and enforcement.

WWF believes such products could have growing appeal.

With many countries facing financial difficulties and yields on government bonds falling, it sees alternative asset classes and long-term financial instruments attracting more interest, particularly among institutional investors such as pension funds.

"Things like green bonds and renewable energy bonds need to be developed along with indexes and benchmarks that bring in new issues, ones that are not heavily weighted on fossil fuels," says Mr Dhirani.

A bank that is fighting for survival cannot focus as much on green issues, says the IFC's Lars Thunell

"It's beginning, but a lot more will be required if we're going to get the scale needed to tackle climate change."

In valuing natural capital, banks do have one advantage.

"They've got a very important capability," says Graham Lloyd, financial services expert at PA Consulting Group. "Because the great core strength of banks is their ability to take an intelligent view of the value of an asset and its associated risk."

Mr Lloyd cites the example of a corn trader in Chicago, who might have little interest in deforestation in the Amazon. "If someone translates the value of a hectare in rainforest into the rainfall in Iowa and the knock-on effect on corn prices, then suddenly that corn trader has a strong interest," he says.

"Financial institutions can assist with the pricing of that."

He also argues that banks could help large environmental projects such as offshore wind farms attract investment by breaking up their risks – whether they are associated with the turbine's transmissions system or marine life – taking some of the pressure away from government backers and making environmental projects more attractive to investors.

"When you service a marine wind farm in the North Sea, you have to take significant and costly steps to not damage marine mammals and, for investors, that can feel like a bridge too far," he explains.

"But if you take that bit of it out and leave them with what they can work with, you have a different proposition."

Of course, dividing up the risks associated with an offshore wind farm or putting a price on the value of ecosystems is new territory for bankers and can be extremely complex.

Not all financial institutions have expertise in environmental issues such as deforestation or climate change.

Moreover, in times of financial difficulty, banks could well argue that establishing a green business unit is too costly.

The IFC's Mr Thunell says that while the financial crisis may have some impact, other factors may drive banks to take sustainability issues into account. "We see a very positive correlation between environmental and developmental impact and financial sustainability."

Mr Lloyd believes that in creating green financial products, banks simply need to rely on skills they already possess.

"What they have are people whose sole purpose is to understand and price risk and to create attractive financial instruments for investors," he says.

"So they have the ability to draw on those resources."

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Credit due for following instinct rather than herd

Profile
Co-operative Banking Group

Running an ethical business has helped the Co-op thrive, says **Andrew Bounds**

Since the 2008 banking crisis, politicians have been desperate to create banks that are low-risk, lend to small businesses, and do not pay huge bonuses to executives.

But while much hope has been invested in entrants such as Virgin Money and NBNK, chaired by Lord Levene, the former Lloyd's of London insurance market chairman, an older example has at times been overlooked.

The Co-operative Banking Group, which traces its origins to 1867, had a good crisis. It made a profit throughout, made comparatively small write-offs for toxic investments and bad loans, and is now in a position rapidly to advance lending.

The group says that is because, rather than follow the herd driven by short-term profits, it followed the instincts and values of its members, who own it.

"Sustainability is in the DNA of the business," says Barry Tootell, acting chief executive.

Lending is funded almost entirely by deposits, with little reliance on wholesale funding. The seizing up of wholesale markets – where banks borrow from others to lend to customers – plunged many member-owned building societies into trouble.

And its age has not stopped it being an innovator. In 1974, the Co-op was the first to offer free banking to those in credit, now common in the industry.

In 1992, it introduced its ethical policy, turning down business from groups it considered unsavoury, such as heavy polluters and those selling arms. Some £1.2bn in loans have been declined for business activities that are considered by customers to be unethical.

Since 1994, customers have voted to choose the charities that their spending should help fund via the Co-op Bank. Some £3m has been donated to more than 80 charities, with a current emphasis on green policies. They also receive dividends – vouchers earned by their spending. Since 2005, the Co-operative Insurance Society has selected its investments on social, ethical and environmental grounds.

The bank has also been backing wind and solar power, and its CIS tower in Manchester – the UK's tallest office building outside London – is now clad in solar panels.

"We are investing £1bn in renewable energy, and £700m has been committed already," says Mr Tootell.

In 1999, it launched Smile, the first internet-only bank, and all its call centres are in the UK.

Gross lending to small and medium enterprises, struggling for funding to grow, rose 31 per cent during 2010, and 33 per cent during 2011.

The 2009 merger with Britannia, a building society forced into substantial write-offs on its lending, has not changed its focus, says Mr Tootell. Rather, it has increased its customer base and geographical reach. Britannia had 250 branches, compared with the Co-operative Bank's 90. Co-op branches are starting to appear inside the group's food stores, and there are now 345 in total.

"The merger is complete. We have integrated the businesses and we are running them as one organisation."

Some Britannia branches remain, to retain customer loyalty, and few Britannia members have left it. Indeed, the Co-op is winning customers from other banks. "Since 2007, we have seen a significant flight to trust. We have 2 per cent market share ... but we get 5-6 per cent of the switches in the market," Mr Tootell says. The group has 6.5m customers.

Responding to the debate about whether "free" banking is that, because customers pay hefty charges for overdrawing, Mr Tootell points to the Cashminder account, used by 300,000 of 1.4m account holders. It offers no overdraft or cheque book, and is aimed at those who would otherwise be reliant on cash only, which locks them out of the discounts available for paying by direct debit.

Cashminder is part of a commitment that includes banking for prisoners. Research shows that if they learn to manage money inside prison, when released they are less likely to get into financial difficulties and be tempted back to crime.

The Co-op has also prioritised young people. Its insurance arm grants lower-cost insurance to young drivers who agree to have a "smartbox" that monitors their driving habits in their vehicle. Its 15,000 17-22 year olds using the system pay an average premium of £1,345 – well below half the national average of £3,478 for that age group, according to the AA insurance premium index. They also have 20 per cent fewer crashes.

But the Co-op's ambition to take a giant leap by buying 630 branches from Lloyds Banking Group is likely to be thwarted. The Financial Services Authority, which regulates the sector, could decide it would have to oversee the group's entire business, including its larger food and pharmacy arms, adding to its liquidity and capital requirements.

The FSA has also raised questions over the mutual's ability to integrate the business and its membership-run board, which includes a Methodist minister, a plasterer and a nurse, though the group points out that they are all trained.

"The Lloyds opportunity was an interesting way towards increasing our scale and reach," says Mr Tootell. "We were doing it anyway, and will continue to do so."

Barry Tootell: bank is making big investments in renewable energy

Battles over astronomic pay may bring it down to earth

Bankers' pay

Daniel Schäfer on the impact of recriminations over remuneration

The heated public debate over bankers' pay has spread from the political realm to the boardrooms this year, with a series of investor revolts at banks in Europe and the US.

Executives at Citigroup, Barclays, USB and Credit Suisse were confronted at their annual meetings with an investor backlash over what shareholders view as inflated and non-transparent pay schemes.

This shareholder pressure is set to become yet another downward force on bankers' pay, in what will exacerbate an already prevalent drop in remuneration.

Pay levels at investment banks, known for their generosity before the financial crisis, have dropped by 30 per cent globally in the past four years on a per-capita basis, according to a recent study by the Association for Financial Markets in Europe (Afme), a lobby organisation.

Bankers' pay has been weighed down by lower returns and a host of regulatory measures that increase the cost of capital, and force banks to shrink their balance sheets.

But will bankers' pay drop even further and if so, what will be the impact on society as a whole?

Bankers and analysts are unanimous in their view that the downward adjustment of remuneration levels is far from over yet.

For one thing, the fragile economic and financial market environment is set to dent banks' revenues for years to come. Global investment banking fees – which include mergers & acquisitions advice, and debt and equity issuance – stood at $30.6bn at the beginning of June for the year so far, the lowest level since 2005 according to data by Thomson Reuters.

With governments and banks seeking to shrink debts, many bankers expect those weaknesses to persist.

Joseph Leung, founder of executive search group Aubreck Leung, says: "Given this relatively low starting point compared to previous years and the overall shrinking investment banking revenue pools we've seen so far, I think it's fair to say that remuneration expectations for this year remain muted."

But besides such cyclical issues, long-term forces are under way that will structurally dent pay in the financial services sector, perhaps for decades. In a study last year, academics Thomas Philippon and Ariell Reshef found that during two eras of financial market euphoria – the 1920s and from 2000 onwards – the finance sector paid a "wage premium" of 70 per cent above the private sector average.

Crucially, they found that the level of bank regulation is the most robust determinant of this wage premium.

With regulators and governments around the world putting the screws on banks, some industry insiders say this premium may be eroded further.

"Long-term historical evidence suggests that the level of regulation is a key driver of remuneration in the financial sector, so this regulatory wave is likely to exert continued downward pressure on banking pay in the years ahead," the lobby group Afme said in its recent research.

Probably the most sweeping structural change for investment banks is the much higher levels of regulatory capital they will be required to hold.

> 'This regulatory wave is likely to exert continued downward pressure on banking pay in the years ahead'

Tom Gosling, a partner at PwC in London, says many investment banks will need to double their return on equity to get back above their cost of capital. He says banks will need to reduce staff costs but at the same time retain capacity for a possible upswing in market and client activity.

"Cutting people's pay will be hard for banks to do – they will find it easier to shed further jobs. But this may be tough to square with keeping the level of capability that they need," he says.

In fact, fixed remuneration at the world's largest investment banks has even increased in the past four years by 37 per cent as banks sought to retain staff and bypass regulation.

The lever that banks are likely to pull further will be bonuses and other incentives. On a per-capita basis, such variable pay has dropped by 55 per cent between 2007 and 2011.

Politicians are preparing laws that would further curb bonuses. In the EU, a proposal is under discussion to limit them to a maximum of 100 per cent of fixed salary.

Investors are pushing for similar changes, asking for the spoils to be divided more equally between remuneration, payouts and retained earnings.

They point out that banks' share prices have fallen faster than total pay. The FTSE Eurofirst banking index, for example, has dropped more than two-thirds in value since 2007.

Bonuses are not only expected to shrink: they are also more often deferred and even subject to a claw-back if present profits turn into losses in the future.

Such measures are already taking hold. A recent poll by the executive-search firm Options Group showed the proportion of investment bankers who received no bonuses at all last year more than doubled to about 14 per cent.

With investment bankers' pay on a steady downward trajectory, bankers and advisers say the wider economic and societal consequences are more profound and structural than before.

"A few years ago, a smaller bonus round would have mainly hit the Bentley dealer in Berkeley Square," a senior adviser to the sector says. "But now people do not see this as a one-off, so they start cutting back on spending for things such as cleaners, restaurants – or even charity donations."

Financial crisis creates greater need for basic services

The unbanked

A simple account is a first step but not all lenders will offer it, says **Rod Newing**

An important social priority in fighting poverty and encouraging economic growth is to address the 2.5bn "unbanked" in the world, 50 per cent of the adult population. The first step in bringing them the stability and benefits of financial services is to get them to use a basic current account that is specifically designed for those with poor credit scores.

"They enable those who cannot get a full service current account to access banking facilities, as they only need to prove their identity and where they live," says David Black, banking specialist at Defaqto, an independent financial research company.

"To get a full service current account you need to have a credit check, which might stop a lot of people who are excluded from mainstream credit."

A basic bank account allows people to receive wages, pension or benefits; bank cash and cheques: pay bills by direct debit or standing order: withdraw cash from a machine: and some include a debit card.

However, they do not allow holders to write cheques, hold credit cards or take out overdrafts.

In the wake of the financial crisis there is concern that, as the banks move to de-risk their balance sheets, they will try to disenfranchise customers without credit scores.

Strictly speaking, because there are no cheques or overdrafts, these accounts are risk free. The problem is that banks lose money on such accounts, even those charging monthly fees, because they are unable to charge high interest rates or sell users other, more lucrative, financial services.

These accounts are often provided as a result of pressure from governments or as a part of social responsibility agenda. Very few customers will become profitable by improving their credit rating enough for a full-service account.

According to MoneySavingExpert.com, an independent website, banks "make it bureaucratically difficult to open one, so unless you specifically ask for them by name, the bank staff may not mention the option. Instead you will just be given normal bank account application forms, fail the credit score and be rejected."

The site's solution is to force banks to offer their basic account to all those rejected after credit checks.

The 2.5bn "unbanked" figure comes from "Measuring Financial Inclusion: The Global Findex Database", a recent report from the World Bank Development Research Group. It found that by far the most common reason for not having a formal account (65 per cent) is lack of enough money to use one.

"This speaks to the fact that having a formal account is not costless in most parts of the world and may be viewed as unnecessary by a person whose income stream is small or irregular," says the report.

The next most common reason reported for not having an account is that banks or accounts are too expensive (25 per cent).

As well as restricting access, in order to control costs, basic accounts are at risk from levying of charges to mitigate losses, such as monthly account fees or charges for withdrawing cash at automated teller machines.

The poor have been most heavily disenfranchised in the subprime mortgage market

However, Graham Lloyd, a financial services expert at PA Consulting Group, finds that withdrawing basic accounts is generally not happening. This is partly because banks do not want to be seen to be pulling out of such a needy sector when they are already on the defensive over their customer image and perceptions of greed.

Also, even the sector's meagre deposits – plus those of any indignant customers who might leave should the bank abandon the disenfranchised – have a premium value in these liquidity-constrained times.

There are already signs of basic account customers resisting imposition of fees.

"It has led to dramatic consumer backlash in developed regions," says Kumail Tyebjee, senior principal of financial services at Infosys, a consulting, technology and outsourcing company. "One of the most visible was against institutions that added fees to debit card services. Disenfranchised customers are seeking out alternative value offerings, such as Walmart Financial Centers and Western Union."

In the developing world, mobile payments systems are cheaper and easier for customers to access. Mr Tyebjee points out 70 per cent of the world's population will own a mobile by 2013. Mobile services are also less costly and more profitable for the banks.

The area where the poor have been most heavily disenfranchised is in the subprime mortgage market.

Mr Black says that heavy risk mortgages are no longer available, medium risk have almost disappeared and although very light risk loans are still available, few lenders in the market are offering them.

He is more concerned about people who took out a normal mortgage some years ago and have since encountered credit problems.

"They won't be able to remortgage anywhere else," he says, "so they are stuck with their lender in its mortgage rate. Similarly, anybody with a heavy subprime mortgage will not be able to move because nobody will want them."

There is no doubt that the financial crisis has created a greater need for basic bank accounts, as credit problems for the disenfranchised increase. Chris Gibson, a director at Navigant Consulting, an expert services firm, believes that the current account market needs greater competition and choice to improve propositions to marginalised customer segments.

"While the market makes much of the moves to improve competition, we are yet to see any difference," he says.

"Several new entrants to the market have yet to add a current account to their product set. Others have launched with a current account proposition, but branch locations situated in more affluent areas mean that only those customers are likely to benefit from their products."

It is harder for the poor to buy bricks and mortar

Money under the mattress is no longer necessary

Developing world

Banking in remote areas presents challenges and opportunities everywhere, as these two articles show. **Jane Bird** finds services in less advanced economies must be adapted to the needs of newcomers

Most people in the more remote parts of the developing world keep their money under the mattress, offering the financial services industry a huge opportunity to win new customers.

But gaining the trust of people unaccustomed to bank accounts is difficult, as is delivering services to often isolated and inaccessible areas.

A quinoa farmer from the Bolivian Andes is mentally programmed to do business informally, with oral deals, and book-keeping done with a notebook and pencil, says Julius Abensur, a financial services expert at PA Consulting Group.

"Debts are honoured because if people default they know they will be expelled from the community." Imposing formal and complex bureaucracy on people accustomed to this way of doing things won't work, Mr Abensur explains.

Winning the confidence of such people involves understanding and adapting to their ways. "A member of the Uros community, who live on floating islands on Lake Titicaca in Peru, is more likely to listen to a casually dressed banker arriving by canoe than one with a tie who wants to avoid muddy feet."

Being close to communities is crucial, agrees Frank Nagel, head of African banking at Netherlands-based Rabobank Development, which has minority holdings in banks in Africa, South America and China.

Rabobank believes that local ownership of the majority stakes in banks in rural communities is essential to success. Having a physical presence is also important, says Mr Nagel, which is why local branches are necessary.

"Banking is about trust, so it has to have a face – your branch," Mr Nagel says. In some places, the branch is a truck, equipped with cash machines and tellers, that visits a weekly market. Even that is quite an operational challenge, because roads are bad, vehicles are heavy and prone to breakdown, and connectivity is patchy in remote areas.

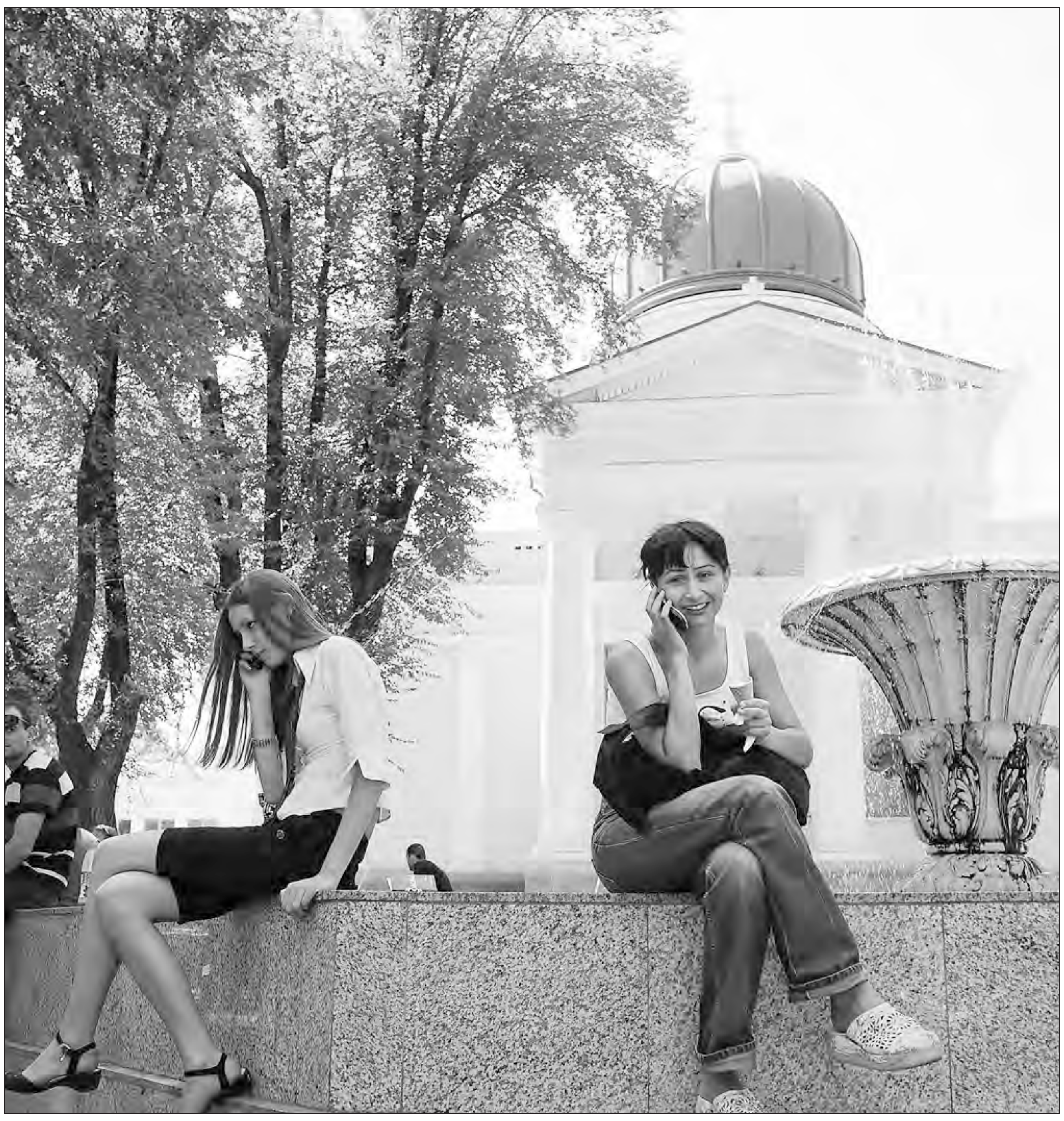
So another approach is for local shops to provide services such as cash withdrawals and deposits, on the bank's behalf. Rabobank Development is in the process of introducing this in Kenya and Tanzania.

Shopkeepers are often keen to take on this role, as it brings in more customers, Mr Nagel says.

PA's Mr Abensur agrees that using local shops adds trust to transactions, because they are "the heart and soul of rural areas".

Having a partnership with a shop can make it possible for a bank to provide the cash that is still the mainstay of rural economic activity, and avoid having to transport it long distances over poor roads. In Ukraine, PrivatBank now offers local shops and small businesses financial incentives to become clients, and deposit their cash in its regional branches so that it is available to customers to withdraw.

Ukraine's fixed phone infrastructure is also unreliable, says Dmytro Dubilet, PrivatBank's marketing director. Because transmission rates are slow, PrivatBank now transfers information from branches to head office via satellite networks or in batches, instead of "live stream".



In Ukraine, transactions can be carried out using simple mobile phone apps
Alamy

PrivatBank allows people looking for additional income to register as agents and sign up customers on commission

But, as in many developing countries, mobile communications are spreading fast, with coverage almost everywhere, and reliable connections. So PrivatBank requires all its customers' to have mobile phones, and uses their numbers as their ID.

Customers can phone the bank and speak to call-centre agents who type their requested transactions into the system. Those with smartphones can also use one of the bank's simple, single-function apps, for example to photograph their gas bill for automatic payment. "It's super easy and very popular with customers who have tried it," says Mr Dubilet.

In Kazakhstan, by contrast, 3G services of up to 8Mbps are widely available. Although most of the country's 16m people live in rural areas, they are rapidly becoming technologically advanced, says Nurlan Zhakiparov, an executive director of Kommertsbank.

"Five years ago, many people did not understand the chip and pin system, and asked colleagues to withdraw cash for them from ATMs."

But no bank in Kazakhstan has more than 20 per cent market share, which fuels strong competition, and makes technology a key differentiator.

This year, Kommertsbank introduced contactless credit and debit cards, and within a few months it will be the country's only bank to have a branch on Facebook. "This will be more than just a source of information, says Mr Zhakiparov; it will provide services such as enabling people to apply for a bank card, make payments, or change direct debit details.

Kommertsbank also offers its customers services such as the ability to order flowers for delivery worldwide, or sign up for roadside rescue.

In another innovative approach to the problem of providing services to remote regions, PrivatBank allows people looking for additional sources of income to register as agents, and sign up customers on a commission basis. About 40,000 such agents have sold at least one product within the past three months.

All they have to do is get the person's name and phone number so that a specialist from the bank can follow up the lead. "We sell quite a lot of products this way," Mr Dubilet says.

Unlike many parts of the developed world, Kazakhstan does not have big a problem with online fraud, says Mr Zhakiparov. This is because it has been able to leapfrog earlier technology, moving directly to more secure systems that present fewer opportunities for fraudsters.

There are huge openings for entrepreneurship in financial services for the developing world, and many people with good ideas for startups, says Kosta Peric, head of innovation at Innotribe, a Swift initiative to enable collaborative innovation in financial services.

He cites the success of text-message-based peer-to-peer payment services in Kenya and Pakistan.

Another area in which banks could have a role is in enabling businesses to accumulate credits for being good traders, similar to star ratings on eBay or Amazon, but amalgamating all their activities, says Mr Peric. Innotribe aims to be a catalyst for such innovations by holding events at which bankers and entrepreneurs from the developing world can meet.

Mobile banking means boats and aircraft for some

Developed world

Charles Batchelor says apps are very handy for customers but the personal touch is still needed

In some remote parts mobile banking means a customised van that visits isolated communities at regular intervals. But, for most bank customers nowadays, mobile banking is an "app" on a smartphone that allows them to check their account and, increasingly, make payments to other mobile devices.

Both represent a response to the challenge banks face in serving widely dispersed customers and previously "unbanked" individuals in a way that makes economic sense.

The financial pressures and changing customer habits that have seen banks slash branch numbers in towns are, if anything, even more acute in the countryside.

"Not so very long ago banks would expect to incur half a million pounds or dollars in fixed costs and the same in variable costs to establish a presence and would calculate they needed 10,000 people to justify a physical presence," says Andy Maguire, global head of the retail banking practice at Boston Consulting Group (BCG).

"But that was probably not the brightest way to think about it; so they look at the customer footprint to find out what sort of an outlet they wanted where.

"This could involve providing a service from the back of a van or light planes landing on a beach. It could involve agency banking from a solicitor's office or sharing the counter of the general store with fishing nets, newspapers and packs of cigarettes."

US banks started to make widespread use of grocery stores, initially simply for cheque-cashing, in the 1960s. Wells Fargo and Bank of America became big users of the format, which saves on construction and fitting-out costs while giving access to large numbers of customers who would otherwise not visit their bank.

And the stores realised they could increase customer loyalty by offering on-the-spot financial services.

Royal Bank of Scotland has a dozen mobile banking offices serving remote parts of Scotland. The service developed from field cash offices used to pay soldiers' wages during the second world war and was launched in 1946 by National Bank of Scotland, since absorbed by RBS. In the 1960s a boat served the islands around Orkney. NatWest runs a mobile banking service in the West Country, South Wales and Cumbria.

The advantage of a mobile branch is that the staff who operate it can provide a fairly full range of banking services. Other low-cost options, including off-site ATMs and unstaffed kiosks, offer a more restricted range and are not suitable for really remote locations because they need a secure power supply and security for restocking them with cash.

But real opportunities for banks to reach remote customers has come with the growth of the internet and the mobile phone.

In Africa and other parts of the developing world that lack traditional banking and fixed line telephone infrastructure, mobile networks have filled the gap, providing mobile-to-mobile payment services.

In South Africa, which straddles the developed and developing worlds, FirstRand Bank claims to have turned itself into the country's largest vendor of iPhones and other smart devices in an attempt to attract customers and increase the range of services used by existing customers. Subsidiary First National Bank's FNB banking "app" allows users to access their accounts, make payments and buy a range of prepaid mobile products.

From Africa, the use of smartphones to make cash transfer is spreading to the developed world.

This year, Barclays launched Pingit for its 12m current account customers, allowing them to transfer money to anyone via a mobile phone.

Contactless payments made by holding a phone against a reader are also forecast to grow with Vodafone and Visa announcing Visa pay Wave, triggering payments for small items. Google, O_2, and T-Mobile have unveiled plans for similar devices while high street chains including Boots and McDonald's have installed payment readers in their outlets.

"The replacement cycle for mobile devices is quite short so the mobile operators can roll out innovations very quickly," says Ted Bissell, mobile business expert at PA Consulting Group.

But systems that allow electronic cash transfers are a long way from providing a full banking service that would benefit remote communities.

Systems for electronic cash transfers are a long way from providing a full banking service

That still requires personal service – even if credit-checking now depends on computer programmes rather than individual judgment.

The tight controls on banking will impose limits on the use of mobiles. "Regulations governing the advice you can give and the requirement to 'know your customer' to prevent money laundering will constrain what people can do on the mobile," says Chris Harvey, global head of Deloitte's financial services practice.

The prospect of tight regulation has not stopped mobile phone companies taking a close interest in providing the networks that make cash transfers and other transactions possible.

In the past they have worked closely with bank partners but could they, like some of the retailers, go it alone? O_2 is seeking a licence from the Financial Services Authority that would allow it offer financial services without a banking partner.

"It is not a question of competition between the phone companies and the banks," comments Ranu Dayal, senior partner in BCG's financial institutions practice.

"It is more about what are the right terms of co-operation.

"The phone companies can provide the channels but you will need a bank or a banking structure to facilitate transactions."

Going mobile: one answer to serving remote areas

Sustainable Banking & Finance

Clampdown on cheats aimed at restoring faith

Regulation

Market abuse is being pursued with new vigour, writes **Brooke Masters**

For many retail investors, the 2008 banking crisis crystallised nagging concerns that the financial markets were rigged against them.

The evidence came from all around the globe, from the taxpayer-financed rescues of AIG and Royal Bank of Scotland to the collapse of Bernard Madoff's Ponzi scheme and the revelation that banks including Goldman Sachs had bet against the same complex products they were peddling.

Small investors fled the markets in droves, and many have stayed on the sidelines, shell-shocked by continuing bad news – the collapse of Ireland's banking sector, the writedown of government debt and possible eurozone exit in Greece.

Rebuilding a safe, sustainable banking sector will require creating conditions that tempt ordinary people back into the markets and one of the best ways to do that, regulators and politicians believe, is by cracking down on cheats of all kinds.

Enforcers from around the world have stepped up their fight against insider dealing and market abuse, bringing criminal cases and stepping up the size of the fines they impose. More and more, they are conducting investigations that cross international borders.

In the past couple of months, the UK secured the criminal conviction of a London spreadbetter who was leaked information on US technology mergers by the wife of a deals accountant in California.

Meanwhile the Hong Kong markets tribunal banned a Boston-based funds manager for trading ahead of a Chinese rights issue. "Stamping out misconduct in the markets is not just the job of the regulator.

"It is in the interests of everyone involved in financial services to rebuild trust and confidence in the sector," says Tracey McDermott, acting enforcement chief of the UK Financial Services Authority.

Since 2009, the FSA has secured 11 convictions and is prosecuting 16 more people for insider dealing.

The US continues to lead the pack in enforcement – last October the US Attorney's office in New York won the longest sentence for insider trading, 11 years, for Galleon hedge fund founder Raj Rajaratnam.

This year it has pressed on with prosecutions of some of his alleged sources of information, pushing the total number of convictions in its sprawling hedge fund probe above 50.

US enforcers are also looking at several recent public market flaps, including the Facebook initial public offering and JPMorgan Chase's giant trading loss, although it is not clear whether they will end up bringing official actions.

Meanwhile, the UK is on a campaign to force City firms to guard inside information more closely, in an effort to cut down on suspicious trading ahead of mergers and earnings announcements.

The FSA is increasingly demanding approved people – in financial firm management or client-facing positions – report misconduct whenever they see it.

Recent cases against compliance officials have hammered the message home.

"The behaviour of approved people is critical to this. Not only must they abide by our rules and principles but they must not turn a blind eye to the misconduct of others," Ms McDermott says.

In Ireland, regulators and prosecutors are continuing to deal with the fallout of the banking sector crisis.

The Gardai is still pursuing a criminal investigation of the collapse of Anglo Irish Bank, while regulators are focused on the boards of the six institutions that received state aid.

In 2011, the Central Bank wrote to all 55 of the sitting board members warning them that if they were still in post after the 2012 annual general meeting, they could be subject to a formal review of their conduct.

Twenty-six, including all the non-executive directors, have said they will resign, according to the Central Bank's annual report.

People familiar with the process said the supervisors have taken a close look at roughly 10 people who are still in place and may pursue regulatory cases against a couple of them.

Hong Kong regulators, for their part, are cracking down on market participants who are based outside the territory. The Market Misconduct Tribunal recently banned a former US-based fund manager from trading in the territory for two years for selling shares ahead of an equity placing by a Chinese fruit and vegetable supplier.

Meanwhile, the Securities and Futures Commission is engaged in a long-running legal battle with Tiger Asia, a US-based hedge fund, over the regulator's effort to freeze some of its assets.

Mark Steward, SFC enforcement chief, says the territory is trying to hammer home the message that Hong Kong will not wink at behaviour that would be unacceptable in the US or the UK.

"I've met a number of foreigners who come here and think Hong Kong is a wild jurisdiction. There is no place for cowboys in Hong Kong," he says.

Firms are starting to respond to all the pressure, hiring more compliance people and spending more on systems to spot suspicious trading.

"More firms are undertaking projects as they now fear a tap on the shoulder by the regulator," says Wolfgang Fabisch, chief executive of b-next, which provides compliance services. "Until now many companies felt they were exempt from monitoring for market abuse but are now taking it more seriously and are starting to act.

"This incorporates both buy and sell-side firms.

"Sell-side firms are more interested in market manipulation and the buyside firms are more interested in the insider dealing aspects."

Coming down: since the nationalisation of Anglo Irish Bank questions have arisen over business practices and lending, including loans to directors PA

P2P market Boost for UK lenders

While the UK's spring Budget brought a move to tax one of the UK's favourite hot snacks and another to clamp down on charitable giving – both later amended – it also brought good news for a niche group of lenders.

Peer-to-peer platforms, which enable individuals to lend directly to each other and to small businesses, were told they would qualify for up to £100m of government investment to help boost the UK's anaemic credit supply.

The move brought into the mainstream a new breed of lenders.

P2P groups appeared in the UK in the mid-2000s, enabling savers to earn higher interest rates by lending to other people rather than stashing money in a bank.

Demand has increased during the financial crisis, as banks have withdrawn credit lines to shrink their balance sheets and guard against another downturn.

Many have been growing quickly in the past few years, and say their loan books have expanded even faster in recent months.

The handful of P2P sites – including Zopa and RateSetter, which offer personal loans, and Funding Circle, ThinCats and Market Invoice, which lend to businesses – are set to lend up to £200m this year.

P2P sites have lower costs than the big high street banks, and can provide higher returns.

People who provide loans – from students to City traders – can obtain pre-tax yields of up to 10 per cent.

Borrowers – either consumers or small businesses – may be able to obtain loans more easily and cheaply than they could through traditional lenders.

The question is whether P2P lenders will thrive, or whether improved bank credit supply could jeopardise their growth.

The groups believe they can offer a sustainable alternative to bank lending, and that challenges facing the banks, such as tougher requirements on capital, and increased transparency over charges will mean they will never return to their unchecked and unprofitable lending they did before the crisis.

Also, government and regulators are determined to improve competition, particularly for SMEs, to counter the sharp fall in lending to these borrowers.

"The UK SME lending market is incredibly concentrated – more than any other in the world," says Samir Desai, co-founder and chief executive of Funding Circle, the largest P2P site for SME loans. "In the UK around 90 per cent of SME lending is in the hands of four banks. In the US there are thousands of regional banks, while in Germany, France – even in China – there is more choice."

Funding Circle, which has applied for some of the £100m of government funds earmarked for alternative finance, lends more than £1m a week on its platform, which is five times as much as a year ago. The company recently raised £10m to fund further growth, and hopes to be lending £10m a month by the end of this year.

Banks are pulling back from certain areas, which P2P groups are keen to fill, such as export invoices. According to Market Invoice, these enable investors to settle bills for companies ahead of their due date.

"Around 30 per cent of UK SMEs are trading with large foreign corporations, but banks only want to deal with UK invoices," says Anil Stocker, co-founder of Market Invoice.

But with any largely untested form of lending, there are challenges, such as consumer protection. Some experts fear that P2P lenders may not appreciate all the risks.

Money deposited in P2P sites is not protected by the UK's Financial Services Compensation Scheme, so any losses have to be borne by individual lenders.

Sharlene Goff