

Corporate social responsibility in the banking sector finance essay

[Finance](#), [Banks](#)



Since ancient times banking practices have always played a significant role in the development and progress within an economy. Banks facilitate financial transactions by collecting deposits from savers and lending loans to those in need of credit. Thus, it enables those that have surplus funds to meet with those who need further funds for expansion and investment purposes. However, it is often the case that mismatches occur between the period at which a depositor wants to save his money and the period at which a borrower would be able to pay up the amount owed by him. Therefore, as an intermediary a bank has to find ways with which to manage the mismatch between short term liabilities of the bank (such as deposits) and long term assets (such as loans).

First and foremost a bank needs to be perceived as being trustworthy and thus needs to gain the public's confidence in order to attract financing. It is needless to say that if a particular bank were to go bankrupt, apart from its shareholders, the general public would also suffer considerably. The collapse of a bank might result in the loss of lifetime savings of individuals and families which were held at the particular bank. This would consequently undermine people's confidence in the financial sector and drive other people to withdraw their money from their own banks which may in turn result in having other sound banks facing serious difficulties to cater for high volumes of withdrawals since a bank in its own nature of doing business holds only a percentage of the funds acquired by depositors and invests the rest in less liquid assets with longer maturities (such as mortgage loans).

It is therefore of prominent importance that for an economy to prosper and grow, and thus for the general wellbeing of the whole community, there needs to be at its core a sound and efficient financial system and that the general public also perceives the system to be sound and trustworthy. In trying to address this issue policy makers have sought to achieve healthy financial systems and to promote public confidence through numerous legislations and regulations. In fact, the financial market is one of the most regulated markets in any economy, particularly the banking sector so as to minimise the risks that a bank is exposed to.

For decades banks were severely restricted with respect to the services offered to clients, as well as methods allowed for financing and investments. This hindered the ability of banks to be competitive with other financial institutions that were not classified as banks and that had more lax regulations which enabled them to offer a wider range of services and take up more risks to finance their operations. Because the highly regulated financial environment was stifling competition between banks and non-banks, regulators loosened up their regulatory requirements so as to create a level playing field for all the financial institutions.

With more lax regulations banks are able to take up more risks and offer a wider range of services to clients meaning also that banks have higher risks to fail or that the public's confidence will be more prone to be undermined because of riskier activities performed by banks. Higher risks and loss of confidence would lead to financial instability and, in some cases, to financial crises where the whole financial market is depressed. This in turn slows

down the whole economy since the financial sector is the backbone of an economy's financing. It is thought that one of the factors that in fact contributed to the 2008-09 financial crisis was a highly deregulated environment (Shah Gilani, 2005-2011). It is also typical that after financial crises regulators start reviewing their supervisory and regulatory standards and reregulate the industry once again. After the financial crisis of 2008-09 regulators are now imposing new regulations in order to ensure that another world financial crisis is avoided. The new amendments require banks to hold even more capital as a buffer for a given amount of risk it is exposed to than it was already required by law. This process of regulation, deregulation and reregulation is a continuous process that changes as the market itself develops and creates new services and thus is exposed to new risks.

Deposit Insurance Agencies are set up for public safety against bank failures. However, in essence it is ultimately the tax-payers themselves that pay the price as the government intervenes to bail-out problematic banks. Because managers running banks are aware of the fact that if the bank fails the government will intervene, it is more likely that they engage in more risky activities and do not exert appropriate due diligence in the running of the business. This problem is known as 'moral hazard'. Thus banks are more likely to engage in hazardous behaviour since if they fail the government will intervene and will not allow the bank to go bankrupt in order to safeguard the public interest.

Also, banks are more difficult to have their performance evaluated than other businesses because of the complexity of the business itself. Thus this

creates the problem of ' asymmetric information' or, stated in other words, the problem that not everyone has the same opportunities to access the same information. Managers and interns within the banking institution have better information on the performance of the bank than outsiders have access to. This is diminished partially through required disclosure and other regulations that deal with insider dealing in order to promote transparency in the financial markets which again will enhance public confidence. However, it is not the first time that we hear about insider dealings or that disclosure of misleading information was presented to the public.

It is therefore clear that although regulation plays an important role in ensuring market stability, efficiency and fairness it is not enough. As John R. Boatright (1999: 7) brilliantly describes in his book ' Ethics in Finance' the law is not the only guide within the financial sector. What is legal is not necessarily moral. He then goes on to define the law by saying that it is simply a crude instrument and cannot be used to regulate all financial activities because of their complex nature. Excessive regulation stifles competition, hinders innovation and it is difficult to regulate certain issues that arise within the financial industry such as the issue of ' conflicts of interests'. Therefore self-regulation is nonetheless important in this highly regulated market and the implementation of CSR within the banking industry has yet a unique and special role as much as the role of a bank itself is unique within a community.

History: BAnking Practices and Society

Banking practices in the past were mainly carried out through the acceptance of gold and deposits to then issue loans with those deposits. Bankers' profits consisted mainly in hefty interests received from loans. Bank customers consisted mainly of kings and the papacy during the 1500s up to 1600s and large loans were lent to finance wars and elections.

Few can be said with regards to CSR before the 1900s in the implementation of banking practices as is the case with other businesses of the time.

However, one may mention the Fugger Family which was one of the greatest banking dynasties after the Medici in the late 16th century. Namely Jacob Fugger established a community for the poor, known as the Fuggerei, which was built in Augsburg in 1519 and is still in use today (Bamber, 2001). This shows evidence of the paternalistic ideology that strongly characterised the economic sphere and business tendencies till the late 1800s.

One may also note the great influential power that the banking sector exerted as early as the 16th century as the Fugger family financed Maximilian's grandson Charles to bribe his electors; while in the 19th century the Rothschild family financed all of Napoleon's enemies. The decisions undertaken by the bankers obviously had an impact on the outcome of events (Bamber, 2001) which shows that from the early stages of the industry banking practices had a strong influence on political, economic and social outcomes.

As banking and lending practices were developed, these were not always considered as fair and just as we may know them today. Banks and other financial institutions tended to arbitrarily choose to whom financial services are given, often denying these services to people of colour or the poor. This could be freely done by banks after the process of deregulation giving them more leeway in their practices than before. This discriminatory practice is known as redlining because some bank managers used to arbitrarily mark residential areas occupied by coloured or poor people in red on geographic maps during the 1930s. Areas marked in red were denied financial services and this had a serious impact on urban development since these lacked the funds necessary for investment and developments leading to further urban decay (Boatright, 1999: 101). It was not until 1968 that banks were prohibited by law to discriminate on housing lending through the enactment of the ' Fair Housing Act' followed by a series of other regulations thereafter (Hunt, 2005).

CSR initiatives developing in the 1950s in the business industry had a ripple affect also on the banking sector were through sanctions and regulations concerning environmental issues on polluting companies banks were also forced indirectly to take action and exercise more attention in the selection of corporate clients in order to safeguard their reputation. The 1980 ' Superfund' in the U. S. and the ' Directive on Civil Liability for Damage Caused by Waste' adopted by the European Commission in 1989 are namely two regulations relating to environmental concern emanating from business operations (IISD, 2010).

The ' Fleet Factors Case' of 1990 was one of the first proceedings in the U. S. that directly attributed responsibility for environmental damages caused by their corporate clients as the courts decided that lenders ' held the capacity to influence the borrower's waste management decisions even if it actually did not do so' (IISD, 2010).

The ' UNEP Financial Institutions Initiatives; (UNEP FI) was launched in 1992 with the collaboration of Deutsche Bank, HSBC Holdings, Natwest, Royal Bank of Canada and Westpac in an attempt to garner financial institutions to promote awareness on the pivotal role that the financial sector has in sustainable development and environment protection and to unravel further on the relationship between economic development, environmental protection and sustainable developments (UNEP FI, 2011). During the same year the ' UNEP Statement by Financial Institutions on the Environment & Sustainable development' was drafted articulating further the role and responsibility taken over by financial institutions in contributing towards sustainable development in businesses and safeguarding the environment (UNEP FI, 2011).

Another Green Paper set out by the European Commission in 1993 required that liability was assumed by the polluter and in case where the responsible party is not identified or unable to pay joint compensation funds financed by the industry should meet such costs on their behalf. The commission addressed also the problems of causation and insurability where more responsibility was exerted upon the shoulders of financial institutions (IISD, 2010).

The UNEP was a main contributor to spread awareness and foster a socially responsible attitude in the way business was conducted within financial institutions through international round table meetings and global surveys on the environmental practices of the financial services sector (IISD, 2010). Thus, banks started experiencing more pressure to avoid the so called 'sin stocks' and pay attention to the social performance of corporate clients and not only to financial performance.

Many other international guidelines have been developed recently and it is important not to forget to mention the contribution of the International Finance Corporation (IFC) which is a member of the World Bank Group towards sustainable development and in promoting fair, open and competitive markets in order to fight poverty (IFC, 2010). Their common shared values found on the IFC website are depicted as follows:

“ To fight poverty with passion and professionalism for lasting results. To help people help themselves and their environment by providing resources, sharing knowledge, building capacity, and forging partnerships in the public and private sectors.”

In 2003 the IFC drafted the 'Equator Principles', a set of guidelines that may be voluntarily adopted by banks aimed to facilitate and aid these institutions wishing to carry out operations in a socially responsible manner. Essentially, the Equator Principles are nothing more than “ a financial industry benchmark for determining, assessing and managing social & environmental risk in project financing” (The Equator Principles, 2006). The Principles are

targeted towards the financing of corporate clients whose investment projects are environmentally and socially responsible and include also advisory services offered by financial institutions with regards to project financing.[1]

‘ Who Cares Wins’ was an initiative undertaken by the financial industry, the UN Global Compact, IFC and the Swiss Government during 2004 (UN Global Compact, IFC, Federal Department of Foreign Affairs, 2009, 2010: 3).

According to this report, the main aim of this initiative is “ to support the financial industry’s efforts to integrate environmental, social and governance (ESG) issues into mainstream investment decision-making and ownership practices through a series of high-level meetings with investment professionals.” Again, here the goal is that of promoting socially responsible project financing through SRI.

The United Nations-backed Principles for Responsible Investment Initiative (PRI) are a set of six principles set up in 2005 in collaboration with some of the world’s largest institutional investors (UNPRI, 2011). This initiative was set up in partnership with the UNEP FI and the UN Global Compact. These principles posit the idea that since environmental, social and corporate governance issues may affect the performance of investment portfolios, thus it is important that an investor takes these issues into consideration when making investment decisions and therefore contribute also to the general wellbeing of society (UNPRI, 2011).

One may mention numerable banks that are truly committed towards the maxim of doing well by doing the right thing and that actively participate with International NGOs to contribute towards the general wellbeing of communities. Deutsche Bank, HSBC Holdings, and UBS are amongst the most known environmentally and socially driven banks in Europe. For the purpose of this thesis I will now proceed on to scrutinising and analysing the CSR policies of the banks mentioned to then compare them with those policies of three leading Maltese banks namely APS Bank, Bank of Valletta (BOV), and HSBC Malta in a later chapter. All information related to the CSR initiatives undertaken by the foreign and Maltese banks selected was extracted from their respective websites and CSR Reports. The main aim is to evaluate the transparency adopted by the Maltese banks and thus the extent to which they inform the general public in the way they go about their commitments towards society relative to well-established and successful foreign banks.

CSR Policies of Foreign Banks

This section will give an insight on how some foreign banks known as being committed towards sustainable development, environmental and socially responsible project financing are currently engaging in CSR policies in order to achieve their goals and manage to be profitable and attract business by undertaking such activities given the existing highly competitive environment from other financial and non-financial institutions. For the purpose of this dissertation, the three foreign banks chosen are headquartered within the European Union territory since the Maltese way of

doing business is very similar to the way it is conducted in Europe even CSR-wise and therefore it will facilitate comparison between foreign and Maltese banks. Furthermore, HSBC Holdings was selected specifically since it is the parent company of HSBC Malta which will be discussed in detail in the next chapter.

Deutsche Bank

Deutsche Bank is a leading German and European financial institution successfully expanding its business globally with a work force of over 100,000 employees in 74 countries and offering a vast selection of financial services worldwide (Deutsche Bank AG, 2011). Deutsche Bank mission statement can be found on its official website as follows:

“ We compete to be the leading global provider of financial solutions, creating lasting value for our clients, our shareholders, our people and the communities in which we operate.”

From the mission statement itself we may denote that the bank is committing itself not only towards its shareholders, clients and employees but their mindset is also headed for the benefit of the communities and their social needs. The banking institution has also formulated a set of values which drive its business orientation. One of these values set out on the bank's website is ' trust' where the bank claims confidently its trustworthiness, reliability and honesty. Other values mentioned are ' performance', ' teamwork', ' innovation', and ' client focus'. Finally, the bank also promises stakeholders that the corporation will be operating with '

responsibility', keeping in mind not only current factors and issues in their decision making but also future consequences and factors that may arise due to today's decisions (Deutsche Bank AG, 2010).

We may note by glancing briefly at the way the bank presents itself that it already carefully depicts itself as being socially and environmentally responsible in all aspects of its structural organisation. This however, is nothing new as all businesses especially banking institutions wish to be alleged as being ethical, trustworthy, honest and socially responsible so as to foster public confidence in their business.

The bank has also received numerous awards or been ranked first for several social, environmental and corporate governance categories during 2010 some of which include ' Environmental Rankings', ' Art and Work Awards', and ' Top Companies that Care' among others. In 2011 the bank has already been awarded the ' Charity Organisation of the Year 2010' and the ' European Employee Volunteering Awards 2011' (Deutsche Bank AG, 2011).

Deutsche bank is renowned for its CSR initiatives internationally nurturing social and environmental awareness while working to alleviate such issues in communities where it operates. According to the bank's official website (Deutsche Bank AG, 2011), Deutsche Bank focuses its " CSR strategy in the areas of corporate volunteering, social investments, art & music and education." The ' Communications & CSR function' is responsible of the bank's global CSR initiatives followed by the approval of such initiatives by the ' Chairman of the Management Board' (Deutsche Bank AG, 2011).

Coordination of CSR operations is prepared at headquarters and then delegated to and implemented locally by the institution's regional teams (Deutsche Bank AG, 2011). This ensures effectiveness and efficiency through its initiatives and as perceived by the bank itself, it makes sure that it is acting as a 'responsible corporate citizen' showing quite clearly that the bank favours and adopts the Corporate Citizenship Theory explained in the first chapter of this thesis.

Deutsche Bank has set up ten CSR units in total till now dispersed globally which are namely the 'Deutsche Bank Foundation', 'Deutsche Bank Americas Foundation', 'Corporate Citizenship UK', 'Deutsche Bank Africa Foundation', 'Deutsche Bank Asia Foundation', 'Deutsche Bank Mena Foundation', 'Alfred Herrhausen Society', 'Historical Association of Deutsche Bank', 'Transatlantic Outreach Program' (TOP), and finally 'Deutsche Bank Donation Fund' (Deutsche Bank AG, 2010). Through these organisations the bank manages its CSR operations worldwide and creates what the bank calls 'social capital' through sustainability, corporate volunteering, social investments, art & music, and education (Deutsche Bank AG, 2011); thus, the bank is CSR oriented at all levels of its operational, and organisational structure.

Figure 2. 1[2]: CSR at Deutsche Bank Founded: 1992

Budget 2009: € 3. 2 m.

The non-profit Alfred Herrhausen Society is the international forum of Deutsche Bank. Its work focuses on new forms of governance as a response

to the challenges of the 21st century. The Alfred Herrhausen Society seeks traces of the future in the present, and conceptualizes relevant themes for analysis and debate. It works with international partners across a range of fields – including politics, academia, and business – to organize forums for discussion worldwide.

www.alfred-herrhausen-society.org/en

The bank's total investments for the year end 2009 amounted to €81. 1 million of which 39% were invested in social investments, 29% were attributed to education and 27% were allocated to art and music (see figure 2. 2 below). Deutsche bank's investments were mainly targeted towards Germany, with total investments amounting to 45% at the end of 2009, followed by the Americas at 23%, and 12% of these funds were allocated to Asia Pacific and the UK. Deutsche Bank's investments in Europe/Middle East and Africa amounted to only 8% of the funds (see figure 2. 3 below).

Figure 2. 2[3]Figure 2. 3[4]

Regional split of total CSR investments

Share of total investments per area of activity

Kate Cavelle, Director of Corporate Citizenship at Deutsche Bank in the UK, stated that the four main reasons why investment banks care about CSR are 'social responsibility, staff motivation, client and public perception' during an interview conducted by 'The Gateway' in 2010. She also argued that at Deutsche Bank it is recognised that the bank should be highly committed

towards CSR. In the UK, Deutsche Bank engages in initiatives such as promoting education so that young people may 'reach their full potential' (The Gateway, 2010). Social Investments undertaken by the bank also include work with the homeless and unemployed persons and works closely with several other UK organisations such as the Globe Theatre and Design Museum. The bank also supports young artists through the sale of art acquired by the bank while keeping employee morale high by changing its art collections through time (The Gateway, 2010). Deutsche Bank is also involved in a microfinance programme where loans are granted with lower interest rates to persons who otherwise would not be able to be granted any credit. According to Kate this is also a good and safe investment undertaken by the bank and thus microfinance is beneficial for the business as well. The bank also encourages employees to get involved in voluntary work and helps out in finding activities that employees may engage in (The Gateway, 2010).

On another note, according to an article written in the Financial Times of 23rd March, 2011, Deutsche Bank was sued for "breaching its duties when the bank sold a complex interest rate product to a corporate client." The bank was fined €541,000 to compensate for the damages inflicted on the client as judge Ulrich Wiechers claimed that the bank should have been clearer when advising the client about the risks involved. Apparently the bank is involved in other eight similar cases at the federal court level involving complex financial instruments known as swaps while it has 17 cases at lower courts (The Financial Times, 2011). This may indicate that although the bank is highly committed and publicly declares its

commitments towards sustainable business in its operations, there is still some work to be done in implementing such goals in the day to day transactions and operations undertaken by the bank.

HSBC Holdings

HSBC is one of the largest financial institutions in the world and is headquartered in London. It operates in 87 countries across the globe. According to the bank's official website the bank was established in 1865 to cater for the increasing trade between China and Europe and was named after its founder which is The Hong Kong and Shanghai Banking Corporation Limited. The bank offers a wide range of financial services to cater for different customer needs including Personal Financial Services, Commercial Banking, Global Banking and Markets, and Private Banking (HSBC Holdings plc, 2011).

The bank's values can be summarised into four concise points found on its official website. HSBC is 'open to different ideas and cultures; connected with its customers, community and each other; and finally dependable and doing the right thing' (HSBC Holdings, 2011). The bank is thus promoting itself as embracing an inclusive environment between employees, and has effective and efficient communication throughout all levels of the organisation including communication with its stakeholders while undertaking sustainable and responsible business practices.

By managing risks the bank aims at addressing business opportunities in a sustainable manner and by taking into consideration present and future

impacts upon the environment and communities, in particular poorer areas (HSBC Holdings plc, 2011). The bank is also enlisted and involved in a number of external organisations among which are the 'UN Universal Declaration of Human Rights', 'UNEP FI', 'UN Global Compact', 'Global Business Coalition on HIV/AIDS', 'Global Sullivan Principles', 'OECD Principles for Multinational Enterprises' and the 'Equator Principles' (HSBC Holdings plc, 2011).

HSBC believes that through "robust business and sustainable revenues" it is also primarily contributing towards the economy, the environment and to the communities and hence, maximising also stakeholder needs (HSBC Holdings, 2011). This statement, in my opinion, is almost synonymous with the arguments put forward in the SVT Theory and Adam Smith's invisible hand that by maximising shareholder wealth, one is also contributing to the benefit of the other stakeholders automatically. The bank is also involved with NGOs so that it may identify how to manage better sustainable risk, while it also works with NGOs to raise financial awareness and help customers on how to manage their finances, thus reducing risks of loan defaulting and keep their home ownership, while of course reducing further the bank's risks related to these loans (HSBC Holdings, 2011). According to the bank's website, it also engages in SRI investments and responds to several surveys and indices from various organisations.

"HSBC considers managing the environmental and social impacts of providing finance to our customers as part of business as usual." (HSBC Holdings, 2011). Thus, HSBC describes its commitment towards CSR through

the assessment of their corporate clients as being ingrained in the nature of their business, and it seems that the bank acknowledges that this is the right way of doing business. Apart from abiding by the Equator Principles, HSBC has also set up a set of 'risk policies' for sensitive areas such as chemicals, defence, energy etc... (HSBC Holdings, 2011). Through its financial services operations the bank is committed to reducing carbon emissions and because climate change impacts directly the bank's customers and its own operations, according to the official website, the bank perceives that it is of utmost importance that these issues are included in its strategies. The bank also engages with microfinance institutions (MFIs) which provide loans and other services to customers. According to the HSBC official website, in India the bank is working with 11 MFIs to provide for financial services to people in rural and urban areas (HSBC Holdings, 2011). The bank also provides for financial services in rural areas situated in China making it easier for farmers and people living in these areas to access such services. The bank also provides for funds in constructing better water infrastructures (HSBC Holdings, 2011).

The bank feels that it is contributing towards the communities it operates in by providing services to clients, employment, meeting its regulatory obligations and other obligations to suppliers, investments in local business and through financial donations or voluntary work and in this way it also secures its success as a bank (HSBC Holdings, 2011). Following to the information found on its website the bank allocated the sum of \$100 million to community investments as at the year ending 2009. The bank entered

into a partnership with ' SOS Children's Villages' in 2006 and established ' Future First' to aid less fortunate children around the world with their educational needs. This initiative has expanded significantly throughout the years and over 500, 000 children benefit from this programme around the globe (HSBC Holdings, 2011). ' JA More Than Money' is an initiative monitored in promoting financial awareness among the youth and is run by HSBC volunteers. Children attending this educational programme range from seven to eleven years old. The bank has also set up other programmes namely the ' HSBC Climate Partnership' which is a five year programme targeted to reduce climate change and its impacts on society and the environment and ' HSBC Eco-Schools Climate Initiative' to raise awareness in school on climate change and what action can be taken to reduce its impacts (HSBC Holdings, 2011).

In the section dedicated to sustainability reporting on the official website of HSBC one may find a number of sustainability reports. The following table was extracted from the HSBC Holdings plc Sustainability Report for 2009 illustrating the implementation of the Equator Principles in the granting of loans.

Table 2. 1[5]: Adoption of Equator Principles in the Granting of Loans

The bank granted only 5 loans which fall under Category A, meaning that these loans may have adverse social or environmental impacts that are diverse, irreversible or unprecedented. Although small in number, the bank still granted such loans to its clients, with a total value of 1, 296 almost 7

times larger than the value granted in 2008 of 178. In 2009 the Category B and Category C amounted for the most part of loans granted by the bank.

Figure 2. 4[6]: Division of Clients' Compliance with HSBC Environmental Policies

Most of the clients comply with HSBC's policy totalling 75% and amounting to 82% in loan value while there are still some clients that do not comply at all with this policy even though these are very small in number and even smaller in value.

The bank's community investments were mainly allocated towards education, which amounted to 45% while 29% were allocated to environmental investments as illustrated in figure 2. 5. The bank also encourages employees to engage in voluntary work, and it works towards reducing carbon emissions on its premises (HSBC, 2009: 16).

Figure 2. 5