RESPONSIBLE RETAIL BANKING IN THE 2020s

Trends, Issues and Opportunities

Santander

VOLANS

BUSINESS IN THE COMMUNITY

The Prince's Responsible Business Network

BACKGROUND

What does it mean to be a responsible bank?

This deceptively simple question is at the heart of this report, which was researched and written by Volans, as part of the Responsible Banking initiative convened by Business in the Community and supported by Santander UK.

The purpose of the initiative is to bring together key stakeholders in the UK retail banking industry to explore how the sector can rise to the challenge of supporting a socially inclusive and environmentally sustainable model of economic prosperity. This is more important than ever in the wake of the COVID-19 pandemic.

In 2019, the UNEP Finance Initiative (UNEP FI) launched the Principles for Responsible Banking. The purpose of the Principles is to accelerate the banking industry's contribution to driving change in line with the UN Sustainable Development Goals ('Global Goals') and the Paris Climate Agreement. As part of this report, we explore how retail banks operating in the UK can put these principles into practice.

As a founding signatory of the Principles for Responsible Banking, Santander is committed both to implementing the Principles in its own business and to influencing the financial services sector towards acting more responsibly. It was with this ambition in mind that Santander UK supported the creation of this Responsible Banking initiative, as a forum for sharing learnings and best practice and identifying collective responses to the challenges ahead. The forum also represents the first step towards articulating a sector-wide view on what it means to be a responsible retail bank in the UK.

An earlier draft of this report was shared with banks participating in the initiative and used as a basis for an online 'roundtable' conversation in June 2020. Key points raised during and after that conversation have been incorporated into this final report – and we are grateful to the participating banks for sharing insights, perspectives and examples.

The ideas presented in this report will continue to influence future conversations as this network continues to grow and will be used to stimulate new thinking and action on how the sector can adapt and respond to shifting social, environmental and economic realities.

Retail banks are stitched into our economic fabric like no other sector. As providers of financial products and services to millions of businesses and individuals across the UK, they have huge influence over the wider economy. If we are to deliver on the ambition of an inclusive, equitable society that operates within planetary boundaries, retail banks have a vital, proactive role to play – wielding their influence to shape an economy that delivers positive outcomes for all. Unless banks step up – and step up quickly – our collective efforts to address the critical social and environmental issues we face will fail.

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THE MACRO CONTEXT

If the opening months of the 2020s are anything to go by, we are in for a bumpy ride this decade. Disruption is no longer just a buzzword: it is now a daily reality. From COVID-19 to Brexit, floods to technological shifts – the business environment is being continually reshaped by social, political, environmental and technological forces beyond the control of any individual business or industry.

At the time of writing, the COVID-19 pandemic is still a major threat to public health and economic stability. Many businesses and households have experienced an unprecedented financial hit in recent months – and, for some, worse may be yet to come. Retail banks have a critical role to play in helping their business and individual customers first to survive this crisis and, second, to recover from it.

Of course, in order to play this role, banks themselves need to be resilient, financially and operationally. COVID-19 has been a test of that resilience and banks have had to adapt fast, for example shifting to primarily web-based customer services, video consultations and remote working for the majority of staff.

There is an opportunity, after the pandemic, to 'build back better', by aligning the economic recovery with the UN Sustainable Development Goals ('Global Goals') and the Paris Agreement. Building a more inclusive, resilient and lower carbon UK economy in the wake of COVID-19 is both possible and necessary. Financing from retail banks (and others) will be critical to enabling and shaping this recovery.

Even before the pandemic struck, capitalism itself was under pressure to evolve. According to the 2020 Edelman Trust Barometer, 56% of people believe that 'capitalism as it exists today does more harm than good in the world'.[1] Over the last 12 months, influential business-to-business platforms like the US-based Business Roundtable[2] and the World Economic Forum[3] have called for a shift to a more stakeholder-oriented model of capitalism. Businesses (and banks), they argue, must be run for the benefit of all stakeholders, not just shareholders. This agenda is likely to become more, not less, important in the wake of COVID-19.

Unless the post-crisis recovery is an inclusive one, capitalism as a whole risks losing its 'licence to operate'.

In the face of growing environmental and social challenges, it is incumbent upon leaders in business and finance to demonstrate that markets truly can be made to work for society and the planet. For those that rise to the challenge, there will be significant opportunities to create and capture new value: meeting societal needs that are inadequately served by today's markets can drive future growth and profitability.

The UN Principles of Responsible Banking, and have been backed by over 170 banks worldwide and are,[4] an important part of the global banking industry's response to this moment in history. It is vital that the Principles catalyse real-world action and change – something we will return to later in this report.

Drivers of change in UK retail banking

What it means to be a responsible bank evolves over time as the expectations of different stakeholders change and the social, environmental and economic context shifts. Turning global principles into national and local practice requires banks to develop strategies and approaches that take this changing context into account.

To that end, this section reviews key trends likely to shape the future of retail banking in the UK across five domains: *Demographics*, *Technology*, *Economics*, *Environment* and *Politics*.

1. DEMOGRAPHICS

As the UK population ages, its financial needs are changing. Currently, 18% of the total population is over 65 – approximately 12 million people. By the mid-2060s, the equivalent figures are expected to be 26% and over 20 million – a quarter of whom will be over 85.[5]

The needs and wants of generation Rent

These future-over-65s are today's millennials – most of whom are preoccupied with nearer-term financial goals, such as avoiding debt or saving for first-time home ownership. Today, 34 is the age at which more than 50% of people in the UK own a home; in 1997, it was 26. As many as one in three millennials may never become a homeowner: hence the moniker 'Generation Rent'.[6]

Enabling these millennials to balance their near-term financial goals with longer-term savings is a vital challenge – and opportunity – for financial service providers. Surveys suggest that there is a significant gap in the market: nearly eight in ten millennials feel they do not have the required information to plan for their financial futures.[7]

Millennials, who are now a dominant force in the UK economy – and will become more so over the next decade – also differ from previous generations in other ways. Climate change is the societal challenge they (and Gen Z) are most concerned about.[8] Increasingly, this climate concern is influencing young people's choices as consumers (including the choices of financial services).

The rise of DIY finance?

Millennials and Gen Z are also by and large 'digital natives': they expect fast online access, data-driven insights and transparency as standard.[9] Studies suggest that nearly a third of young adults consider 'how easy it is to use a smartphone app' as a primary factor before switching or opening a bank account.[10] This has fuelled the rise of a cohort of 'neobanks' – digital-first, or digital-only, providers of banking products and services – such as Monzo, Revolut and Starling.

According to Max Rothery, VP of Community at **Finimize**, a fintech firm that caters primarily to millennials, the big trend to watch is 'people doing things themselves':

'The travel industry used to have an agency model where you would go to an agent to go on holiday. And they say, okay, here's all the different holidays. We'll book everything from the flights, to the hotel, to your dinners. We will do that for you.

Now you find your own Airbnb, you plan your own flights, you find the best price. You do everything yourself. And that is one of the most enjoyable parts of going on holiday. The same is going to happen in finance.

People will be buying their own portfolios, buying their own funds, deciding how much they are going to put away from their salary, deciding what they are going to invest in… From a consumer side, the behaviour is going to be much more control, oversight and action. And from the business side, it is all about opening up the tools so that people can make smart decisions.'

The shift to digital banking brings potential challenges to be mitigated as well as opportunities to be seized. Cybercrime and online fraud are on the rise. And, as digital-only offerings increase market share, there is a risk of some parts of the population being excluded. In 2018, 8% of people in the UK (4.3 million people) were estimated to have zero basic digital skills. A further 12% (6.4 million adults) were estimated to have only limited abilities online.[11]

2. TECHNOLOGY

Over the last few years, the emergence of fintech[1] has been a significant source of disruption within the banking industry – and that is likely to accelerate during the 2020s. The role of data is critical. As Anu Sachdeva of **Genpact** puts it:

'Banks will need to transform their models to compete with the likes of Google, Apple, Facebook, and Amazon. They'll have to become digital services businesses that are able to monetize data and build products and services around predictive insights into their customers.'[12]

Big Tech eyes up banking

Amazon, in particular, appears to have plans to enter the retail banking space. Its strategy so far has been to target customer segments that are underserved by traditional banks. This includes offering basic checking and debit account services to younger consumers in a fee-free model.

According to analysis by Bain & Company:

'Amazon has spotted a segment of customers that it can serve better, and the company can worry about making money later... It can afford to go after this previously unprofitable segment in part because it will be able to transform the economics of banking; Amazon does not have the burden of an expensive branch and contact center network... Instead, Amazon could steer new customers to "just ask Alexa". The company can also avoid a lot of the customer acquisition costs... because it already has digital relationships with so many Americans.'[13]

Consider how closely this description of Amazon's strategy adheres to the theory of disruptive innovation as set out by the late Clayton Christensen and colleagues:

'Entrants that prove disruptive begin by successfully targeting those overlooked segments, gaining a foothold by delivering more-suitable functionality—frequently at a lower price. Incumbents, chasing higher profitability in more-demanding segments, tend not to respond vigorously. Entrants then move upmarket, delivering the performance that incumbents' mainstream customers require, while preserving the advantages that drove their early success. When mainstream customers start adopting the entrants' offerings in volume, disruption has occurred.'[14]

It remains to be seen whether Amazon – or another Big Tech firm – can successfully disrupt the retail banking market, but past experience suggests incumbents are often slow to respond to unmet customer needs. As Taavet Hinrikus, CEO and Co-Founder of peer-to-peer international money transfer business **TransferWise** told us:

'Banks are a little bit stuck in the previous century with their technology and their business models. They're really not thinking about "how do we build services for our customers?" They're thinking much more about "how do we build things for ourselves, how do we keep on feeding our greed?" If the banks had been thinking about how to give customers a quick, cheap way of transferring money, they could have done it. But there's something in the system, something in the water they're drinking that's preventing them from doing it.'[15]

The transformative potential of Open Banking

Another area where data looks set to be a disruptive force is in the implementation of Open Banking[2].[16] The goal of Open Banking is to foster innovation and competition in the banking industry, improving the quality and diversity of

[1] Open Banking requires firms to: 1. Make it possible for people to share their financial transactional data far more easily with third parties online. 2. Allow third parties to initiate payments directly from a person's account as a bank transfer as an alternative to credit or debit card payments. 3. Make public and openly share their product information and importantly, their customer satisfaction scores and separately other 'service level indicators'3.

See https://www.openbanking.org.uk/

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products and services available to customers. The key technological and regulatory innovation is to open up individuals' financial data to alternative providers in a secure way.

A report published in 2017 by Faith Reynolds likened Open Banking's potential impact on retail banking to the impact of e-commerce on retail:

'The advent of e-commerce at the end of the 20th century has significantly changed the way the retail market works over the last decade and a half, with some established retailers, like Argos, PC World and Oasis, successfully adapting their business model to compete with new market entrants with different approaches and models. Open banking could disrupt the financial services market in a similar way, creating opportunities for new entrants and challenging existing providers to raise their game.'[17]

Proponents of Open Banking argue that harnessing and opening up customer data has the potential to dramatically improve customers' access to financial services and their financial wellbeing. As Gavin Littlejohn, Chairman of the **Financial Data and Technology Association** (FDATA), told us:

'Today, 95% of the population doesn't get financial advice. In my parents' generation, people had a relationship with their local bank manager, who could give them informal advice. But, because we've moved to internet banking, nobody really has a relationship with their bank manager any more…

Given the massive market penetration of smartphones, there is an opportunity to use applications to help people make informed decisions. Apps are only ever as smart as the data you present to them, though. So Open Finance is really about enabling the consumer to have the computing power and the data science combined in their pocket to become a financial advisor.'

The potential of Open Banking is about much more than just disrupting traditional banking products and services; it's about improving consumer outcomes across the board. As one consumer expert notes (quoted in *Open Banking: A Consumer Perspective*):

'Who knows better than your bank whether you're overpaying for your energy bill for example… We see potential for the banking sector to be disruptive in ways that might help solve other consumer problems – switching in the energy market for example… generally we'd see banking as part of that whole ecosystem of using this data to disrupt consumer markets.'[18]

The better harnessing of data has huge potential to create new value and improve consumers' lives, but the data revolution also brings new risks that will need to be managed. For example, as algorithms come to play an ever-greater role in decision-making, algorithmic bias will become an increasing concern for both banks and society.

3. ECONOMICS

The UK economy is currently experiencing an unprecedented shock to both supply and demand, this is severely testing the financial resilience of businesses and households. The Bank of England has warned that there are likely to be long-term 'scarring effects' to the UK economy.[19] SMEs, which accounted for more than 60% of total employment and more than 50% of total turnover in 2019,[20] are likely to be particularly badly affected by the crisis. Some will go bust; others will come out of the crisis with significantly weakened balance sheets. All will need support from their finance providers to first survive.

Struggling to get by

For many, the COVID-19 crisis has compounded what was already a bad situation in terms of financial wellbeing and resilience. According to a 2019 report, 35% of UK adults are either 'overstretched' or 'on the margins'.[21] Data from the Money & Pensions Service shows that 11.5 million people have less than £100 in savings to fall back on, and 9 million regularly borrow to buy food or pay bills.[22] In short, for tens of millions of UK adults, making ends meet is a challenge at the best of times.

Furthermore, there is a worrying overlap between those who are struggling financially and those with mental health conditions. According to the Money and Mental Health Policy Institute, almost one in five of people with mental health problems are in 'problem debt' (meaning they have been seriously behind on payments for bills or credit agreements, or have been disconnected by a utility provider, in the past year) – three and a half times the rate among people without mental health problems. This equates to roughly 1.5 million people across the UK who have a mental health condition and are in problem debt.[23]

Concerningly, there does appear to be a causal link between poor financial wellbeing and poor mental health, at least in some instances.

39% of UK adults

say that money worries have 'really affected them' at some point and they suffer from lack of sleep and feelings of anxiety as a result. [24]

More than one in eight (13%) people in problem debt have thought about suicide in the last year – and 3% have attempted suicide (compared to a base rate of 0.8% amongst those not in debt). That equates to more than 100,000 suicide attempts by people in problem debt each year in England alone.[25]

The disruption of work

While the rise of the 'gig economy' has undoubtedly brought benefits for some workers in terms of increased flexibility and autonomy, it has also left a large proportion of the UK population especially vulnerable to an economic shock, such as the one we are currently experiencing. Gig economy workers typically have minimal job security and lack access to benefits such as paid sick leave or paid parental leave. As of 2019, an estimated 4.7 million people (one in ten working-age adults) were working in the gig economy – up from 2.3 million people in 2016.[26] In the final quarter of 2019, just shy of 1 million people in the UK were on a zero-hours contract, according to the Office for National Statistics – a more than five-fold increase from a decade ago.[27]

As automation impacts more industries, trends towards a more precarious labour market are likely to continue, leaving a large chunk of the UK population financially vulnerable. Clearly, the implications of this stretch far beyond the role of financial service providers – but banks are not mere bystanders in this story. Faisel Rahman, Founder & CEO of **Fair Finance** – a social enterprise that works to make finance more inclusive and equitable – is critical of mainstream banks' failure to serve the needs of customers whose financial lives are volatile and uncertain:

'Banks have just increasingly decided that they do not wish to be lending to the lower income brackets and to people with complex finances and lives. Unfortunately, that's happened at the same time as many people's finances have become more complex. Job patterns are shifting. Income flows are becoming a lot more volatile and the cost of living is getting higher. All this means that banks are pulling out from lending to many people, which is opening up a very big market of underbanked individuals (ie. people who have a bank account, but who either do not have access to banks' full range of products and services or who, for one reason or another, choose not to go to their bank for their financial needs).'

One of the long-term legacies of the 2007-8 Financial Crisis has been to make the UK banking sector more risk-averse – partly in response to post-crisis regulatory changes and partly because of a change in culture prompted by the crash. This shift has had both positive and negative consequences. There is little doubt that many banks were in a stronger position to deal with the COVID-19 crisis as a result of regulatory and cultural changes that came out of the last crisis. There is also little doubt that individuals and SMEs with high risk profiles have suffered because many banks have, in effect, chosen to withdraw from riskier market segments.

Unequal access to finance

At present, different groups in UK society have different levels of access to finance, often on different terms. This may not be a result of conscious discrimination, but there is clear evidence that ethnic minorities and women face structural barriers that affect their economic wellbeing [28, 29]– and access to finance is an important part of the story.

A 2013 report by Warwick Business School found that businesses with black African principal owners are 11.9% more likely to be rejected for an overdraft and are, on average, charged 2.12% more on interest rates for loan repayments compared to businesses with white principal owners.[30] In a similar vein, a survey by the British Bankers' Association (now UK Finance) in 2016 found that 73% of black-owned SMEs have worse than average external risk ratings (compared with 47% for all SMEs).[31] What's more, many female and ethnic minority entrepreneurs don't even make it as far as applying for a loan, because they believe their application is likely to be denied.

Partly as a result of these (real and perceived) barriers to accessing finance for women and ethnic minorities, these groups are under-represented amongst business owners in the UK.

Black business owners are 11.9% more likely to be rejected for an overdraft

4. ENVIRONMENT

Irrespective of what governments and businesses do, the climate crisis will get a lot worse before it gets better. Global temperatures will continue to rise for years to come. Extreme weather events will become more frequent and more severe – in the UK and around the world.

A societal awakening

The simple fact that the symptoms of climate change will continue to worsen over time means that the intensity of concern among activists and society at large will only increase. There will still be peaks and troughs in terms of societal engagement and activism on climate change, but these will be in the context of steadily rising awareness, concern and desire for meaningful action from business, finance and government.

While there is, considerable focus on managing climate risks associated with banks' business loans and investments (with the Bank of England proposing to introduce 'climate stress tests'[32]), dealing with climate risk is only part of the story. The shift in societal awareness around climate change also creates opportunities for those able to deliver products and services that cater to the growing demand – especially amongst younger generations – for transparency and positive impact.

According to the Department for International Development's 2019 'Investing in a Better World' survey, three in five people say it is important that businesses and financial institutions do good and avoid harm to people and the planet.

More than 50% of people say they are interested in investing sustainably now or in the future.[33] Another recent survey of UK consumers found that:

- 70% want banks and savings providers to be more transparent about where their money is invested
- 63% agree that their money needs to be moved away from fossil fuels and invested in clean energy instead
- 41% believe having any money invested in the fossil fuel industry is morally wrong.[34]

Contrast this with the reality that, in the four years since the Paris Climate Agreement was adopted in 2016, 35 global banks – including several that are based, or operate, in the UK – have provided $2.7 trillion of financing for fossil fuels. The amount of fossil fuel financing by leading global banks has in fact risen in every year since the

Paris Agreement was signed, standing at $736 billion in 2019, up from $640 billion in 2016.[35]

As awareness of this mismatch between rhetoric and reality grows, along with rising concern about the climate crisis, it is plausible that we are now approaching a tipping point. Consumers may start to vote with their feet in much larger numbers than has traditionally been the case. Opting for financial service providers that offer greater transparency and which use customers' deposits to finance climate-friendly projects.

5. POLITICS AND REGULATION

Another area of opportunity for banks is in the provision of 'green' financial products. These include green loans (used to finance or re-finance projects such as energy efficiency improvements or pollution prevention and control) and green mortgages (which offer customers discounted mortgage rates once they have upgraded the energy rating of their home). Though the market for green loans and green mortgages is still emerging in the UK, experience elsewhere suggests the opportunity for scale and impact could be significant.

Regulation will continue to be a key driver of change in the banking industry – arguably even more so in the wake of the COVID-19 crisis, which has forced regulators and banks to work together to manage the financial impacts of lockdown. This has already triggered a more hands-on approach from regulators in some areas – for example, the Prudential Regulation Authority has put pressure on large UK banks to suspend dividend payments, share buybacks and cash bonuses to senior staff.[36]

In other areas, regulators are likely to hit pause on the implementation of new requirements: for example, the Bank of England's plans to introduce 'climate stress tests' for banks are likely to be postponed. But, longer term, COVID-19 is likely to increase rather than decrease regulators' focus on climate risk. The pandemic has provided a stark reminder of the dangers of systemic risk.

The death of free banking?

Every few years, a version of the same headline appears in one or more UK newspapers heralding the imminent demise of 'free banking' (the provision of fee-free current account services for those in credit). Though free banking remains the norm in the UK at present, it is very much a live issue.

The Financial Conduct Authority's high-cost credit review in 2019 shone a spotlight on the issue of overdraft fees, which, in effect, subsidise free banking for those in credit. It's clear that the regulator is not entirely satisfied with the industry's response so far: although many customers (particularly those using unarranged overdrafts) will be better off as a result of rate changes, some (largely those using arranged overdrafts) will be worse off.[37]

Bevis Watts, CEO of **Triodos UK**, argues that,

'since the 1980s, the UK has been addicted to free banking. The UK is exceptional in this regard. There is no country of comparable size and wealth in which free banking is the norm.'

Watts, whose bank offers a current account for £3 a month, thinks that free banking will, in the long run, prove unsustainable. The combination of pressure from the FCA to bring down the cost of credit and the need, post-COVID-19, for banks to rebuild their balance sheets may well be the trigger for what some consider to be an overdue rethink of retail banking's business model.

Implementing Open Banking

The ongoing work of the Open Banking Implementation Entity, which was set up by the Competition and Markets Authority in 2016 'to create software standards and industry guidelines that drive competition and innovation in UK retail banking', is another vital component of the regulatory environment.[38]

Access to enough customer data is a key barrier to entry for potential innovators in retail banking. As Gavin Littlejohn, who is a member of the **Open Banking Implementation Entity Steering Group**, explains:

‘If you're a company wanting to launch a new product in an existing market or launch a product in a new market, you don't have the required data to train your algorithm. And, of course, the customer is never going to give you their data in the hope that you come back in a year with a product. So there's an inefficiency in the market. The big incumbents do not have much motivation to innovate, and they're sitting on all the data. And those that want to innovate don't have the data: they're raising capital and trying to prove that they can get their offerings to work, but they can't get it right because they can't train their algorithms.’

Fixing this market inefficiency remains a work in progress, but the long-term direction of travel is clear. Undoubtedly there will be resistance in places but realising the full potential of Open Banking is something regulators are unlikely to give up on.

THE RESPONSIBILITIES OF BANKS

The UN Principles for Responsible Banking, set out a framework for action to accelerate the banking industry's contribution to achieving the Sustainable Development Goals and the Paris Climate Agreement. The Principles are summarised in Figure 1 below.

Figure 1: The Principles for Responsible Banking, UNEP FI[39]

PRINCIPLE 1: **ALIGNMENT** We will align our business strategy to be consistent with and contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks.	PRINCIPLE 2: **IMPACT & TARGET SETTING** We will continuously increase our positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from our activities, products and services. To this end, we will set and publish targets where we can have the most significant impacts.	PRINCIPLE 3: **CLIENTS & CUSTOMERS** We will work responsibly with our clients and our customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations.
PRINCIPLE 4: **STAKEHOLDERS** We will proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals.	PRINCIPLE 5: **GOVERNANCE & CULTURE** We will implement our commitment to these Principles through effective governance and a culture of responsible banking.	PRINCIPLE 6: **TRANSPARENCY & ACCOUNTABILITY** We will periodically review our individual and collective implementation of these Principles and be transparent about and accountable for our positive and negative impacts and our contribution to society's goals.

To date, more than 170 banks worldwide have signed up to the Principles. Simply signing the principles does not make one bank more responsible than another. Banks will ultimately be judged not on their aspirations, but on the outcomes they deliver for all stakeholders – including customers, employees, shareholders and society at large.

UNEP FI's guidance document[40] lists several steps that banks can take with regard to serving retail customers in line with the Principles. In effect, these boil down to three key priorities:

Encourage and incentivise sustainable behaviour and consumption choices. For example, banks 'can finance and incentivise sustainable energy use through "green loans" for home insulation, the use of renewable energy, or carbon offsetting.'

Develop strategies for addressing retail customer segments that are currently under-serviced by banks. For example, banks should 'consider expanding and adapting (their) current offerings to the "bottom of the pyramid" through microfinance, micro-insurance, low-cost savings products and transactional services.'

Help retail customers acquire the knowledge and skills to effectively manage their finances. For example, 'through financial literacy programmes... (or) working with customer advocacy organisations.'

Enabling transformation

At the heart of the Principles is a commitment to align strategy with the transformative agenda that is encapsulated in the Global Goals and the Paris Agreement. Doing so will require much more than incremental improvements to business as usual. Entire industries, sectors and national economies need to be reconfigured in relatively short order to deliver a more socially inclusive and environmentally sustainable model of prosperity. These whole economy transformations will create both huge opportunities risks. Banks have a critical role to play in financing the transition, using their expertise to help clients unlock the opportunities and mitigate the risks associated with disruptive innovation.

Earning customers' trust

Banks can only play this role if they take care of certain fundamentals – ensuring they are well capitalised, operationally resilient, and robust in their approach to risk management and customer data security. Trust is also key. More than a decade on from the 2007-8 financial crisis, there is still work to be done to rebuild trust in the sector. The persistence of 'bonus culture', a significant gender pay gap[41] and lack of diversity (particularly in senior leadership roles) across the industry, a lack of transparency and accountability – all of these issues play into the sector's ongoing reputational challenges, and all will need to be addressed in order for banks to (once again) become trusted partners to their customers.

Stakeholder perspectives on responsible banking

For **Faith Reynolds**, a Consumer Representative for the Open Banking Implementation Entity, responsible banking is fundamentally about improving customers' financial wellbeing. *'What is the value that banks are providing that actually changes the outcomes that you see downstream? In what ways are customers better off for having engaged with their bank? Have they increased their savings? Have they decreased their debts? Are they more stable in terms of financial health? Are they more resilient?'*

For **Faisel Rahman**, Founder and CEO of Fair Finance, the crux of the matter is about whether – and how – banks fulfil their obligation to serve *all* sections of society, not just those that are most profitable and least risky. In Faisel's view, there is currently a large chunk of the UK population that is 'underbanked', in the sense that they have bank accounts but do not have access to banks' full range of products and services. 'By choosing to be out of a particular segment of the market,' he says, 'banks have kind of decided that that segment of the market is not deemed worthy of their services.'

Meanwhile, **Marcos Eguiguren**, Executive Director of the Global Alliance for Banking on Values – a network of 60 financial institutions with $200 billion of combined assets under management – believes that the Principles for Responsible Banking don't go far enough. Specifically, he argues that the only thing a responsible bank should do with depositors' money is to lend to the real economy, 'to projects and companies that are either environmentally clean or provoke a fairer economy and a better community.'

Doing less harm and more good

All financial activities have a social and environmental impact, whether positive or negative. As the spotlight on impact becomes stronger – banks will need to review and, in some instances, update criteria for which activities they will or will not finance.

Many financial institutions already screen out lending to, or investing in, certain ethically problematic industries such as tobacco, arms manufacturing, or fossil fuel extraction. Increasingly, this method is likely to be seen as the minimum acceptable approach required for a bank to maintain its social licence to operate.

The next step, which some banks have already taken, will be to become proactive in seeking to catalyse positive social and/or environmental impact through lending activities and product innovation. To do so credibly and authentically, banks should look to set clear targets and KPIs for non-financial performance and then link a portion of employees' remuneration to these KPIs.

A responsible banking industry

This section has, so far, focused on what responsibility means for banks as individual institutions. But that is only part of the story. There are also issues of collective responsibility that can only be addressed if the sector works together – and collaborates with other stakeholders.

For example, the issue of some segments of the market being underserviced by banks is a systemic challenge, not something that can necessarily be fixed by any individual bank. Likewise, the implementation of Open Banking is a collective responsibility – and a collective opportunity.

To some extent, trust and reputation are sectoral issues too, meaning that many of the issues that contribute to negative societal perceptions of the sector are likely to be best addressed through the development of new industry-wide standards.

ISSUES, OPPORTUNITIES AND EXAMPLES

This chapter outlines the opportunity space that exists for UK retail banks to act on the Principles of Responsible Banking in ways that will help strengthen and future-proof their businesses. The chapte includes illustrative examples of how some organisations (in the UK and elsewhere) are stepping up to these challenges already.

The chapter is structured in three parts. First, we consider banking's *social* impact – specifically in relation to the promotion of financial wellbeing and inclusion. Second, we look at the sector's *environmental* impact – in particular how it can respond to the climate crisis. Finally, we examine what it means for banks to engage responsibly with *technological* change, leveraging the potential of new technologies to deliver better outcomes for customers, while mitigating potential negative impacts.

Social: financial wellbeing and inclusion

As we have already seen, roughly a third of UK adults are either 'overstretched' or 'on the margins' in terms of their personal finances.[42] Many also face mental health issues that, when combined with financial problems, can trigger a dangerous downward spiral into despair.[43]

Several long-term demographic, economic and technological trends are likely to exacerbate these challenges. Automation and the rise of the gig economy are disrupting the nature of work and leaving many workers with negligible financial security. As Millennials get older, many are struggling to build up assets and save for later life – making it likely that a large proportion of this cohort will face financial problems in old age. The COVID-19 pandemic has severely impacted the finances of millions of UK businesses and workers and is likely to cast a long shadow as many SMEs and households will take years to fully recover.

Meanwhile, ethnic minorities and women continue to face structural barriers that impact on their financial wellbeing. By discouraging women and ethnic minorities from starting businesses, these structural barriers likely reduce the level of entrepreneurship, employment and growth in the UK.

In January, the **Money & Pensions Service** set out a 2020-2030 Strategy for Financial Wellbeing that identifies five ambitious national goals for the decade (see figure 2).[44] As the foreword to the strategy argues:

'Building consumers' financial responsibility and financial wellbeing should be a strategic goal for the financial services sector. This will mean financial services embracing a change in corporate purpose and culture to focus on individual financial wellbeing. Resources will need to be rebalanced from crisis support to prevention. Consumers will need simple, affordable products and the required information to make better decisions.'

Figure 2: The UK Strategy for Financial Wellbeing, Money & Pensions Service

Financial Education

24 million adults in the UK don't feel confident managing their money.[45] Changing that statistic will require a step-change in the way that financial education is delivered at all levels across the UK. Many banks already deliver financial education and literacy programmes targeted at particular segments of the population. But to really solve the financial knowledge gap in the UK population, a more joined-up approach between banks, government agencies, charities, and educational institutions is required.

Increasing the number of children who get a meaningful financial education is one key priority identified by the Money & Pensions Service. Although financial education has been on the national curriculum for secondary schools in England since 2014, the most recent Children and Young People's Survey by the Money & Pensions Service finds that the proportion of children and young people who recall learning about how to manage money at school has actually gone down slightly since 2016 – from 40% to 38%.[46]

One organisation that is working to turn the tide on this trend is [Young Money] (part of Young Enterprise), which equips teachers to deliver financial education in schools. Young Money creates tools, resources and teacher training programmes for roughly 7,000 teachers a year, as well as offering quality assurance for other financial education providers – from banks to volunteers, to schools and colleges that can accredit as 'centres of excellence' for financial education.

Russell Winnard, Director of Programmes and Services at Young Money, is broadly positive about the work UK banks do on financial literacy, though he calls for a more 'joined up' approach:

'There needs to be a range of solutions. That doesn't mean every bank needs to go and create a whole range of solutions. It means we maybe need to present all of our offerings together a little bit more… It's being a little bit more collaborative, and a bit smarter about how we present it all to schools.'

What might accelerate progress at a national level? Winnard argues that publicly benchmarking the UK's performance against other countries would help increase the pressure on the government to put resources into improving financial education. The OECD's Programme for International Student Assessment (PISA) conducts a financial literacy assessment every three years, but to date the UK has not participated.

Empowering people to take control of their own finances

'*When people become informed, they become confident. And when they become confident, they make better decisions,*' says Max Rothery, VP of Community at **Finimize**, a fintech company that is 'on a mission to empower everyone to become their own financial advisor.'

Finimize's goal is to overcome the apathy or disempowerment that many people feel in relation to their personal finances by making finance fun and intelligible – something that people choose to think about on a daily basis. Having started as a daily newsletter that explains what's happening in the world of finance in 3 minutes, without any jargon, Finimize now offers an app and has created online and offline communities in cities around the world. '*We want to do for finance what Headspace [the mindfulness app] does for mental wellbeing*,' explains Rothery. '*It's about building up this daily habit and taking people's knowledge level to the point where they can make informed choices*.'

Other members of society need very different kinds of support to take control of their finances. The Gambling Commission estimated in 2015 that over 2 million people in the UK are either problem gamblers or at risk of addiction, with around 43,000 suffering from a serious habit.[47]

To help customers who are struggling to manage their gambling patterns, **Starling Bank**, in partnership with the Money and Mental Health Policy Institute, introduced a Gambling Block feature on the bank's app to allow customers to easily disable spending on gambling.[48] Recently the bank updated the feature to introduce a 48-hour delay in disabling the block to further protect customers, based on the advice of gambling charities.[49] Starling was the first UK bank to introduce a gambling block in 2018 but, since then, several other banks have followed suit.

Banking the underbanked

Financial exclusion, in the sense of lacking access to a bank account, is a negligible problem in the UK, according to Faisel Rahman of **Fair Finance**. The bigger challenge is how to serve the 'underbanked'. Many different people can fall into this category. Ethnic minorities, women, and those with mental health issues are all over-represented among the underbanked. Other groups, such as homeless and ex-convicts, often struggle to access banking services, which can compound the challenges they already face in achieving a reasonable level of financial security and wellbeing.

Fair Finance itself is one of several responsible finance organisations that caters to the 'underbanked'. Today, Fair Finance deals with about 25,000 people a year – lending to roughly a third of that number, while offering advice and/or referrals for the remainder. Fair Finance is growing at 20-25% a year, according to Rahman.

The big constraint faced by Fair Finance and other responsible finance providers, such as credit unions, is access to capital. Rahman does not expect to see mainstream banks making radical changes to the way they serve customers with a poor credit history (the so-called 'subprime' market). Instead, he argues that banks should lend more to responsible finance institutions that serve this subprime market on non-exploitative terms to enable them to grow their own lending books. Otherwise, he warns, the market will continue to be dominated by irresponsible, high-cost, exploitative lenders.

Social impact lending

In the wake of COVID-19, SME lending is a hot topic, since it is primarily SMEs that will power the recovery. In this context, innovative financial instruments such as Social Bonds could have a particularly important role to play.

In November 2019, **The NatWest Group** became the first major UK financial institution to issue a Social Bond, raising approximately £650 million. The purpose of this social bond is to finance lending for SMEs in deprived areas of the UK. The objective is to conserve and create jobs in areas with the highest levels of unemployment and lowest levels of job creation in the UK.[50] The announcement marked the first exclusively social bond issued under the International Capital Market Association's (ICMA) Social Bond Principles in the UK.[51]

Environmental: responding to the climate emergency

Awareness of – and concern about – climate change is on the rise and this will continue as media coverage about extreme weather events escalates. More than 30 years after *The Green Consumer Guide* (co-authored by Volans Founder John Elkington) became an international bestseller, the age of the green consumer may finally have arrived. Concerns that were once niche are fast becoming mainstream and are influencing the way consumers think about everything from food and energy to fashion and finance.

Transparency

Civil society campaigns are shining a spotlight on the role of banks and other financial institutions in fuelling the climate crisis, and encouraging customers to find ways to align their money with their values. One such campaign is **Switchit**,[52] which calls on customers who care about the environment to switch their bank account to a 'green alternative'. The campaign recommends just three banks for UK customers: Nationwide, the Co-operative Bank and Triodos Bank.

The **Make My Money Matter**[53] campaign, which launched in June 2020,[54] has the potential to activate consumers and increase pressure on financial institutions for transparency and positive impact. The brainchild of veteran film director and campaigner Richard Curtis, the campaign's initial target is the pensions industry., Bank will also n the spotlight.

One bank that appears well placed to ride this wave of demand for transparency and positive impact is **Triodos**. '*At Triodos, we believe that transparency is fundamental*,' says Bevis Watts, the bank's UK CEO. Triodos publishes details of every organisation it lends to and anyone can access this information via its website or, for customers, its mobile app. Its lending is focused on organisations that can demonstrate positive environmental, social or cultural impact and it refuses loans to businesses that do not meet its strict minimum criteria.[55]

Several recent start-ups from around the world are creating products and services designed specifically to appeal to the growing proportion of consumers who are concerned about climate change. Examples include: Swedish fintech start-up **Doconomy**,[56] which launched DO Black, 'the world's first credit card with a carbon limit' in 2019; Canadian fintech start-up **Mogo**, which offsets one pound of CO2 for every dollar spent using its prepaid Visa card;[57] and German-based start-up **Tomorrow**,[58] which offers a bank account that offsets your carbon footprint.

Green products

Several UK banks have started offering 'green' lending products. **Lloyds**' Clean Growth Financing Initiative offers loans to businesses for green purposes such as improving energy efficiency, switching to low carbon transport options, or reducing waste.[59]

In a similar vein, **HSBC UK**, **Barclays** and **NatWest Group** collaborated with Derwent London, a large Real Estate Investment Trust (REIT), to launch a Green Revolving Credit Facility in October 2019. The five-year £450 million revolving credit facility includes a 'green' tranche of £300 million, making it the first revolving credit facility provided to a UK REIT that meets the Loan Market Association's Green Loan Principles. The credit facility will be used to finance the development or refurbishment of commercial and residential buildings to deliver improved energy efficiency and reduced consumption of natural resources.[60]

For homeowners, **Barclays** offers a Green Home Mortgage, which allows customers to access a lower interest rate when buying an energy efficient home.[61] **Nationwide** recently announced a £1 billion fund for green mortgages. It will offer 'preferential' mortgage rates to customers buying a new-build property that has an A-rated Energy Performance Certificate. The bank has also said it will offer loans with a 1% interest rate, up to £25,000, to homeowners who want to upgrade the energy efficiency of their homes.[62]

In Wales, **Monmouthshire Building Society** is launching a government-backed pilot scheme for new-build homes at two new low-energy developments. The scheme will offer mortgages that incorporate energy efficiency, with the potential to increase the mortgages' affordability by up to £12,000 for very low-energy homes.[63]

The **Green Finance Institute**'s Coalition for the Energy Efficiency of Buildings launched a major report on financing retrofits at scale in May 2020, which highlights a wide range of potential solutions – from lending products such as Property Assessed Clean Energy (PACE) loans to data and enabling frameworks such as building renovation passports. Off the back of this work, the Green Finance Institute and its partners are now working to create a number of pilot schemes to demonstrate how these solutions can work in practice.[64]

Technological: banking in the age of data

Open Banking and, more broadly, the harnessing of data and analytics have huge potential to transform banking for the better: reducing costs, improving access to financial services, tackling money laundering, and helping customers improve their financial wellbeing. For banks, this means opening up customer data in a responsible way for others to innovate with, while also mitigating the potential downsides of the shift to an ever more digital banking system, such as vulnerability to cybercrime, algorithmic bias and digital exclusion.

One initiative that aims to play a key role in enabling this to happen is the **Global Open Finance Centre of Excellence** (GOFCOE) in Edinburgh.[65] Among other things, GOFCOE plans to develop an 'MOT for algorithms' that will enable banks, insurers and fund managers to have their algorithms tested for discrimination and bias. GOFCOE also plans to work with banks, police and intelligence services to pool data and develop more effective systems for tracking and responding to money laundering.

CONCLUSION

At a time of unprecedented disruption to the UK economy as a result of the COVID-19 pandemic, it is easy to become fixated on the here and now. But, if anything, the pandemic and its consequences underline the necessity of addressing the issues covered in this report. From financial resilience, which is being tested like never before, to the climate crisis, which, if unaddressed, will cause much greater disruption to lives and livelihoods over the decades ahead.

Addressing these topics and putting the Principles of Responsible Banking into practice is not simply a matter of corporate social responsibility. (CSR). The social, economic, political, environmental and technological trends highlighted in this report are fundamentally reshaping the market in which banks operate, creating both new risks and new opportunities.

To survive and thrive during a period of immense change banks will be required to reimagine much of how they do business. Banks need to create new products and services, new business models and new ways of interacting with customers. New modes of collaboration with all stakeholders will ensure the sector as a whole serves the needs of society.

As this report has sought to demonstrate, banks are starting to do just that, launching new products and services that directly address social and environmental goals. Many of these innovations remain at pilot scale today. Avital task for the 2020s will be to learn what works and replicate it fast.

This is more than just a moral imperative: it is also a business imperative.

Products and services that deliver positive social and environmental impact are likely to be major sources of growth for the banking industry in the decades ahead. As the fintech revolution continues and more tech firms become involved in the retail banking market, banks can be certain that if they do not innovate fast to capitalise on opportunities linked to social inclusion and environmental sustainability, others will.

In this context, healthy competition between banks (and other finance providers) is essential, but not necessarily sufficient. There are aspects of the responsible banking agenda that affect the industry as a whole and that are likely to require deep collaboration – not just between banks, but also with regulators, industry bodies, standard setters, non-profit organisations and campaign groups – to address.

A year on from the launch of the Principles of Responsible Banking, progress is being made. Targets are being set, strategies developed, and governance structures and processes put in place. But for the UK retail banking industry, the journey has only just begun. The decade ahead has the potential to be an era of profoundly positive disruption.

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FURTHER READING

- **BankingFutures**, Banking Small Businesses: Forging Closer Ties between Banks and the Real Economy
- **BankingFutures**, Pathway to Long-Term Value: Identifying and Defining Long-term Value Drivers for Banks
- **Child and Youth Finance International**, Banking A New Generation - Developing Responsible Retail Banking Products For Children And Youth
- **Common Vision**, Millennials and Money: Banking in the age of the robot
- **Common Vision**, Millennials and Money: Banking in the age of the 100 year old
- **Common Vision**, Millennials and Money: Banking in the age of fake news
- **Common Vision**, Millennials and Money: Banking in the age of the renter
- **Common Vision**, Millennials and Money: Understanding young adults' financial experiences
- **Department for International Development**, Promoting women's financial inclusion – A toolkit
- **European Central Bank**, Working Paper Series: Gender bias and credit access
- **Faith Reynolds**, Open Banking: A Consumer Perspective
- **Finance Watch**, Financial exclusion: Making the invisible visible
- **Genpact**, Banking in the Age of Instinct
- **Global Alliance for Banking on Values**, Do sustainable banks outperform? Driving value creation through ESG practices
- **Institute of International Finance**, **European Banking Federation**, Global Climate Finance Survey
- **Money and Mental Health Policy Institute**, Debt and mental health: a statistical update
- **Money and Mental Health Policy Institute**, The Money And Mental Health Manifesto 2019 - Five ways to boost mental and financial wellbeing across the UK
- **Money & Pensions Service**, Transforming customer wellbeing – what can retail banking do to build financial capability?
- **Money & Pensions Service**, UK Children and Young People's Survey Financial Education in Schools
- **University of Cambridge Institute for Sustainability Leadership Banking Environment Initiative**, Bank 2030: Accelerating the transition to a low carbon economy

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