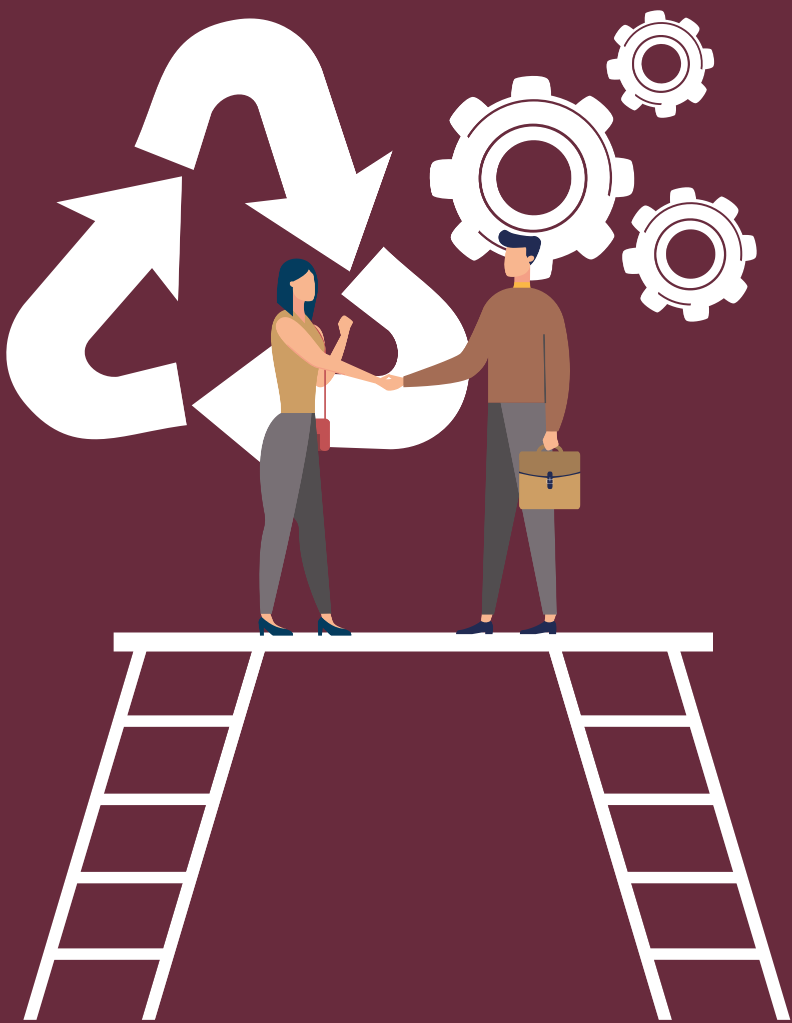
Andorran Banking
Associació de Bancs Andorrans

SUSTAINABILITY HAS BECOME THE ANDORRAN BANKING INDUSTRY'S CORE BUSINESS



Andorran Banking Observatory

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Sustainability has become a sign of our times. The conservation of the environment, the fight against climate change and the ambition of attaining fairer and more rational social development have become a widespread concern. Now, more than ever before, this concern for sustainability is seen as an unstoppable trend, and even more so after experiencing an unprecedented health crisis, which has reinforced the need to commit to sustainable development in order to face the future with confidence. Just as in all other areas of society, the Andorran banking sector has placed the concept of sustainability, understood not just as a concept related to the conservation of the environment but also as the need for businesses to act responsibly in all fields of action, amongst its strategic lines.

The contribution of the Andorran banking sector to the more sustainable and fairer development of the world is not new. In fact, it has a long history of returning part of its profits to society by way of social support, a mission that has been ever-present since the birth of banks and that around 20 years ago started to be channelled through what has become known as Corporate Social Responsibility (CSR). CSR is understood to be the voluntary integration in the management of an organisation of social, labour and environmental concerns, and respect for the human rights that affect all of its stakeholders. It is the strategy through which businesses take responsibility for the impact their activities have. In Andorra, one of the pioneering sectors in this management model was in fact the banking sector, due to its large size and international outreach.

In recent years, a more advanced corporate social responsibility model has been developed based on Environmental, Social and Governance (ESG) policies. This new approach arose to facilitate sustainable investment decisions in the financial sector, which has a greater impact on the smooth running of businesses and their sustainable development. Thus, in addition to the range of actions that have been promoted since the outset on social issues, subsequently followed by environmental ones, banks have started to take **corporate governance** criteria on board as part of their internal processes, which involve the implementation of codes of ethics and good conduct, the independence and transparency of governing bodies, compliance with gender equality on organisational charts, equal pay, etc. To this regard, great progress has been made recently in adapting banking regulations to European standards in the fight against money laundering, transparency and good governance, and a new step forward is about to be made on the matter of investor protection with the adoption of MiFID II.

Investments in CRS around 6% of profits

In 2019, the Principality's five banks earmarked more than 5 million euros for CSR, a figure that accounts for around 6% of profits. Out of all of the actions, the most visible and most long-standing are **social**, through the contributions made in areas such as culture, sport, health and education, and the support given to business fabric. Indeed, it is thanks to banking that a number of major events have been able to be run that have taken the name of Andorra beyond our borders, in addition to the fact that banks pursue initiatives that promote healthy lifestyles, the fight against illnesses such as cancer, sport as a starting point to assist the most disadvantaged groups in society, amongst many other forms of sponsorship. Altogether, this contributes to the social well-being of the community, whilst providing the sector with indirect benefits as a result of strengthening its ties with the country. Furthermore, Andorran banks have historically been behind the creation of various foundations and not-for-profit organisations such as UNICEF Andorra and the charity Patronat de Dames de Meritxell.

The Andorran banking sector has also made great strides on **environmental** matters, despite being a sector that has a relatively low impact in comparison with other more contaminating industries. Year after year, banks have introduced measures for keeping their consumption of power, water, plastic and paper as low as possible in order to reduce CO2 emissions, and some banks even have their own environmental management system. Initiatives have also been set up for calculating the carbon footprint of banks and to offset it by funding international sustainability projects.

Alongside the internal management actions put in place to address environmental matters, Andorran banks also support projects related to sustainable mobility and energy efficiency, although few sustainability plans have been rolled out in the country to date. However, it is expected that this situation will soon change thanks to the change in society's way of thinking that has been felt on a global scale, as well as to the strategies that the Government of Andorra and the energy supplier Forces Elèctriques d'Andorra (FEDA) wish to introduce on energy diversification and renewable energy.

The area in which the sector can most contribute is in socially responsible investments

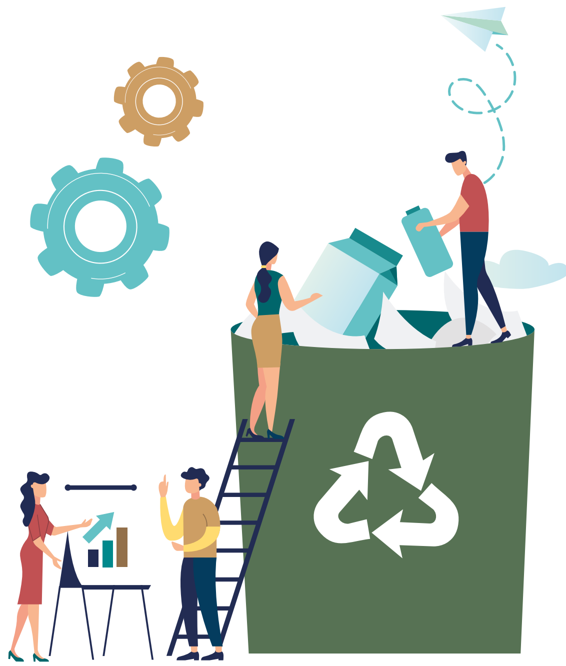
For some years now, many banks in the country have disclosed all of their corporate social responsibility affairs in what is known as a non-financial report. Unlike what has become standard on the level of the European Union, although these reports are not yet compulsory in Andorra nor must they be audited, some banks have pre-empted the regulation and publicly report their financial, environmental and social impacts, in line with the international standards set in the Global Reporting Initiative (GRI), an independent organisation that works in coordination with the United Nations. In addition, some banks have taken one step further in the direction of transparency by starting to draw up integrated reports, which show a full picture of their business context, the management of ESG risks and the strategies that enable them to deliver added value. Integrated reports must follow the guidelines of the International Integrated Reporting Committee (IIRC).

Channelling customers' capital into sustainable projects

Following international trends and demands for an increasingly environmentally friendly society, the boards of directors of the banks in the Principality have started to consider the need to go beyond their sustainability strategies and to tackle this issue on a global scale. Thus, the ultimate goal is to safeguard sustainability, not only through CSR and each bank's internal processes, but also **through their core business**, that is, managing savings and investments.

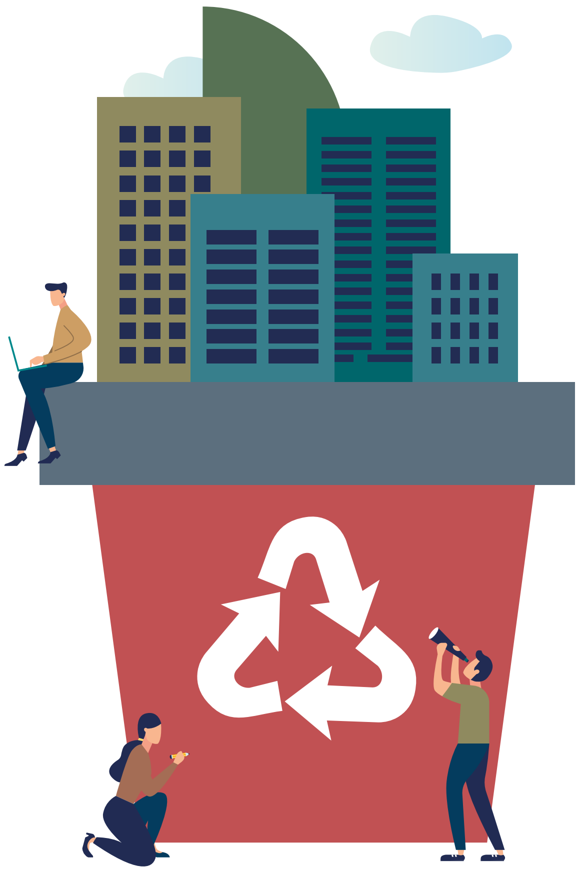
The first initiatives to tie in the concept of sustainability with the banking business entailed the creation of products such as senior loans for purchasing electric vehicles or refurbishing buildings, although their impact is still somewhat limited. There is also still a long way to go in the area of sustainable investments. Leading figures in the sector say that the best way for banks to contribute to tracing out a more sustainable world is **"by channelling our customers' capital into sustainable projects that are up and running in the global economy"**. They talk about the global economy, rather than the local one, based on the country's size, which makes it difficult for Andorra to have listed companies. They see great potential in it, as if awareness could be raised among Andorran investors to this regard, a "great business and social transformation" could be attained.

Andorran banks began to tread the path of socially responsible investing (SRI) ten years ago. This approach to investing takes environmental, social and corporate governance factors (the ESG criteria mentioned above) into account for making investment decisions in order to generate sustainable long-term returns. They have done so by either managing customised portfolios under these criteria, through the creation of structured products linked to sustainable investment funds handled by the international managers with which they work, or through fully sustainable investment funds created in Andorra – most of which have appeared over the past three years.



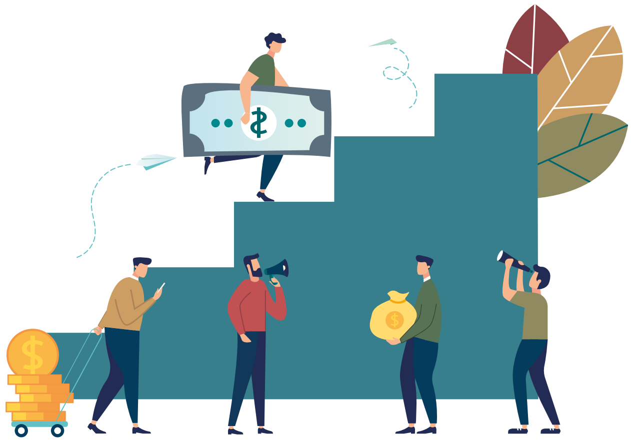
Initially, these types of investments were managed under exclusive criteria, that is, excluding companies with bad environmental, social, ethical or forced labour practices, such as the arms sector. The system has moved forward and is currently based on ESG criteria, which are more global and more open, because they can take in businesses from specific sectors able to accredit good environmental, social and good governance practices and, therefore, that deliver a great deal of added value. Thus, investors who choose this type of company no longer have to sacrifice their returns, on the contrary: it has been proven that sustainable funds[1] are comparable to conventional funds , and that they even mitigate risk as their internal processes are thoroughly examined.

The last major step taken that has brought about a major improvement in Andorran banks was the launch of **in-house investment funds managed exclusively using these criteria.** There are two reasons for the selection of this type of products: to respond to the growing concerns observed in customers, among the youngest above all, and to fulfil the desire of banks to strengthen their sustainability strategies, which in this case favours companies that have made a firm commitment to them. Furthermore, investment funds make SRI accessible to as many customers as possible, as options are available that do not require a minimum investment so there is now room for small investors rather than only having products exclusively designed for large investments as was the case before. Through these funds, investments may be made in companies all over the world accredited as being socially responsible, whether through equity instruments or products such as green bonds – which are enjoying great success in Europe as they diversify the portfolios of large investment and pension funds – in what is called impact investment, that is, investments that seek social and environmental returns, or microfinance schemes in emerging markets. Some of these funds have a twofold impact: they enable customers to earn money through sustainable investments, as well as donating part of the management fees to charity projects or charity organisations in Andorra.



1. International Monetary Fund (IMF) (October de 2020) *Sustainable Finance: looking farther.* Chapter 6 of the Global Financial Stability Report (GFSR). Retrieved from https://www.imf.org/en/Publications/GFSR/Issues/2019/10/01/global-financial-stability-report-october-2019#Chapter6.

An unstoppable trend



Although there is still not very much demand by private customers for socially responsible investing in Andorra due to a matter of economy of scale, what is clear is that this is an unstoppable trend on an international level. According to the last Global Sustainable Investment Review[2], sustainable investing in the world's five biggest markets had grown by 34% in 2018 over a period of two years, specifically, in the amount of 30.7 billion dollars. This means that 26% of assets managed worldwide are subject to sustainable investing criteria, a proportion that in the case of Europe is now as high as 50%.

Moreover, some of the world's most reputable fund managers have announced a switch of all of their products to more sustainable investing, whereby they have side-lined companies that use fossil fuels or that pose a high risk to the climate. The United Nations is also promoting the adoption of Principles for Responsible Investment (PRI)[3], a global project intended for the financial system to pay greater heed to ESG criteria in its processes and investment decisions. As one would expect, Andorran banks also follow sustainable investing criteria that set these principles and fund managers in some of these banks have already taken them on board. Signing up to these PRI entails basing all investment decisions on criteria of social responsibility and putting exhaustive control procedures in place to ensure compliance with them.

Along the same lines, the European Commission approved an action plan in 2018 on sustainable investing for a greener, cleaner economy[4]. The ultimate goal of this document is for the financial sector to place greater emphasis on sustainability in its investments and that more funding is earmarked for environmental projects. Amongst the measures it covers is greater transparency in corporate reports to upgrade the information that reaches investors and to establish a **standard classification system for sustainable investing.** This latter aspect is important because it would put an end to one of the problems investment managers encounter: the need for common methodologies in order to decide whether an investment fulfils ESG criteria. To mitigate this shortfall, the Andorran banking sector has the support of databases, and the risk control and investment management tools used by the international managers with which it works, in addition to the sustainability indices drawn up by some stock markets and credit rating agencies. The country's banks are mindful that every endeavour must be made to be able to distinguish between companies and investments that are really sustainable and others that undergo greenwashing, which is used to create the impression that an organisation's products and policies are environmentally friendly with the aim of making more money.

2. Global Sustainable Investment Alliance (2019), *2018 Global Sustainable Investment Review* [PDF file] Retrieved from http://www.gsi-alliance.org/wp-content/uploads/2019/06/GSIR_Review2018F.pdf.
3. PRI Association (2019). *Principles for Responsible Investment.* [PDF] Retrieved from https://www.unpri.org/download?ac=9764.
4. European Commission (8 March 2018), *Sustainable finance: Commission's Action Plan for a greener and cleaner economy* Retrieved from https://ec.europa.eu/commission/presscorner/detail/es/IP_18_1404.

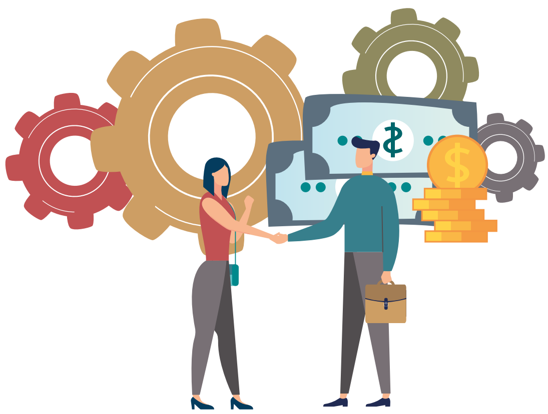
The trend is unstoppable because sustainability is not a fashion, it's a necessity. It is clear that more policies are required both in the public and private sectors in order to conserve the environment and stop climate change. From a social point of view, good practices in the sphere of human resources will obviously have an impact on a business' productivity, and that supporting the community helps create a better image of a company. Insofar as governance is concerned, investors evidently prefer boards of directors that are transparent and socially responsible.

Banks devote up to 6% of their profits to Corporate Social Responsibility actions

In Andorra, one type of customer that is showing a marked preference for management more focused on sustainability criteria is the institutional investor, which has pushed investment managers at Andorran banks to increase their range of sustainable funds. Therefore, the current challenge is to increase both offer and demand. In turn, this is increasingly attracting private customers, to whom it has been demonstrated that choosing sustainable investing does not mean relinquishing financial returns.

However, the position on return on equity is not unanimous. While some investment managers insist that sustainable investing is yielding higher returns that conventional investing, others believe that this may be the result of the fact that this is a new trend, but that its long-term performance must be analysed because, ultimately, this may entail constraints on the investments chosen. Furthermore, it must also be taken into account that in addition to cash returns there is the more intangible satisfaction of having invested in concerns that benefit the common good. What is clear is that in the long-term **corporate governance criteria must be borne in mind whenever deciding whether investing in a company is a good idea** as this enables risk to be reduced, as demonstrated by many instances worldwide caused by irresponsible ways of conducting business, as was the case of the bankruptcy of Lehman Brothers in 2008.

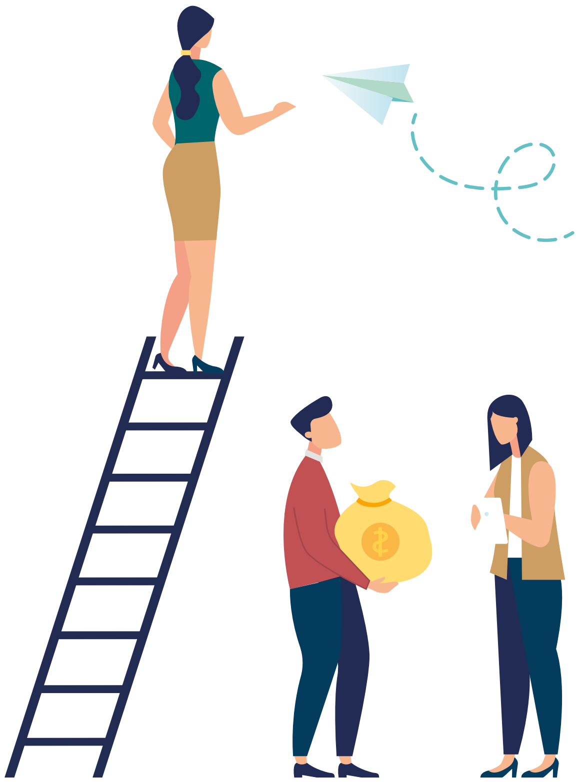
Taken as a whole, this means that we are faced with a scenario in which, for the first time, non-financial information is starting to influence markets, which are reacting to the consequences a business may suffer because it is not sustainable or socially responsible. This has meant that the financial sector has had to take an approach of **integrating sustainability in its risk management practices.** Up until now, only the financial statements and the performance of a product were analysed to calculate equity returns and, in the case of extending loans, only economic risks were taken into account. However, from now on it will also be necessary to assess social, reputational and environmental risks, such as those arising from climate change or from the fact that a business deals in a prohibited source of energy, for instance. These are still questions to which banks are giving relative importance as there is still a certain degree of uncertainty around them, but in the mid-term consideration is being given to the analysis of these risks that will gradually become more relevant.



Aligned with the Sustainable Development Goals

In order to tackle the matter of sustainability from a more global point of view, Andorran banks have also made a commitment to contributing to the attainment of the Sustainable Development Goals (SDGs) set by the United Nations in its 2030 Agenda. To this regard, the banking sector is **aligned with and enforces SDG strategies and initiatives on Corporate Social Responsibility on the basis of these worldwide goals**, so that it is able to follow the same path traced out on an international level, and to reaffirm its global commitment to society. Indeed, the banking sector is aware, as noted by the United Nations, that in order to attain a more sustainable world, government- and institution-driven actions are not enough, but rather requires the engagement of the private sector. In view of the above, Andorran banks have undertaken to continue to commit to and promote initiatives and positive impacts that help attain the milestones set out in the SDGs and the 2015 Paris Climate Agreement.

In addition to signing up to the SDGs, some banks are now also signatories of the United Nations Global Compact, which promotes 10 principles based on human rights, labour matters, the environment and the fight against corruption. They have also adhered to the United Nations Environment Programme Finance Initiative (UNEP FI), which is responsible for promoting sustainable investing. In fact, last September UNEP FI conducted an extensive review following which it passed the Principles for Responsible Banking[5]. The aim of these principles is to determine the role and responsibilities of the banking industry in the development of a sustainable future, and that are in fact aligned with the SDGs approved by the UN.



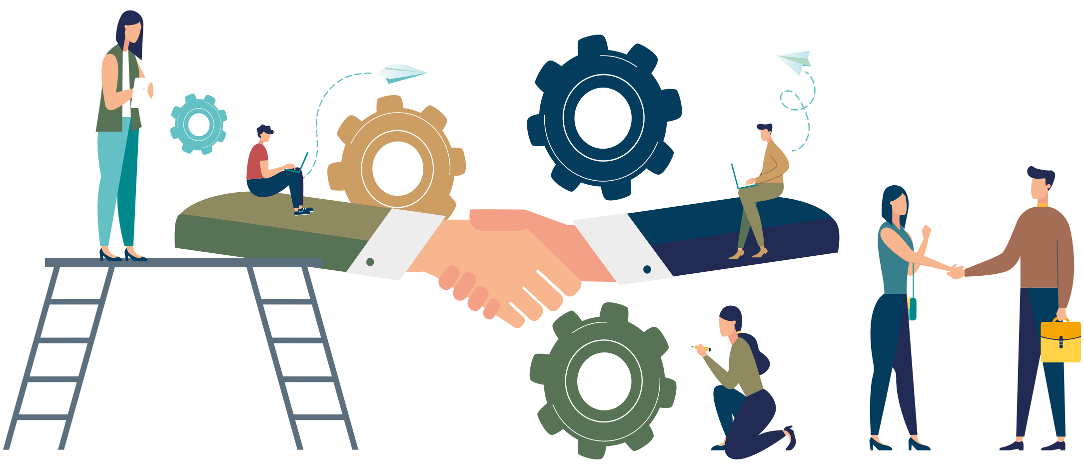
5. UNEP Finance Initiative (2019) Principles for Responsible Banking. Retrieved from https://www.unepfi.org/banking/bankingprinciples/.

Support to local sustainability projects

With a view to the future, Andorran banks anticipate that they will be able to build on this strategic change that entails engagement with a more sustainable financial system. This does not just mean improving their internal processes and encouraging socially responsible investing, which is undergoing exponential growth, according to insiders in the sector, but also to help finance more sustainable initiatives in the country. To date, demand had been low but assessments of the financing of these types of projects now enjoy special worth in the credit ratings of some banks, and they all hold any type of financing in this field in high esteem. Moreover, it has been forecast that the demand for this type of investment will start to rise, whether due to the policies it is expected that will be introduced by FEDA and the government in relation to the implementation of the Energy Transition Act, in order to raise greater social awareness, or because technological developments lead to sectors such as electric vehicles and, therefore, the demand for loans to acquire them will grow. In fact, across Europe sectors with a high sustainability rating such as recycling, energy efficiency, logistics and mobility are experiencing significant growth.

The COVID-19 crisis has brought to light the more social facet of banking and its goodwill in giving support to the country in these crucial times

Despite the fact that because the country is small there are projects and products that will never be significant for the Principality, the Andorran banking sector is working with its eyes on international trends on sustainability, such as investments in circular economy initiatives, the issue of green bonds, mixed financing mechanisms to help emerging countries to fulfil the SDGs, and investments to mitigate and adapt to climate change. Other areas to be explored in the future are educational programmes devoted to sustainable financing, in order to raise awareness amongst the population about this imperative trend. “This is the way the world is going and we are already focused on this”, say those from the sector.



The role of banking in these crucial times

The banking sector's engagement with sustainability has inevitably been affected by the COVID-19 health crisis. Following the sudden fall of markets, investment funds subject to ESG criteria best bore the brunt[6 7], due to the type of companies in which they invest, but also because most investments are made in the long-term.

In addition, banks have also pointed out that businesses, especially big ones, from the financial and other sectors, must adopt very different social measures to those in place to date, and banks must now adapt to the new demands and needs of society. As a result of the crisis, in terms of sustainability attention has now turned from environmental issues to focus on more social concerns, such as the approach businesses must take in the management of their human capital.

However, what has really come to light in this health crisis is the role banks play in giving support to the country in difficult times. Indeed, the concept of sustainability is also understood as "sustaining" the society to which they belong so that it works in the best way possible, not just out of altruism, but also to ensure a prosperous environment in which business can survive. The sector is convinced that crises such as this one show "who is by society's side and who is not", and highlight the **joint commitment banks have to cover the financing of financial aid.** Thus, at times like these it has come to light that more than ever the banking sector must continue to engage in sustainable and socially responsible practices, whose maximum exponent is the voluntary act of returning to society a part of what it has given in the form of social support.

6. Moshinsky, Benjamin; Tan, Jenn-Hui (16April 2020), *Outrunning a crisis: Sustainability and market outperformance.* Fidelity International. Retrieved from https://www.fidelityinternational.com/editorial/article/outrunning-a-crisis-sustainability-and-market-outperformance-2ce135-en5/.
7. *Funds Society* (16 April 2020) Impacto del COVID-19 en la gestión de carteras: inversión sostenible y control de riesgos (Impact of COVID-19 on portfolio management: sustainable investing and risk control). Retrieved from https://www.fundssociety.com/es/noticias/negocio/impacto-del-covid-19-en-la-gestion-de-carteras-inversion-sostenible-y-control-de-riesgos.

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