vigeo rating The way to responsible investment

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Sector Study

Diversified Banks Europe 2014

Rome - 31 March 2015

Presentation overview

- A short introduction: Vigeo and its methodology
- Diversified Banks 2014: sector composition and key issues
- Most material issues for banks: risks and key findings
- Conclusions and discussion

Vigeo's methodology

International Standards

- ✓ Conventions, Recommendations, Declarations, Directives from the UN, ILO, Global Compact, OECD, etc.

6 Domains Of analysis

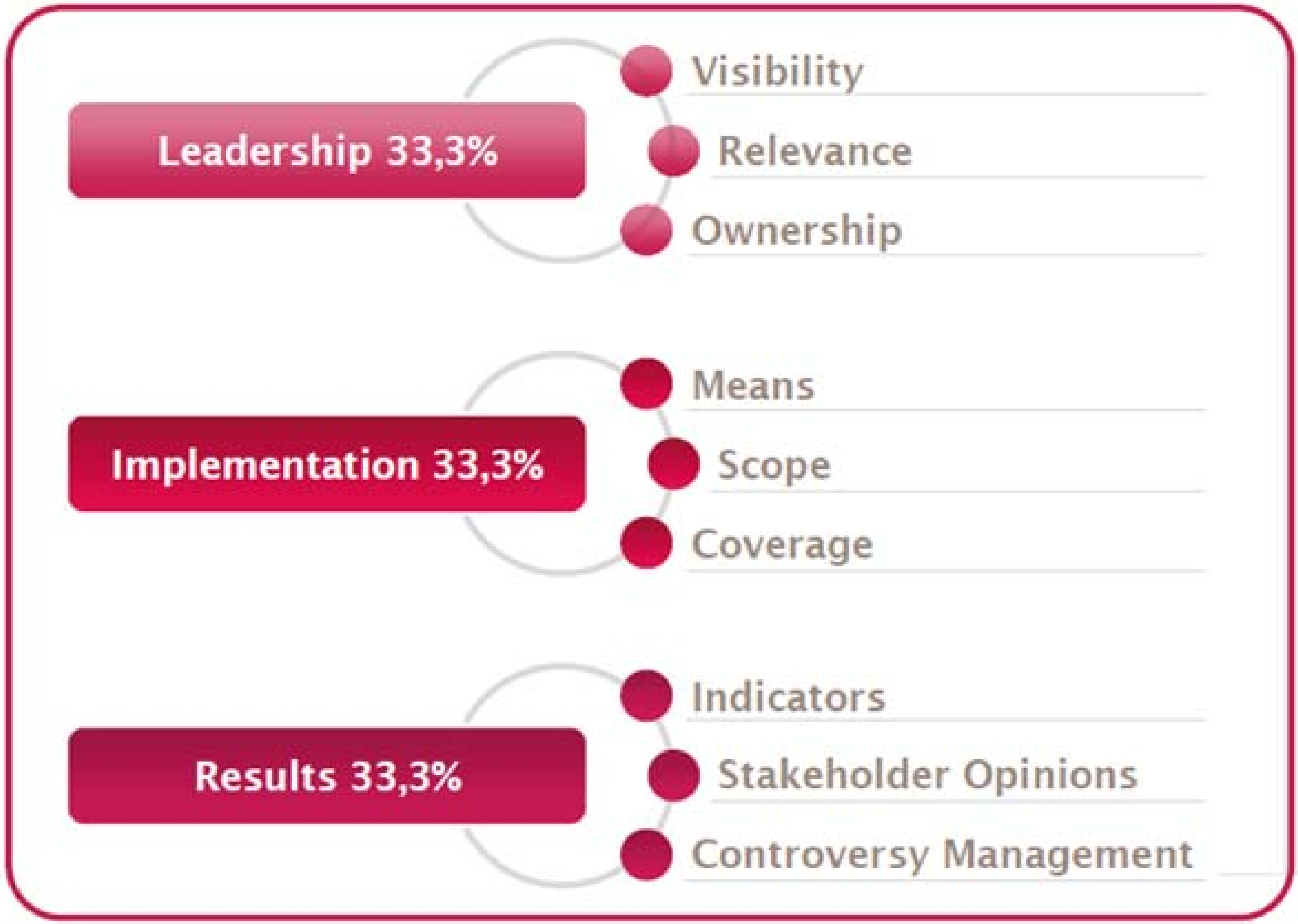
- ✓ 6 domains of analysis representing the different interests of different stakeholders

Sector Specific Analysis

- ✓ **38 Sustainability Drivers** and over **300 principles of action are used** to question companies and their integration of CSR concepts into their managerial systems

- Business Behaviour
- Community Involvement
- Corporate Governance
- Human Rights
- Environment
- Human Resources

Sustainability drivers are analyzed through a 3 level approach:



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Our scores = expressions of Vigeo's opinion on managerial performance

We express them as:
Advanced (60+/100)
Robust (50-59/100)
Limited (30-49/100)
Weak (0-29/100)

Our ratings = our opinion on the 'ranking' on domains compared to sector peers

Diversified Banks 2014: sector composition

The European Diversified Banks sector consists of **33 large banks**. Compared to the previous review all banks remained in the panel and 5 newcomers entered: ABN Amro, Banque Fédérative Crédit Mutuel, Groupe BPCE, ING and Rabobank.

Diversified Banks include banks with total assets of at least EUR 200 billion. All 16 European listed G-SiB's (as of November 2014) are included in this sector.

Smaller banks are treated in the Retail & Specialized Banks sector (currently under review, composed by 74 banks).

Most diversified banks are active in commercial, retail and corporate banking. Some banks have also have important investment banking activities: Crédit Suisse, Deutsche Bank, UBS, Barclays and Natixis.

vigeo rating

13 key sustainability drivers for the sector

Fundamental CSR objectives

- **C&S 1.2** - Information to customers
- **C&S 1.3** - Responsible Customer Relations
- **C&S 3.1** - Prevention of corruption and money laundering

- **HRT2.4** - Non-discrimination

Strong vulnerability of stakeholders

- **ENV1.1** - Green products & SRI
- **ENV2.2** - Climate Change: indirect impacts

- **CIN1.1** - Social and economic development
- **CIN2.1** - Financial Inclusion

High corporate risk concentration

- **CGV1.1** - Board of Directors
- **CGV2.1** - Audit & Internal Controls
- **CGV4.1** – Executive Remuneration

- **HRS2.3** - Responsible management of restructurings
- **HRS3.2** - Improvement of health and safety conditions

2014 overall performance overview

Number of domains with "+" or "++" ratings (*vertically : idem with "-" and "--"*)

	0	1	2	3	4	5	6
0			Lloyds Banking Group Banca Monte Dei Paschi Di Sien ABN-AMRO Hldg	Groupe BPCE Banque Federative du Credit Mutuel Intesa Sanpaolo S.p.A.	Credit Agricole SA	Societe Generale	BNP Paribas RABOBANK
1	UniCredit	COMMERZBANK	Banco Bilbao Vizcaya Argentaria (BBVA) Natixis ROYAL BANK OF SCOTLAND GRP	Danske Bank ING Group	Standard Chartered		
2	Erste Bank		Nordea AB	CaixaBank			
3	Banco Santander S.A. Skandinaviska Enskilda BK	KBC UBS R Deutsche Bank Barclays					
4	Credit Suisse Group Swedbank AB	DNB A	HSBC Holdings				
5	BANKIA						
6	Svenska Handelsbanken A						

Information to clients (C&S 1.2) and Fair treatment of clients (C&S 1.3)

According to the EBA Consumer Trend Report 2014 mis-selling practices, indebtedness of clients, lack of transparency of fees and risks **continue to be crucial issues for consumers,** which are losing confidence in the financial institutions.

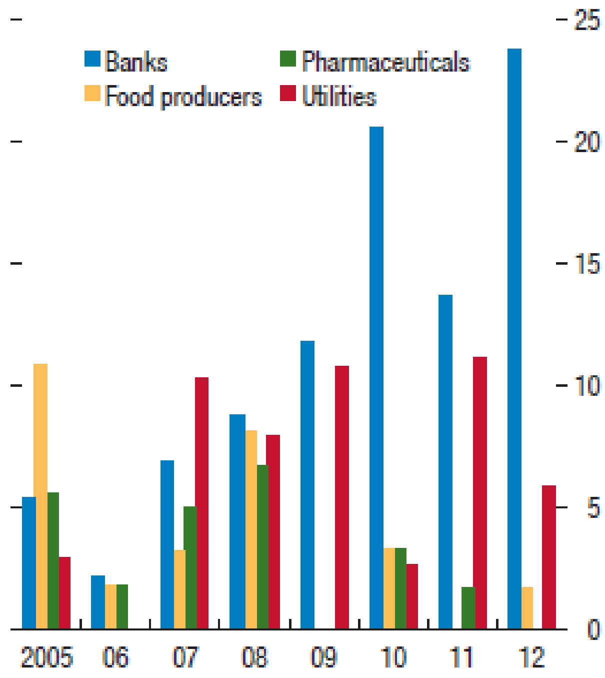
Retail banking is changing rapidly: clients have **increasing expectations** on products and transparency and the competition is intensifying.

Consumer protection remains a compliance priority for banks: a "tone at the top" is needed to integrate consumer protection in the bank's corporate culture.

Banks failing to adopt strong processes to ensure transparent and fair treatment of clients can face higher reputational, legal and human capital risks, while losing significant market opportunities.

Figure 3.4.1. Customer Complaints
(Percentage of companies with customer complaints)

Banks are increasingly under the spotlight because of consumer complaints or dissatisfaction.



Sources: Thomson Reuters Datastream; and IMF staff calculations.

Prevention of corruption and money laundering (C&S 3.1)

In recent years, banks saw a **huge number of court orders, condemnations and fines**. Non-compliance seems a constant in banks' practices and this **is becoming very material.**

Banks globally have paid out more than $166 billion in legal settlements since 2008!

"A 34% cut in our corporate ethics should return us to profitability."

ft.com > companies > financials >
December 26, 2014 2:28 pm

Bank settlements hit $56bn in most expensive year on record

In December 2014, in its dashboard for EU bank sector, the EBA warned that legal costs have and will continue to materialize, in some cases severely impacting banks' profitability

Information to clients (C&S 1.2) and Fair treatment of clients (C&S 1.3)

Banks are aware of their responsibilities: 84% formally commit, with different level of engagement, to inform customers on products' risks, avoid misleading practices, achieve customers' satisfaction and handle complaints. Banks are also increasingly aware of the importance to manage clients' complaints carefully and improve customer satisfaction, while specific departments are often in charge of the oversight of these topics.

All banks report some means to ensure transparency in information to customers, but only in 21% of the cases they are considered comprehensive. For instance Societe Generale adopted an internal referential guide, for consumer loans as to mortgage lending, on the basis of the definition of Responsible Lending and launched a campaign of self-assessment of practices across all retail banking networks and consumer credit subsidiaries.

In terms fair treatment of clients, actively monitoring data on customer satisfaction and staff awareness and training are the most common measures. Only a minority of banks have ongoing dialogues with consumer associations and/or an accessible system to handle complaints coordinated by a third party (ombudsman service).

In general, a change in corporate culture is needed: 42% of banks are involved in allegations concerning mis-selling practices and the provision of deceiving information to customers.

Business ethics (C&S 3.1)

Increases awareness of the sector: all banks disclose formalized commitments on the prevention of corruption and money laundering . All banks report on operational and internal control systems on business ethics (training, whistleblowing, audits, risk assessments).

More advanced measures (external audits on the prevention of corruption, AML due diligence on countries and sectors) are reported by less than 50% of banks. In the minority of cases the systems also cover sales agents and business partners.

73% of banks are involved in serious allegations, including:

- November 2014: USD 4.4 billion fine by UK and US regulators for the manipulation of FOREX: the banks involved include RBS, HSBC and UBS.
- July 2014: **BNP Paribas** settled for USD 8.97bn violating of US sanctions.
- May 3014: **Crédit Suisse** fined USD 2.6 bn for having helped Americans evade taxes.
- UK banks see climbing costs for the mis-selling of Payment Protection Insurance (PPI) scandal: according to the FCA, total banks' PPI payouts to clients are GBP 13.4billion.

TOP 3 PERFORMERS

- **ING (57/100):** ING discloses a sound framework to prevent corruption and ML. Adequate measures in place to ensure responsible and transparent relations with clients.
- **Nordea (57/100):** Nordea set up a comprehensive system to ensure clients are informed properly. Product Responsible Units are responsible for product development matters in co-operation with the Customer Responsible Units to clear and simplify information on products and marketing messages.
- **ABN-AMRO (56/100):** Advanced policies and systems in terms of relations with clients and business ethics. The complaints management system involves the Complaints Institute Financial Services (KIFID).

BOTTOM 3 PERFORMERS

- **Credit Suisse (33/100):** involvement in several allegations related to customers issues, for instance on misleading and deceptive contractual practices. Concerns several cases of fraud linked to setting financial benchmarks.
- **UBS (30/100):** recurrent and serious allegations related to inadequate information to customers about risky investments. Involvement in the manipulation of LIBOR, Forex and other benchmark rates, as well as in fraud on credit default swaps, tax evasion and money laundering.
- **HSBC (29/100):** numerous allegations related to mis-selling practices and questionable business ethics. Involvement in the payment protection insurance (PPI) scandal, as well as in the manipulation of LIBOR, Forex and other benchmark rates and fraud cases in the US.

Source: Financial Times - [HSBC in Swiss tax avoidance storm]- 9 February 2015

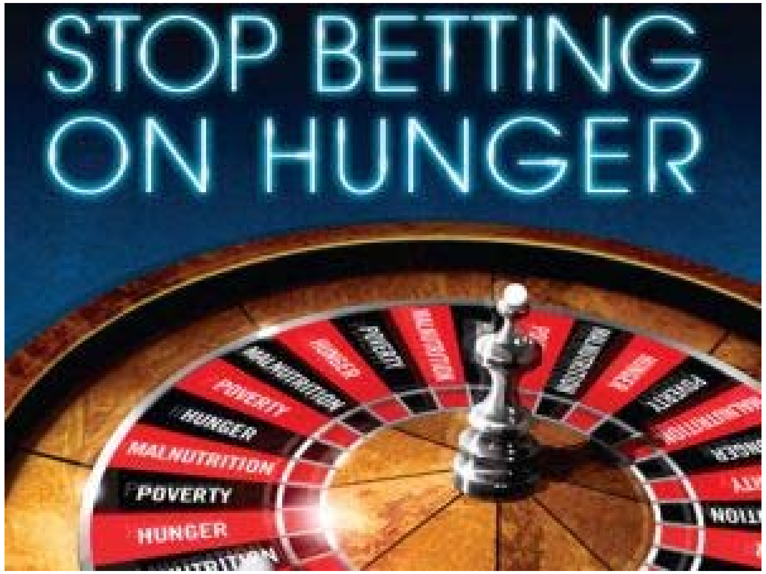
Promotion of social and economic development (CIN1.1)

According to the latest ECB "Survey on the access to finance of enterprises", SMEs continue to be concerned about the availability of bank loans. Banks are now deleveraging, but they can lose important opportunities in this market. Banks are expected to support SMEs and business start-ups not only through lending, but also with training, technical assistance, advice.

At the same time, banks should avoid activities that have a negative effects on society (as **tax avoidance** - of both clients and banks – and **commodity speculation**) and which are now at a strategic crossroad.

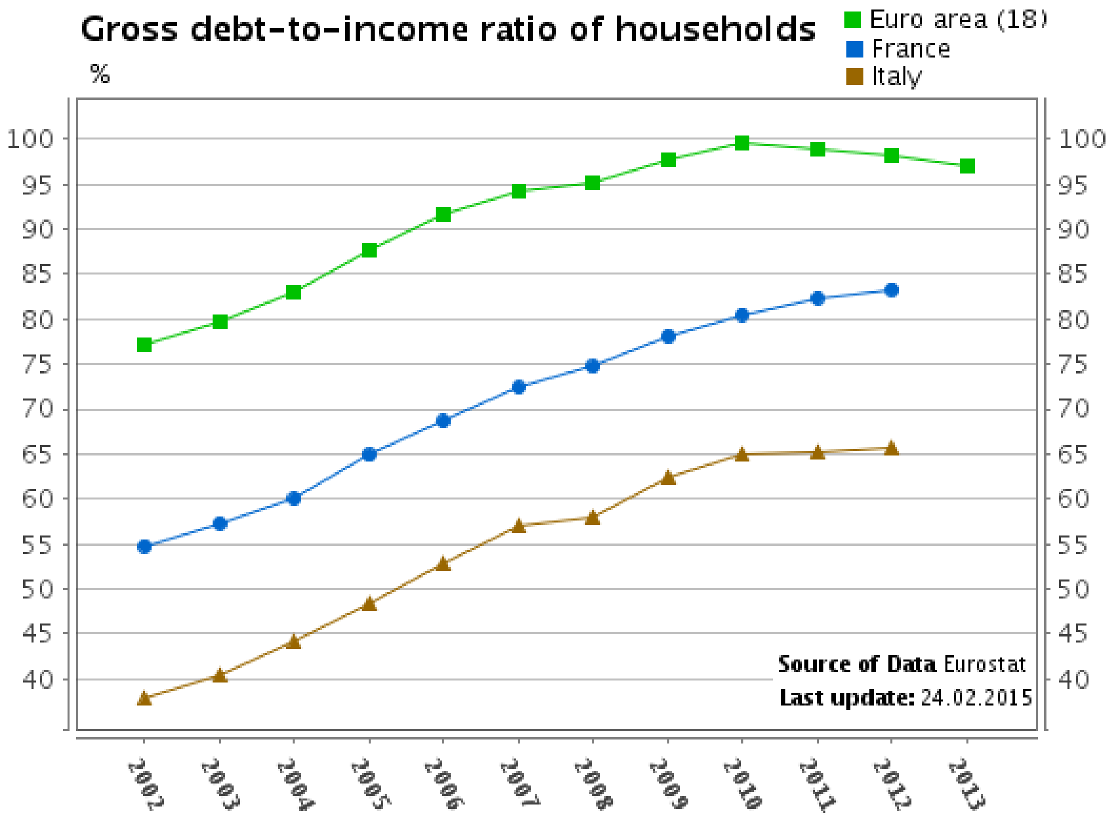
It's not (only) a matter of social responsibility!

Events such as the recent crackdown on tax havens by G20 and OECD or the NGOs campaigns against food speculation (as part of the MiFID II) may seriously impact a bank's **corporate reputation**, decrease the operation efficiency and increase the exposure to **legal** and **operational risks**.



Financial inclusion (CIN2.1)

According to recent data from the European Commission, 7 % of all EU consumers, i.e. 30 million Europeans above 18, **do not even have a bank account**…



…while the average household debt outstanding is increasing, wages are shrinking and retail clients are more financially vulnerable.

In this context, banks are expected to offer **inclusive financial products** and to adopt systems to **detect and responsibly manage cases of over-indebtedness**.

Bank failing to doing so may not only see their reputational capital eroded, but also lose opportunities in terms of retail market share and efficiency.

Promotion of social and economic development (CIN1.1)

All banks commit to support social and economic development, but only 15% have set targets.

82% of the banks under review have deployed significant efforts to foster the economic development: support to SMEs (94%) and cooperation with NGOs (66.6%) are the most frequently observed programs. Other measures – such as system to prevent the negative societal effects of speculation and tax avoidance – are more rarely addressed (30%).

Performance indicators: 21% of banks in the panel disclose increasing contributions or other KPIs (loans to SMEs, micro credits etc.) relevant for development issues, while 36.3% of companies still fail to report any KPI.

Tax avoidance: following the initiatives of OECD, G20, CDR IV and French Banking law, EU banks demonstrate a higher level of awareness on the prevention of tax avoidance: 54.5% of them issued a commitment to prevent tax avoidance, compared to 42.8% in 2013. However, 50% of banks face either controversies or criticisms on tax issues (e.g. 40% cited in the ‘Luxleaks’ scandal), inquiries regarding tax fraudulent behaviours (Barclays, Unicredit, KBC) or for their involvement in strategies to help clients’ tax evasion (UBS, Credit Suisse, Deutsche Bank, HSBC).

Financial inclusion (CIN2.1)

83% of the banks commit to address financial inclusion and/ or overindebtedness.

Almost all banks (except Commerzbank) communicate on measures adopted to foster **financial inclusion**. 90% of banks provide financial education to groups at risks and a large majority offers basic banking services (76.6%) or inclusive credit products (63.3%). Cooperation with stakeholders (43.3%) and specific training for sales people (20%) are more rare.

Clear improvements are visible in terms of **fair management of overindebtedness**: only 3 banks do not describe any step in this regard (specific support programs, monitoring of weaker clients). 40% of banks set up specialized departments or/and partnerships with stakeholders. Finally, sales personnel received training on overindebtedness in 30% of the banks reviewed.

4 banks face allegations on issues linked to improper practices or processes in foreclosures cases: HSBC, Banco Santander, RBS.

The best performances are achieved by Groupe BPCE and Intesa Sanpaolo (63/100). Both companies make significant efforts to promote the financial inclusion of people with low income and to manage over-indebtedness cases responsibly.

TOP 3 PERFORMERS

- **BNP (69/100):** comprehensive polices and measures to promote local development (support to micro-finance providers, SMEs etc..). Some measures to cope with the negative impacts from tax avoidance and food speculation. Support programs for customers in difficulties. Improving KPIs.
- **Rabobank (68/100):** extensive efforts to promote social and economic development. Rabobank has formulated clear positions on the avoidance of speculative trading and tax evasion. Extensive programs for financial inclusion, in Europe and in developing countries. Improving KPIs.
- **Groupe BPCE (67/100):** extensive support to SMEs, local economies and authorities. Advanced practices on financial inclusion, in partnership with local NGOs. Improving KPIs.

BOTTOM 3 PERFORMERS

- **UBS (26/100):** General commitment to the promotion of local social and economic development. No information is provided on the systems to prevent tax avoidance and several allegations have been faced in terms of tax evasion and tax avoidance.
- **Nordea (27/100):** Some measures in place, but commitments to promote local social development and the accessibility of financial products are not visible.
- **Svenska Handelsbanken (21/100):** no information is provided on measures in place to support customers in financial distress. Measures reported on promotion of access to basic financial services are limited to financial literacy training. Lack of formalized commitments on the issues at stake.

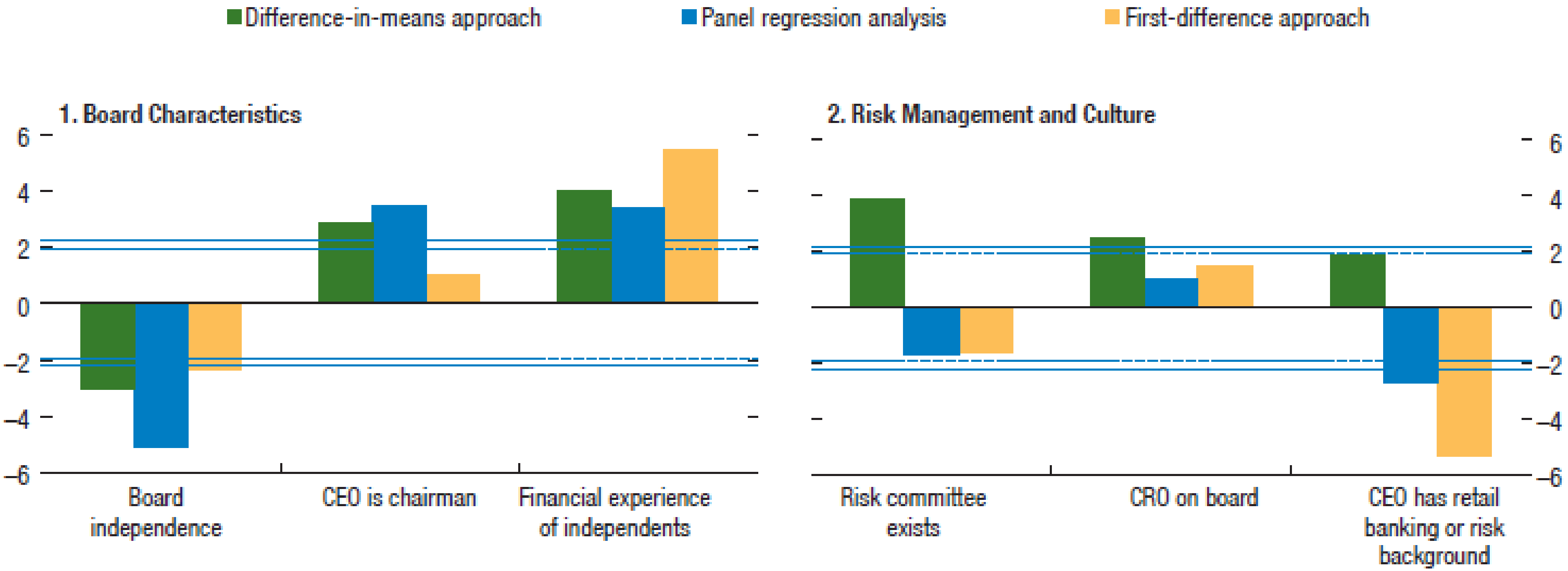
Board composition (CGV1.1) & Audit and Risk Management (CGV2.1)

Banks with a more **independent Board** and a **risk management framework in line with international recommendations** are generally better placed to supervise and control risks

IMF - Global Financial Stability Report: Risk Taking, Liquidity, and Shadow Banking – 2014 (800 banks in 72 countries)

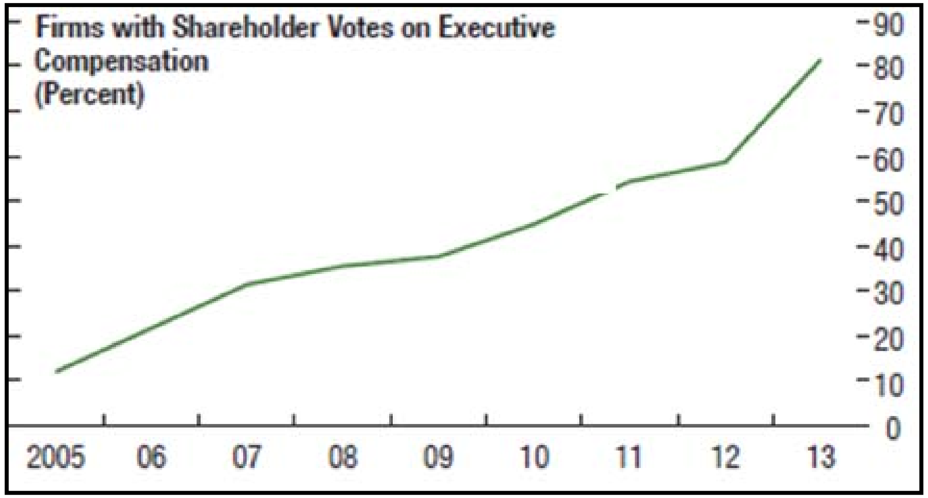
Figure 3.4. Bank Governance and Risk Taking
(z-statistics)

Various approaches to investigating the relationship between governance, pay practices, and risk taking in banks give generally consistent results.

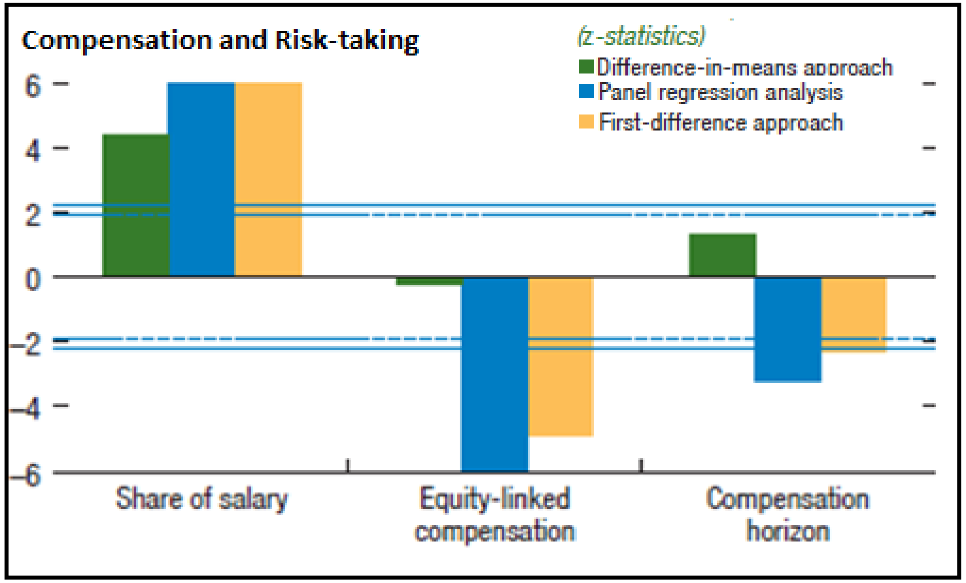


Executive Remuneration (CGV4.1)

Bankers' pay has fully recovered! But «**Say-on-Pay**» is now the mainstream and remuneration is under increasing scrutiny of both investors and the public opinion.



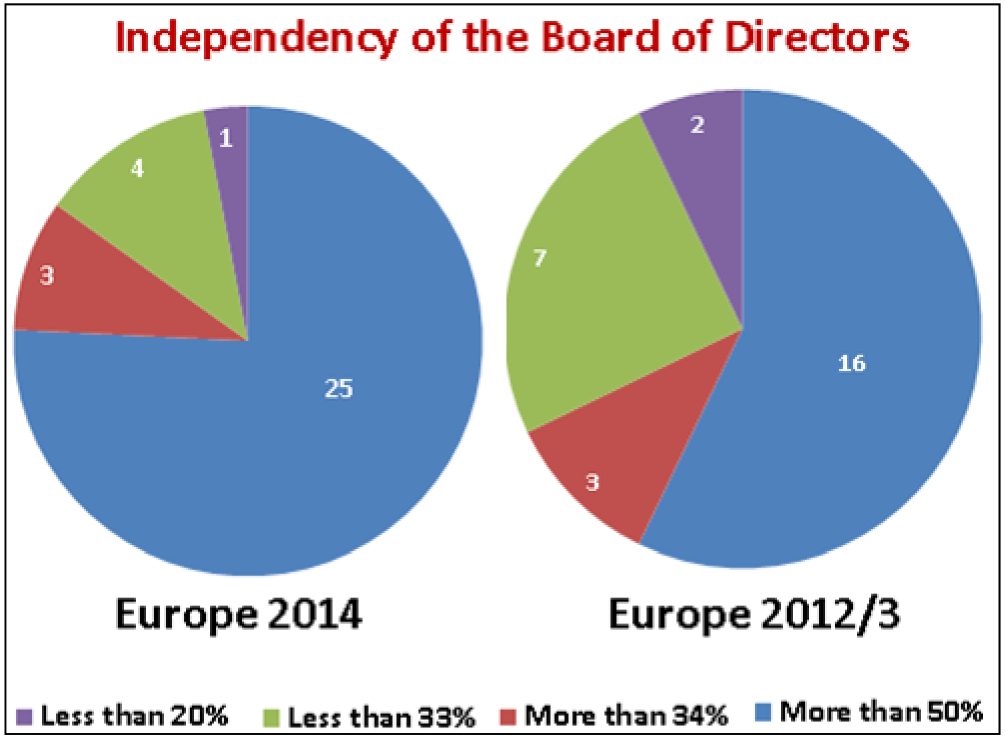
Longer-term incentives for bankers are generally associated with less risky banks!

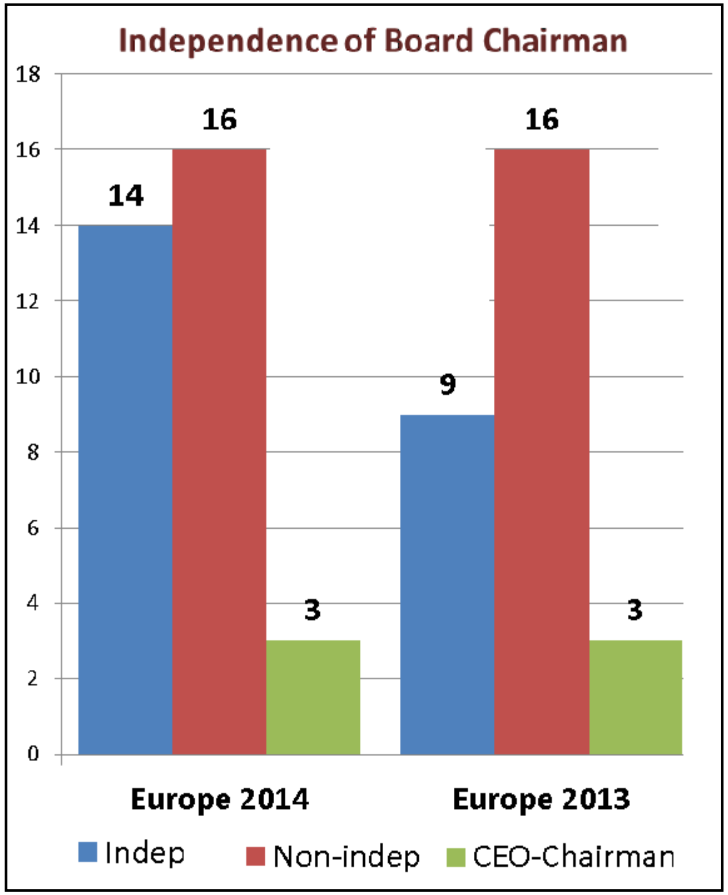


IMF - Global Financial Stability Report: Risk Taking, Liquidity, and Shadow Banking – 2014

Board Composition and functioning (CGV1.1)

There is an increasing attention by investors and shareholders on the composition of Board of Directors





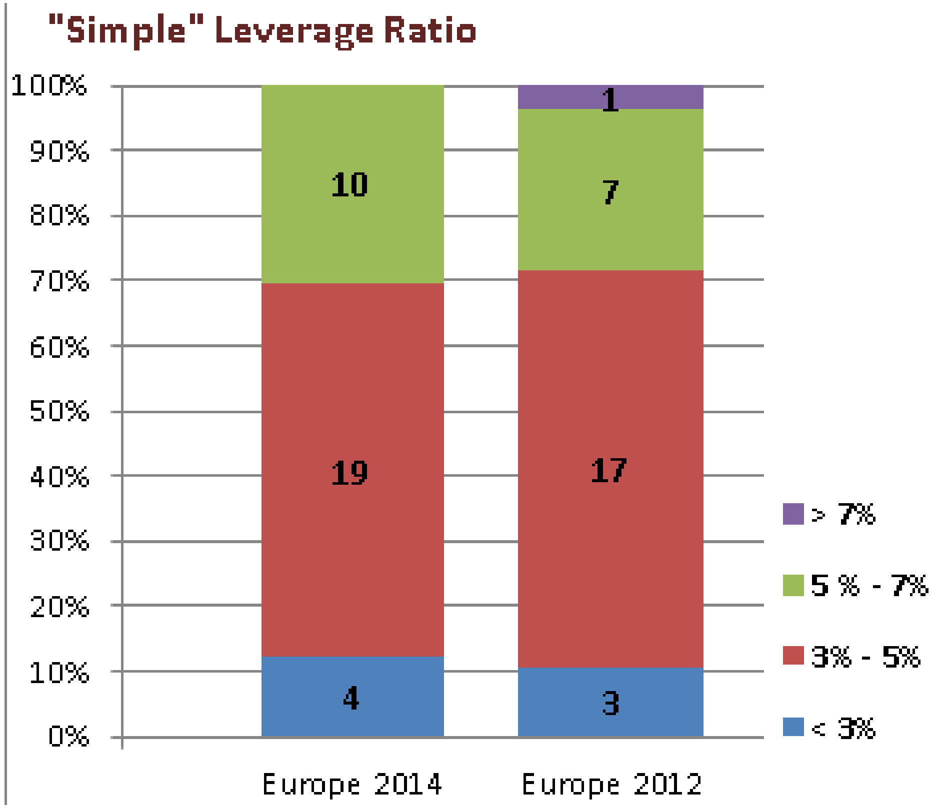
Almost 90% of banks formally reviewed **CSR issues at Board level**, but only 9 banks (27%) established a dedicated Board Committee explicitly responsible for CSR issues.

Internal control and Risk management (CGV 2.1)

European banks show **clear improvements in terms of management of risks.** More than 75% of banks have now established a **stand-alone Risk Committee at Board level**. Only 8 banks (24%) show best practices in terms of Risk Committee composition.

80% of banks disclose the process of **identification and supervision of material risk takers** (2014 guidelines by EBA). However, only 5 banks describe training for MRT on risks management and 20 banks are involved in controversies related to internal control failures

Capitalization is improving, with only 4 banks (Deutsche Bank, BMPS, Crédit Agricole and Natixis) at 31/12/2013 having a simple leverage ratio (Equity minus goodwill and less tangible assets, over total assets) below 3%.



Executive Remuneration (CGV4.1)

Among those banks which put executive remuneration to a vote at the last AGM, in 8 cases the related resolutions were approved with less than 90% of votes: **UBS, Lloyds, Credit Suisse, HSBC, BNP, Barclays, KBC** and **Standard Chartered** (41% of votes opposed the bank's new pay policy!).

The transparency on the performance indicators linked to the allocation of annual bonuses has improved, but only few banks disclosed the actual quantified targets. Around 50% of the banks under review make use of CSR and/or risk-adjusted performance conditions.

Almost one listed bank every two (44.8%) does not disclose the rules guiding the allocation of **long-term incentives** or does not have incentive plans based on multi-year accrual period yet.

Looking at the **risk-adjustment of remuneration**, 77.8% of banks comply with the basic recommendations of the EBA (at least 60% of variable remuneration deferred over a minimum period of three years), but only 6 banks introduced longer deferral periods, up to 5 years.

Corporate Governance: key findings

TOP 3 PERFORMERS

- **RBS (72/100):** advanced performances of governance, despite the recurrence and severity of controversies on internal control failures. The Board is highly independent and has good practices. RBS' new remuneration policy is based on LTIs, also covering risk and non-financial objectives.
- **RABOBANK (71/100):** The Board is fully independent, and it is evaluated periodically by a third party. The LIBOR case revealed failures in the internal control system, for which the bank has taken corrective measures. No variable compensation is granted to executives.
- **Danske Bank (70/100):** All Board members are considered independent and the roles of Chairman and CEO are separated. Executive pay is deferred for 4 years with clawback provisions.

BOTTOM 3 PERFORMERS

- **KBC (43/100):** Only a minority of Directors are independent. The process of monitoring of MRT is not disclosed. Major restrictions have been identified to shareholders rights to convene extraordinary meeting. The annual bonus to executives is linked to financial and non-financial indicators, but targets are not disclosed. No long-term incentive plan in in place.
- **Skandinaviska Enskilda BK (41/100):** In 2014 non-audit fees to the external auditor were more than 66% of total fees paid. SEB does not respect the one-share-one-vote principle. The bank does not have a transparent remuneration policy in place.
- **Svenska Handelsbanken (31/100):** Only a minority of Directors are independent. The audit committee has a limited role. The one-share-one-vote principle is not respected.

Green products and SRI (ENV1.3)

With the integration of environmental considerations in the assessments of loans and credits, banks can influence companies' behavior towards more environmentally friendly activities.

The management of **environmental risks in loans and project finance** can mitigate the exposure of the bank to reputational and operational risks.

Banks have fiduciary duties to act in the interests of their beneficiaries, also by integrating **environmental considerations in their investment strategies.** The 2014 PRI Report on Progress showed that 67% of asset owner signatories ask their investment managers to integrate ESG issues into their investment processes.

ESG issues can affect the performance of their investment portfolios: research shows a direct relationship between ESG performance and financial performance of firms (see for instance: Eccles, Ioannou, and Serafeim (2013))

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Climate change: indirect impacts (ENV2.2)

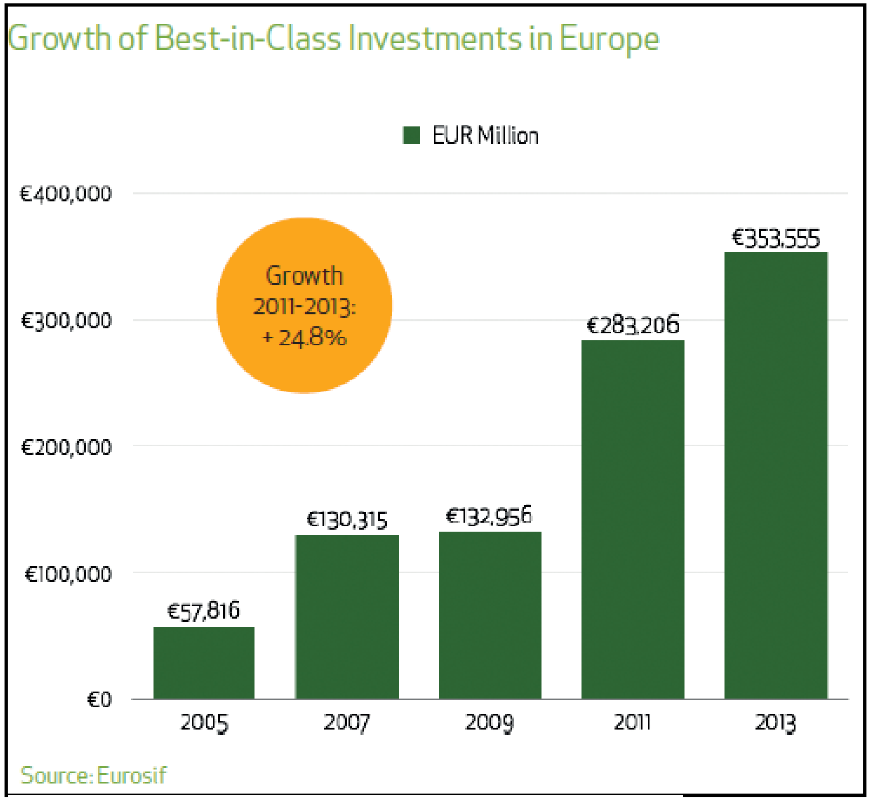
According to the Global Risks 2014 by the World Economic Forum, climate change is among the five most likely and most impactful risks in 2014.

Banks are expected to recalibrate risk management to integrate climate change considerations, both in lending and investment decisions. Banks are also expected to develop new products and services that support solutions for the transition to a low-carbon economy.

Hot topic: stranded assets
In the 2014 report "Unburnable Carbon", the Carbon Tracker Initiative and the London School of Economics argue that there is a growing "**carbon bubble**" in financial markets: between 60 and 80% of coal, oil and gas reserves of publicly listed companies could be classified as unburnable if the world is to achieve emissions reductions that offer the greatest chance of limiting average global warming to 2°C.

Green products and SRI (ENV1.3)

Clear improvements are visible in terms integration of environmental criteria in lending and investments activities. Almost all banks report some commitments to offer green products, but these commitments remain often very general.



European SRI Study 2014 –Eurosif

- All banks disclose processes to include environmental criteria in credit decisions, increasingly also through training and environmental risk assessments.
- The coverage of environmental assessments of lending is increasing (not just on project finance).
- An increasing number of banks screen investments on ESG.
- Assets covered by SRI strategy is still a niche, but mainstreaming is more common.
- However, still 75% of banks face criticisms from activist NGOs for their financing of environmentally controversial projects.

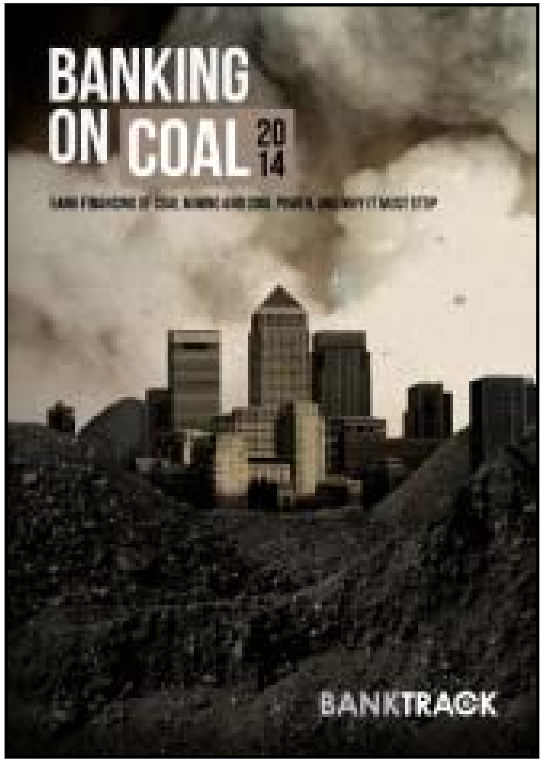
Climate change: indirect impacts (ENV2.2)

The sense of urgency of climate protection is in no way reflected in the sector performance, just slightly increased from the previous review. The number of banks with policies on climate sensitive sectors is increased, but **no bank has set quantitative targets**. The majority of banks set up a **dedicated structures** responsible for the coordination of climate protection.

Almost all banks refer to their methodology to include climate risks assessment in financing activities, in 50% of cases supported by training for credit analysts. RBS, HSBC and Lloyds also report extensively on their climate advice services

Only RBS and Crédit Agricole disclose very partial **data on indirect CO2 emissions**

Banks are still major financers of industries most responsible for climate change: according to the 2014 report "Banking on Coal", 92 commercial banks invested more than EUR 373 bn in the coal industry between 2005 and mid 2014.



TOP 3 PERFORMERS

- **Crédit Agricole (64/100):** Crédit Agricole integrates environmental and climate change risks in the lending activities through the adoption of specific sector policies. Amundi is very active in responsible investments and committed to achieve EUR 100 bn of SRI assets managed by 2016.
- **UBS (63/100):** solid environmental risk management frameworks and policies for most climate sensitive sectors. UBS engages in SRI strategies, covering 24.1% of invested assets in 2013.
- **Standard Chartered (63/100):** SC is well positioned in terms of management of indirect environmental and climate change risks in corporate lending activities: specific risk assessment tools are described and their applications go beyond high risk sectors.

BOTTOM 3 PERFORMERS

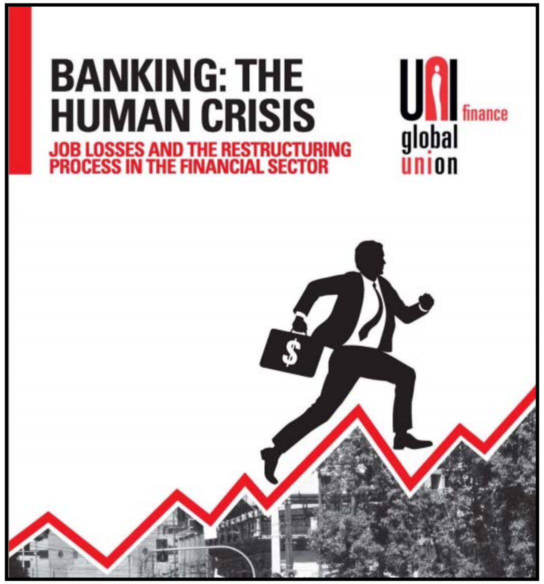
- **Erste Bank (37/100):** EB's efforts to include environmental risks in its lending and investment activities has improved. However, the company's performance is very week regarding the minimization of climate change impacts from its lending and investment activities
- **Barclays (37/100):** Barclays integrates environmental standards in its lending activities through Environmental Impact Assessments, but information on integration of environmental criteria in investment activities is limited. In terms of fight to Climate Change fight, Barclays's assessment procedures are confined to risky projects.
- **Svenska Handelsbanken (27/100):** policies and efforts to reduce climate change related risks are not disclosed.

Responsible management of restructuring (HRS 2.3)

Also according to the Bloomberg Global Poll, the banking industry **will continue cutting jobs in 2015**. The reductions will affect firms around the world, but especially Europe. Only 8% of respondent expect banks to add jobs in 2015. European banks already have announced large job cuts this year. Poorly executed restructurings can effect the banks' **operational efficiency, reputational capital and social cohesion**.

Work-related stress (HRS3.2)

According to the 2014 report 'Banking: the human crisis' by UNI Finance reveals that more than 80% of the of the world's 26 banking and finance unions cited deteriorating health as a major problem for their members. Large restructuring processes increase competition between employees. Performance related pay structures increase the feeling of pressure on workers. If not properly managed, work-related stress may negative impact the social cohesion and motivation of the workforce.



Human capital

Banks still cope with formulating and implementing a Human Resources management able to deal with a number of challenges that may be very impacting on the quality of human capital.

These qualitative issues relate to the ongoing process of **restructuring,** alleviating high work pressure and **stress levels** and promoting employability throughout the professional life of staff. The relevance of the first two challenges is getting more acknowledged, but employability and especially age conscious HR management are seldom an integral part of managerial practices.

Taking into account the interests of older employees in case of restructuring – which has become mandatory in some countries – is one of the few aspects that gets some attention. With an ageing workforce and older employees often being conceived as a buffer for restructurings, banks risk to lose valuable human capital and to conflict with societal expectations of raising retirement age

Human Capital: key findings

TOP 3 PERFORMERS

- **BNP Paribas (71/100):** BNP’s main strengths in the HR domain is the broad scope of collective bargaining, with agreements addressing the quality of the work environment: work flexibility, stress management, responsible management of restructurings and age conscious HR management.
- **Rabobank (68/100):** Agreement with trade unions on flexibility, age conscious HR and mobility plans for commuting. Advanced measures to deal with the restructuring (6,000 job cuts by 2016).
- **KBC (66/100):** formally commitment to social dialogue. Extensive measures to limit the impacts of reorganizations. Advanced career management framework, also specifically addressed to older employees. Preventive policy to cope with stress. The absenteeism rate decreased in recent years.

BOTTOM 3 PERFORMERS

- **Barclays (33/100):** weak reporting on fair management of reorganizations, despite the 12,000 jobs cut announced in 2014 and concerns raised by workers unions. Programs in place to tackle work related stress remain unclear and H&S indicators are not disclosed.
- **Bankia (33/100):** information on policy frameworks on management of reoganizations and social dialogue is not available. HR-related KPIs are not disclosed.
- **Credit Suisse (30/100):** lack of formalized commitment on H&S and of disclosure of KPIs. Despite the job-cuts going on, the framework to ensure the responsible management of restructuring appear weak.

Thanks for you attention!