Policy Statement – Banking

December 2022

1. What we believe

1.1 Synopsis

We believe that banking is a fundamental part of our social and economic life. It is hard to imagine a modern society without banks to provide the essential services and products we need to manage our finances. Whilst banks have evolved to fulfil a crucial social function, we must not forget that they are also commercial organisations that exist to meet the needs of their customers and make profits to bolster their capital reserves and reward their investors. We have seen that banks are not perfect and can make mistakes. Bank failures are rare but when they do happen, the consequences can be far-reaching. Because of their systemic importance to economic stability, the banking industry is highly regulated to prevent excessive risks and protect savers. Banks' performance is closely tied to the performance of the economies of the countries in which they operate. Similarly, to maintain the trust and confidence of investors and customers, their corporate values need to align with those of the society they seek to serve. This means that they have to be clear on what they stand for, in the way they treat customers and staff, as in the types of business activity they are willing to support. Where concerns are raised in relation to banks' environmental, social or governance credentials, they will generally be open to engagement to protect their franchise. This Policy sets out our expectations of banks in relation to the theological and ethical pillars of Investment adopted by the Central Finance Board and Epworth. Banks' performance against these expectations will be tracked to support decision-making.

1.2 Background

The banking sector is vitally important in providing access to cash and financial services for individuals, households, businesses from sole traders to multi-national corporations, not-for-profit organisations and charities, other financial institutions, local authorities and national governments. Their primary role is as financial intermediaries, taking in funds from those with surplus cash (depositors) and lending it to those who need funds (borrowers). As such, they provide depositors with a way of earning interest on their money, which in turn is paid for from the interest charged to borrowers.

Through their lending, banks support growth and investment. The amount of money supply circulating in an economy is controlled by central banks, either by adjusting the level of reserves banks are required to hold against deposits, or through open market operations, i.e. buying securities (liquid assets) from banks to increase money supply, or selling securities to banks to reduce it. Central banks also use interest rates to stimulate or depress economic activity which are passed on to markets via the banks – lower rates encourage borrowing and investment, whereas higher rates stifle borrowing and reward savers. Another important way in which the banking sector supports economic activity is by maintaining the complex payments system between banks that facilitates trade and commerce in retail outlets, wholesale markets, between importers and exporters, and increasingly online. In this way, they play a pivotal role in delivering government monetary policy and ensuring that economies function smoothly.

The essence of banking is risk management. Banks' approaches are reflected in statements of risk appetite and lending policies, the main purpose of which is to maintain portfolio quality, avoid risk concentrations and over-sized exposures in order to protect depositors and ensure ongoing viability. Banks are also responsible for protecting themselves and the banking system from being abused or misused for criminal or other disreputable purposes, e.g. money laundering or fraud. Banks are essential to market processes. Some larger banks underwrite new debt and share offerings, help to facilitate company sales, reorganisations, or mergers and acquisitions, plan and manage the financing for large projects, provide risk management solutions and hedging strategies, and act as market makers in securities markets, providing trading services for investors and ensuring there is sufficient volume of trading (i.e. liquidity) in the market to enable trades to take place seamlessly.

Like any other commercial enterprises, banks can make mistakes and fail. Recent examples are PPI[1] mis-selling and the Global Financial Crisis.[2] Bank scandals and failures can have serious repercussions, potentially destabilising the banking system and triggering a loss of confidence that can send shockwaves through financial markets and economies. However, the consequences of banks getting things wrong can also impact the lives of ordinary people, inflicting financial distress and suffering on individuals, businesses and local communities. For this reason, bank safety and soundness are a major public policy concern. To minimise market disruption and limit bank failures, the banking industry is highly regulated, with individual banks required to be authorised (licenced) and subject to regular supervision and evaluation. Some larger banks are deemed 'systemically important' and are required to comply with higher capital requirements and more stringent regulations because of the potential impact their failure would have on the global financial system.

Maintaining partnerships with a panel of banks is critical to the work of the Central Finance Board of the Methodist Church (CFB) and Epworth Investment Management Ltd (Epworth) for both business operations and investment management purposes.

Relationships with banks are complicated because they are multi-faceted. Relationships are built over time and are based on history, a track record of delivery, understanding, and trust. The CFB and Epworth are exposed to banks in a number of ways. Portfolio exposure to banks may be through direct equity investment. Fixed interest funds include investments in bank bonds. Cash funds will invest in Floating Rate Notes and Certificates of Deposit issued by banks, or place money in bank deposits for a fixed term. In addition, there is heavy reliance on bank systems and processes to transact business, maintain records, and report on holdings.

The nature of banks' business means that they lend to a variety of entities across a range of sectors and geographies. This provides a spread of risk but may mean that elements of a bank's business are in areas that do not fully align with the theological and ethical pillars that underpin this policy. In particular, banks have a critical role to play in supporting the transition of the global economy to net zero emissions by 2050 by implementing commitments to reduce financing for fossil fuel companies.

The CFB and Epworth have adopted seven theological and ethical pillars that have been designed to inform engagement and investment decisions. These are: Earth and Ecosystem; Labour; Equality; Conflict; Health & Wellbeing; Society; Fairness, Responsibility and Transparency; and Conflict. These are linked to the United Nations' Sustainable Development Goals.

2. What we expect

We expect the banks we deal with to be run prudently and in full compliance with regulatory requirements and standards of conduct in all jurisdictions in which they operate.

[1] Payment Protection Insurance. PPI was designed to cover repayments if borrowers were unable to pay themselves due to redundancy or inability to work. Up to 64 million PPI policies were sold in the UK, mainly between 1990-2010, many of which were found to have been mis-sold. The scandal resulted in banks paying billions of pounds compensation to policyholders.

[2] Global Financial Crisis (2007-8) was a severe worldwide financial and economic collapse that cost many ordinary people their jobs, life savings, homes, or a combination of the three.

Other relevant expectations will be derived from our priority matrix:

Earth and Ecosystem

We expect all companies to limit and reduce their greenhouse gas emissions and intensity resulting from their own processes, their supply chains, and the use of their products and services. In addition, we expect banks to be committed to reducing their support for fossil fuels and aligning their lending and investment portfolios with the Paris Climate Agreement and net zero emissions by 2050 by setting targets for 2030 or sooner which are consistent with a net zero pathway.

Labour

We expect banks to treat all employees and contractors with dignity and respect, to safeguard their physical and mental health and wellbeing, to meet local laws and international agreements, to recognise the right to unionising, to pay a fair wage, and to value diversity and inclusion. We also expect banks to seek to promote the same standards with those in their supply chains and those to whom they provide financial support, including consideration of the impact of operations on the safety and wellbeing of local people, and zero tolerance for accidents, the illicit use of forced or child labour, and racial or sexual discrimination.

Equality

We expect banks to pursue better representation of race, gender, ethnic origin, neurodiversity, and sexual orientation across all areas of operations – including Board and C-suite level. Banks should develop policies and procedures that actively promote inclusion and diversity in their recruitment processes. Banks should also adopt corporate culture practices that promote an understanding and inclusion of minorities.

Society

Recognising the societal shift towards digital channels and the reduced demand for physical presence that is affecting the whole of the high street and driving branch closures amongst traditional banks, we expect banks to carefully consider the social impact of proposed branch closures as part of a balanced delivery strategy. Where banks are contemplating changes to their representation and service coverage in an area, we expect them to consult respectfully with local communities and explore creative ways to maintain access to their services and products.

We expect banks help provide vulnerable people with access to bank accounts and services.

Fairness, Responsibility and Transparency

Good governance is about the relationship between investors and the companies in which they invest so as to reassure themselves of the strength and appropriateness of the governance regime in place. We expect banks to meet the standards set out in our corporate governance policy .

We expect banks to be socially responsible and to manage their activities with integrity and transparency, holding themselves accountable to stakeholders on matters of sustainability, environmental performance and other ethical concerns.

We expect banks to show consistently that fair treatment of customers is at the heart of their business model.

We expect banks to disclose where they engage with governments on policy and legislation, and to be transparent where they support political parties, candidates or campaigns.

We expect banks to have a publicly available and transparent tax policy that outlines its position on tax compliance, tax planning and tax reporting.

Conflict

We expect banks to work actively towards peace. This means promoting human rights, upholding international sanctions against aggressive and oppressive regimes and not supporting illegal occupations by providing finance to business activities in illegally occupied territories.

We also expect banks to have robust systems and controls in place to prevent corruption and the laundering of the proceeds from organised crime linked with illegal arms sales, drug cartels, human trafficking, prostitution rings, fraud, extortion, the financing of terrorism and other forms of activity associated with conflict, violence and exploitation.

We would not expect banks to be involved in financing the production of nuclear or other controversial weapons that are banned under international treaty law.

3. How we measure

Our expectations will form the basis of a research and monitoring template. This template will identify a company's exposure and risk to the issues outlined in this policy and will output a scorecard for the company. It will utilise external research providers such as Sustainalytics, TPI, CDP, as well as in-house analysis and company-own reporting. Our in-house analysis would consider issues such as regulatory censure, fines, press reports, and controversies.

Companies will be graded A-E, with A being a leader and D being a laggard. Companies with unacceptable scores or which breach specific exclusionary criteria will be graded E and excluded. Details of our research and monitoring can be found on our website.

4. What we aim to do

We will aim to maintain relationships with an appropriate panel of banks that individually and collectively meet the operational and investment management needs of CFB and Epworth and broadly align with our ethical standards as defined in the pillars. Based on the pillars, we will develop and implement a sector action plan, taking into account institutional goals, stakeholder value preference, significance of potential outcomes, and portfolio impact. This will focus on engagement and may also include public activism, re-evaluation, or referral.

The acceptability of any exceptions to the principles set out in the pillars will depend on their severity and materiality in the context of a bank's overall business. In extreme cases, disinvestment will be considered but only after persistent and/or significant moral failure that violates our ethical pillars and the bank is unwilling to engage.

Though we will aim to engage across all expectations outlined in this policy, particular focus will be given to the climate emergency. We will seek to meet with banks to discuss the key opportunities and hurdles they face in the transition to a low carbon economy, encouraging verified emissions reduction targets, and challenging them through AGMs or voting strategies in areas where they fail to meet expectations.

This document and its outcomes will be reviewed annually to ensure they reflect sector realities and that expectations and engagement activities meet stakeholder priorities.