Scaling up impact measurement and management for banks

Banking for Impact working group

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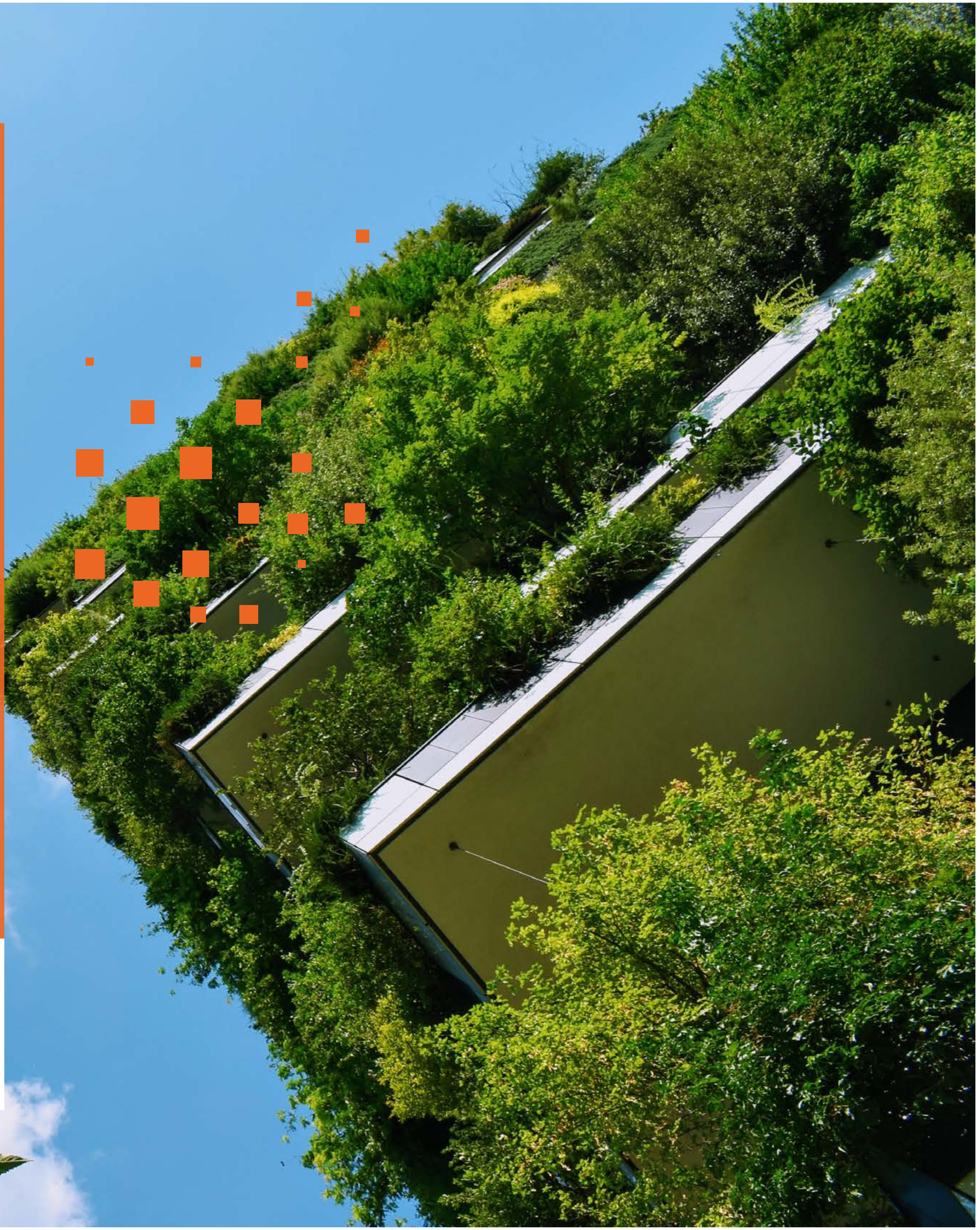

Thoughts on Banking for Impact

A company's long-term licence to operate depends on its creating value for all stakeholders – clients, employees, investors and society at large. This is also true for ABN AMRO. As a bank, we certainly have an impact on our stakeholders. If we understand our impact by measuring and reporting, we will also begin to understand where we can achieve the most positive impact and at the same time reduce our negative impact. Ultimately, we will be able to allocate resources more effectively, and achieve our goal of building a better, more sustainable economy.

Robert Swaak, CEO ABN AMRO

Danske Bank is fully committed to increasing awareness and action for sustainable progress. It is a fundamental element of how we will develop the bank going forward, as we believe that sustainability is essential for creating lasting value for all our stakeholders while contributing to solving society's challenges. Developing an approach for measuring and analysing our impact will benefit our stakeholders as it will allow us to take better decisions; create better transparency and, not least, allow us to systematically decrease our negative impacts while increasing our positive impacts on society and nature. We therefore look forward to collaborating with other market leaders in this field, and play our part in developing a common method for the industry.

Carsten Rasch Egeriis, CEO Danske Bank

Financial accounting is a useful means of measuring performance. Unfortunately, its prism tends to be narrow, and it misses out on several critical impacts that economic actors have – both positive and negative. As the world increasingly begins to accept that the role of a corporation is to cater to several constituencies, not just shareholders, it becomes imperative to create a better scorecard, one that takes these "non-financial externalities" into account. Banks have the opportunity of being at the leading edge of creating such report cards, and DBS is therefore delighted to partner with like-minded organizations in trying to set up approaches and standards to take this agenda forward.

Piyush Gupta, CEO DBS Bank

Impact weighted accounts are the path forward to re-imagining our economy and will be especially important to banking and capital markets going forward. The impacts of companies on people and the environment are affecting companies' ability to attract talent, customers and investors, while exposing them to the actions of regulators and tax authorities. At the same time, banks' shareholders, employees and customers demand transparency on the impacts of lending and financial products. Good banking today requires impact to be measured.

George Serafeim, Faculty Co-Chair Impact-Weighted Accounts Project, Charles M. Williams, Professor of Business Administration

The world economy needs a market-based system where social and environmental impacts are just as transparent as financial profit metrics. Measuring previously unreported elements will help the private sector tackle critical societal challenges such as climate change and inequality. The banking sector, with the ability to appropriately price social and environmental risks, is well positioned to lead this transition. Through Banking for Impact, UBS is proud to be at the forefront of this effort, working in partnership with Harvard Business School, Impact Institute, ABN AMRO, Danske and DBS.

Ralph Hamers, CEO UBS Group

Banks have been part of societies for more than 4000 years. All the while, they have been the stewards of financial capital, storing and lending money, managing assets and facilitating financial transactions, thereby stimulating the financial growth of economies worldwide. This century has seen the recognition that the welfare of society also relies on other capitals: natural capital, intellectual capital, social capital and human capital. It only makes sense that banks will become shepherds of these capitals as well and lead in the transition to the economy of the 21st century: the impact economy. This is a market economy where work, entrepreneurship, innovation and technology are dedicated to creating a positive impact on the world. The movement towards banking for impact makes business sense as well. In the end, throughout history the most reliable long-term profit driver of banks has been the actual value they created to society.

Adrian de Groot Ruiz, Executive Director Impact Institute

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Executive Summary

Our global economy remains stalled at a critical juncture where value outweighs values. Despite increased momentum for global initiatives in support of society and the environment – fundamental change isn't happening fast enough. This is because the pursuit of economic value is preventing the fulfilment of societal values. Well-known threats continue to be ignored in favour of a short-sighted economic system that focuses on optimizing profit before all else. The negative side effects are piling up – runaway climate change, natural resource depletion, increasing inequality, diminishing social safety nets and a widening gap between rich and poor. Governments, civil society and corporations all agree – we need to move fast to tackle this issue.

A new economy

The remedy is a more inclusive market economy, one that serves people and the planet, not just shareholders. An economy where the practices, policies and standards attached to social and environmental objectives hold the same weight as those attached to financial profit. Where companies have the opportunity to change their value to, and role in, society, while consumers, through their purchasing decisions, further encourage companies to pursue impact. Ultimately consumers, governments and shareholders reward executives for generating profits in a manner that contributes to the public good. This is what's known as an impact economy.

The financial services sector is especially well positioned to lead this transition. It has the ability to mobilise capital, direct funds into areas that benefit society and to appropriately price social and environmental risks.

This paradigm shift offers significant upside. The financing gap to achieve the SDGs is estimated to be USD 2.5 – 3 trillion[1] per year, with private finance expected to play a large role.

To meet this demand financial institutions have responded with many positive initiatives - such as carbon accounting, impact investing, development impact bonds, and SDG partnerships - but more is needed.

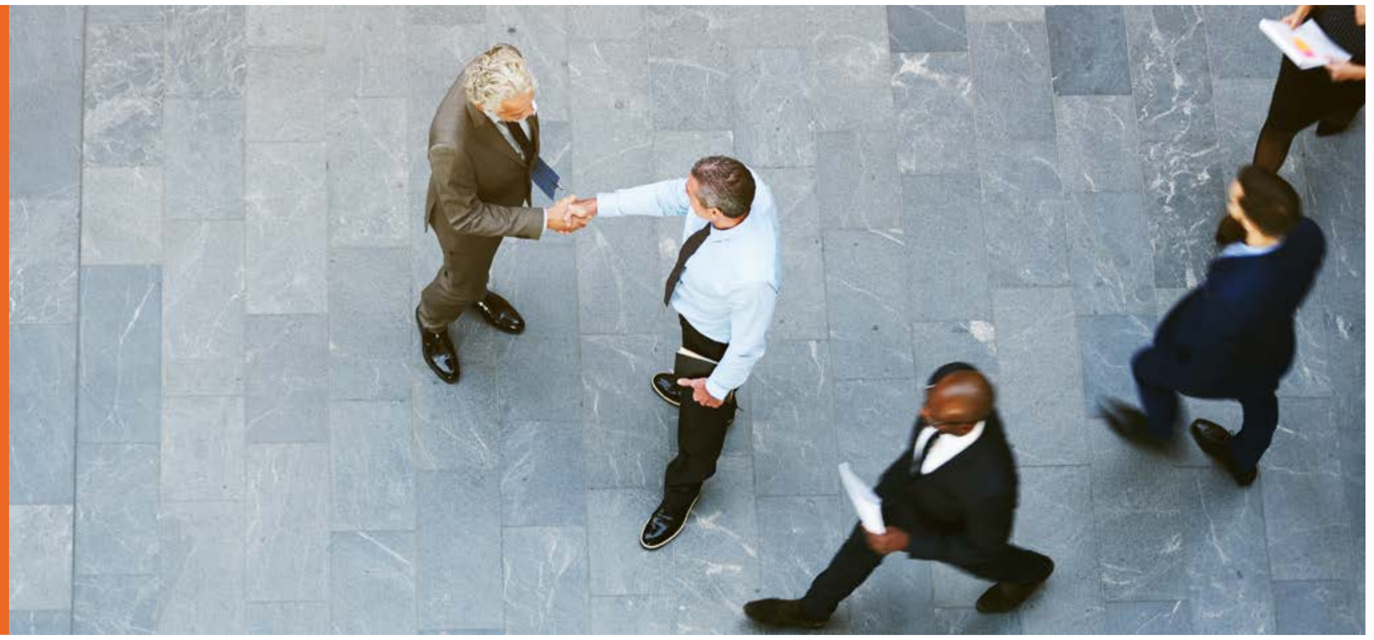
The transition

Transitioning to an impact economy may seem a simple task – we know the problem, the solution and the key players. But the journey won't be simple. Three things are needed for this transition to be successful; companies need to measure, manage and report on their impact.

Companies need to utilise a fact-based approach for measuring the environmental and social impact of their activities. Corporate executives need to be able to manage their impact and factor non-financial consequences into their decision-making, including impact on human, social and natural resources. They need to evaluate decisions using a multi-stakeholder perspective, giving investors, civil society, communities, employees and other stakeholder groups a seat at the table. Finally, they need to be transparent by reporting on their impact and credibly communicating their value creation to these stakeholders.

1 Rethinking Impact to Finance the SDGs (UNEPFI, 2018).

In 2019 over 50 organisations had started valuing their impacts[2]



Financial institutions, who we already know have a big role to play, also need to be able to measure, manage and report their impact– a substantial challenge as the majority is indirect and occurs through lending, financing and investing activities, meaning firms must be able to combine the impacts of all of their clients.

Where are we now?

Some work has already been done, with the Impact Weighted Financial Accounts Initiative (Harvard Business School) and the Integrated Profit and Loss Framework (Impact Institute) launching approaches to help organisations with the complex task of measuring their externalities. In 2019 56 companies experimented with monetary impact valuation, producing environmental or total profit and loss accounts. More importantly many financial players are also rising to the challenge with over twenty impact-centred industry initiatives underway including the high-profile launch of the Principles for Responsible Banking which to date, has been signed by over 220 signatories, representing more than USD 54.5 trillion in assets or over 40% of the banking industry[3].

That said, there's no concrete guidance as to how this should be done. And the complexity of measuring and managing financial firm impacts' explains why only a few have done it. As long as impact measurement and reporting remains unstandardized and there is no guidance on the attribution and aggregation of impact across the value chain, we will not be able to move forward. So more progress is needed – and quickly.

The way forward

To help get there the Banking for Impact (BFI) working group aims to create a common impact measurement and valuation (IMV) approach. BFI will define a robust, scalable and cost-effective method for the quantification, valuation, attribution and aggregation of impacts for the sector. And with industry involvement the goal is to scale up and standardise these efforts over time.

In this white paper, we (1) examine how the financial sector can benefit from better non-financial reporting standards, (2) look at current practices for measuring and reporting impacts, (3) identify new industry initiatives and outline what their strengths and shortcomings are, and (4) present a four-pronged approach for how financial firms should collaborate to tackle IMV in the future.

To make the vision of an impact economy, promoted by financial institutions, a reality, BFI will consult with relevant sector-related initiatives (e.g., Principles for Responsible Banking). This white paper represents an open invitation to all financial players, knowledge institutions and other relevant organisations to join in building this inclusive community to promote, harmonise and strengthen this work.

2 Impact Weight Accounts Report, Harvard Business School, 2019.
3 Appendix 2: Gap analysis of impact measurement and valuation (IMV) initiatives.

A collaboration by:

Robert Swaak, CEO

ABN·AMRO

Piyush Gupta, CEO

DBS

Ralph Hamers, CEO

UBS

Carsten Rasch Egeriis, CEO

Danske Bank

George Serafeim

George Serafeim, Faculty Co-Chair
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Adrian de Groot Ruiz, Executive Director

IMPACT™ INSTITUTE

Why Banking?

Transitioning to an impact economy will not be easy, but financial institutions can help us get there more quickly

Financial institutions are in a unique position to establish themselves as the drivers of the transition to an impact economy. As the facilitators of capital across multiple sectors, they can direct funds into organisations that benefit society as well as influence others to change and/or create more sustainable business models.

That said, banks and financial institutions differ fundamentally from other companies in that their most significant contributions are indirect, far-reaching and occur through their client activities, making measuring and assessing impact far more complex.
Further, why should financial institutions be committed to this transition and why should they strive for more accurate impact measurement and reporting? In brief, because by not doing so they risk damage to reputation and credibility. Further, new theories of dynamic materiality highlight the financial risks associated with a lack of understanding of environmental and social impact. Impact measurement and reporting is a way to future-proof financial institutions. These are just a few of the reasons it's in financial institutions' best interest to actively pursue the transition toward an impact economy.

Risk mitigation

Financial institutions spend a lot of time and resources on weighing risk. So it's no surprise that the most popular argument for improving impact valuation is from the risk perspective. Social and environmental impacts are increasingly materialising on balance sheets, resulting in severe consequences, from dependency on natural resource accessibility to potential reputational damage to vulnerability in the face of new regulation. Evidence shows that the more financial firms work to measure social and environmental risks, the more they can positively affect the health of financial assets.[4]

The finance industry will be heavily impacted by the consequences of climate change. Carbon Brief has estimated that a 1.5°C temperature rise will result in economic losses of 8% of GDP per capita by 2100. These impacts are effecting us already: Swiss Re estimated economic losses of USD 330 billion in 2017 alone, of which just USD 136 billion were insured.

Climate Adaptation Summit (January 2021), The Physical Risk and Resilience Statement

Values-based Banks continue to outperform Global Systemically Important Banks on financial returns and growth, show more stable returns, focus on the real economy and clients' needs, and the delivery of social and environmental impact.

Global Alliance for Banking on Values (2020)

Results and returns

Transitioning to an impact economy is an opportunity for financial institutions and their clients to invest in tomorrow's winners. If, while making a decision on who to finance, a firm has a clear understanding of the full spectrum of impact on all stakeholders, that firm can position themselves and their clients strategically for the transition, while at the same time accelerating its pace. In addition, clients stand to benefit when their financial institution embraces the topic of impact measurement from an investment perspective, as there's growing evidence that impact measurement translates into financial returns.[5]

4 Real Economy – Real Returns: The business case for values-based banking, January 2020, Global Alliance for Values on Banking. Further, Green bonds have shown to be more resilient than traditional bonds in times of crisis, (Nordea, 2020).
5 An increasing amount of research shows that focusing on positive impact correlates with better and less volatile performance: Harvard Business School (2014) found that firms in the high sustainability group outperformed those in the low sustainability group. McKinsey (2019) found that a strong ESG proposition correlated with higher equity returns.

Achieving the SDGs is expected to open up at least USD 12 trillion of market opportunities in four economic areas: Food & Agriculture, Cities, Energy & Materials, Health & Wellbeing. For comparison, the global GDP was USD 80 trillion in 2019.

BSDC (2017), Better Business, Better World Report

Transparent reporting

In the future, the financial system will be expected to discuss returns on non-financial as well as financial capitals and to share their impact-management approach. For example, as required by the Principles for Responsible Banking, financial institutions will need to identify their significant impacts, analyse them, outline their process for setting appropriate targets and define actions needed to reach them, while monitoring their progress, and communicating accordingly. Additionally, the EU Taxonomy, a method of classifying and scoring the performance of ESG funds, is already being looked at by the European Banking Authority in relation to capital requirements rules. While these regulatory initiatives may look European focused, asset managers globally need to pay attention as there's potential for Europe's regulation to inform future standards elsewhere in the world.

Through transparency of their own impacts, financial institutions can help accelerate this transition and drive the agenda. Further, the sooner financial institutions can standardise and implement a clear approach to measuring and reporting impact, the better. Doing so will prevent a last-minute scramble to come up with reporting methods. It will also result in more accurate reporting that reduces confusion and uncertainly for clients, stakeholders and regulators and provides investors with comparable and consistent information. Finally, there is strategic value for institutions to demonstrate their accountability by adopting impact management strategies, so that they can credibly report on progress.

Responsibility to society

Financial institutions were founded to create well-functioning economies and support individuals and communities. This mandate hasn't changed, even though historical events have warped public opinion of this role. As the primary drivers of capital, financial institutions are in the perfect position to lead the solutions to the challenges society faces. And increasingly, their clients and employees want to do so as well. By acting as leaders in the transition toward the impact economy, financial firms will support their own reputation while also attracting the next generation of clients (millennials, generation Z) and talent who are increasingly concerned about environmental and social issues.

Only 41% of millennials believe big business has positive impact on the wider society, down from 76% three years ago.

The Deloitte Global Millennial Survey 2020

Current Climate

How do financial institutions report on their performance today?

Today, organisations deal with two separate and disconnected systems: one for financial performance and one for non-financial (i.e., environmental, and social performance.

The two systems lead to two separate narratives: one telling how a profitable a company is and the other highlighting whether it is good for people and the planet.[6] We know, however, that a company's social and environmental performance can influence financial results – in the short term and even more so in the long run. The inability to integrate impact on people and planet into decision-making and performance evaluation creates the real risk of undervaluing the companies that take a multi-stakeholder perspective and do good and overvaluing the ones that do not.

CSR and ESG approaches

There are currently two primary sources of insight into a bank's non-financial performance:

1. Self-disclosed sustainability, or CSR, reports, and
2. ESG ratings and scores.

Combined, these sources generate an abundance of ESG and sustainability data. However, this leaves banks faced with an increasing number of metrics, of limited value, since sustainability and ESG indicators do not address real value creation.

1. Self-disclosed reporting

Many banks publish sustainability reports following the Global Reporting Initiative guidelines, have adopted the Equator Principles, and have included environmental risk assessments in their credit policies, among other things. However, experts remain inconclusive about the relationship between CSR and banks' value creation.[7] Many existing initiatives offer disclosure "frameworks", suggesting guidance to companies on how to self-report, but not necessarily on what to report. Across the banking sector, this often leads to multiple disparate disclosures on the same topic that do not adequately communicate how they create value from a multi- stakeholder perspective. Indeed, reporting initiatives target differing, but specific, stakeholder groups ranging from civil society to investors.

In addition, most do not focus on value-creation. There is however a convergence of frameworks that is taking place. In September 2020, for example, five leading framework and standard-setting organisations – CDP, CDSB, GRI, IIRC and SASB – announced a shared vision for a comprehensive corporate reporting system that includes both financial accounting and sustainability disclosure, connected via integrated reporting.[8]

6 Where ESG ratings fail: the case for new metrics, Institutional Investor, www.institutionalinvestor.com/article/b1n706z8lqfscs/Where-ESG-Ratings-Fail-The-Case-for-New-Metrics.
7 M. Miralles-Quirós, J. Miralles-Quirós, J. Hernández, 'ESG Performance and Shareholder Value Creation in the Banking Industry: International Differences', Sustainability, vol. 11, 2019, pp. 1-15.
8 Statement of Intent to work together towards comprehensive corporate reporting, September 2020.

Comparison of firms' normalized scores for different rating agencies.[9]

2. ESG ratings

ESG ratings may also pose their own unique challenges to impact measurement and management. Additionally, ESG ratings have been shown to provide inconsistent results and are inherently subjective.[10] Third-party ESG rating agencies, for example, produce ESG ratings and scores that often vary markedly by provider and typically build upon undisclosed calculation methodologies. MIT research shows the correlation between different ratings to be demonstrably low (see figure). Also, the units for ESG metrics are typically normalised between given ranges (e.g., 0-100) and are not directly attributable to different capital types or comparable in monetary terms. So, while ESG data often can be informative to help shape an understanding of ESG performance, they are rarely useful for understanding the full scope of a company's impacts.

Managing value through measuring impact on key stakeholders

Along with the global trend towards sustainability, ESG measurement and reporting has become more popular, and these issues are increasingly salient, especially as a growing portion of a firm's value is believed to lie in intangible assets. While non-financial performance insights are important in their own right, they do not go the distance in addressing real value creation. Instead, they offer a diverging set of data points, either focusing on activities, existence of policies and/or inputs and outputs. Meanwhile impact is what ultimately affects stakeholders.

In 2020, asset managers launched a record number of 505 new ESG funds. In Europe, flows into ESG funds in 2020 were almost double those of 2019, at EUR 233 billion.

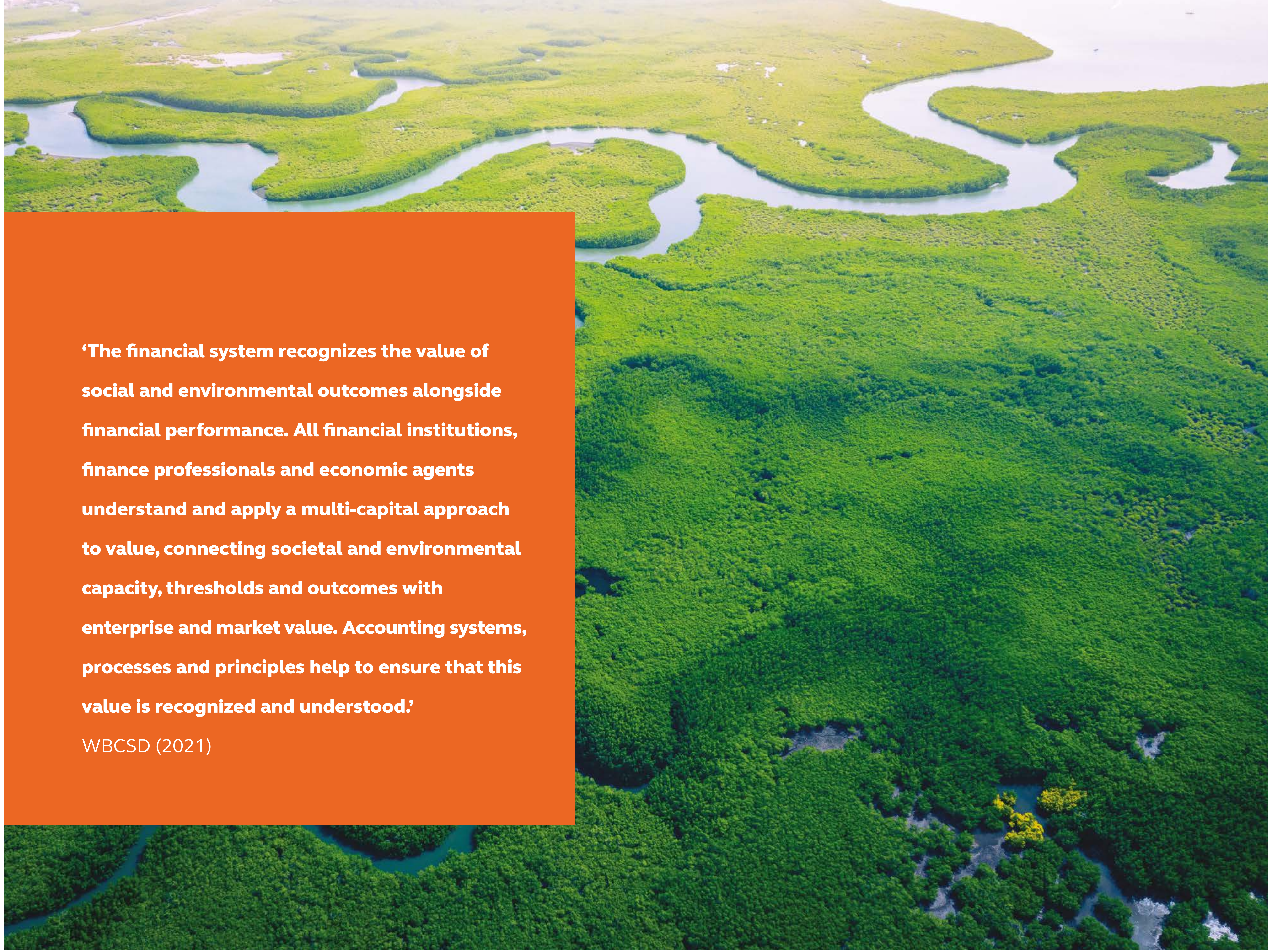
Morningstar (February 2021), European Sustainable Funds Landscape: 2020 in Review

9 Aggregate Confusion: The divergence of ESG ratings (Berg, F., Koelbel, J. & Rigobon, R., 2019).

10 See for example: T. Doyle, 'The Big Problem With 'Environmental, Social and Governance' Investment Ratings? They're Subjective', Investor's Business Daily, 2018. and H. Christensen, L. Hail, C. Leuz, 'Adoption of CSR and Sustainability Reporting Standards: Economic Analysis and Review', SSRN, 2019.

Thus, the common thread remains that neither sustainability reporting initiatives nor ESG rating institutions are currently designed to assess value-creation for all stakeholders in the banking value chain. To do this requires quantifying, valuing, attributing and aggregating all the material impacts of a financial institution. A bank without the cognisance of impact – not knowing what value it creates, for whom and how it can create value tomorrow – poses a major risk in today's environment. Without clear guidance on what to measure, there are too many options and little guarantee that the metrics available will be either comparable or relevant.

We need to move toward methods and metrics which provide credible information on the effects of company's actions and activities on their stakeholders, such as people and the planet. A methodology that is objective and quantitative and provides complete and comparable impact data and can be used to help with decision making. While impact measurement and valuation is a young science and is imperfect with differences in exact measurement methods and techniques, it fits these criteria.



'The financial system recognizes the value of social and environmental outcomes alongside financial performance. All financial institutions, finance professionals and economic agents understand and apply a multi-capital approach to value, connecting societal and environmental capacity, thresholds and outcomes with enterprise and market value. Accounting systems, processes and principles help to ensure that this value is recognized and understood.'

WBCSD (2021)

On the Horizon

Is there a better method to report impact on the horizon?

The impact measurement and valuation (IMV) landscape is diverse and evolving, with various initiatives providing guidance on the identification and measurement of impact.

It is important to assess the suitability of these initiatives – whether they could develop a robust, data-driven, quantitative, open source IMV approach as well as whether that approach is both rigorous and feasible to implement for a wide set of financial institutions. To this effect, BFI has completed a study on mapping this landscape for IMV initiatives. A two-step comparative analysis was conducted, the overview of which is outlined below and supplemented by details in Appendix 2.

Step one

The level of sophistication of IMV practices has progressed, yet also remains a major challenge. The existing IMV practices we looked at differ greatly in the specificity, robustness, and neutrality.[11] All three criteria are important prerequisites for an effective and credible impact methodology that can be open sourced to establish a reliable standard and achieve wide-spread uptake across the financial sector.

Step two

We identified a taxonomy of qualities that a standardised IMV approach needs to have to produce reliable, relevant, comparable, and consistent impact information (see Appendix 2, Table 2). In short, the approach should allow for the quantification, valuation, attribution, and aggregation of impact, explicitly cover direct and indirect impacts and allow for multi-capitals and multi-stakeholder views.

Authorities globally expect financial institutions to disclose information and metrics on their exposure to climate and environmental risks, **NFGS, 2020** Examples include the EBA, the Federal Reserve and the Financial Conduct Authority (FCA). The Monetary Authority of Singapore (MAS) and the Bank of England specifically emphasize the need for more consistency, comparability and transparency in reporting, **Bank of England, 2019**.

Now, business leaders and boards will need to show great courage and commitment to their stakeholders. We need to move even faster – to create more jobs, more prosperity, and more inclusivity. I have great confidence in the ability of businesses to help move us out of this crisis and build a more inclusive capitalism.'

Larry Fink's 2021 Letter to CEOs

11 Specificity refers to the degree to which an initiative is specific in providing insight into an actual process instead of being a high-level position or theory paper. Robustness refers to the degree to which the presented method is based on verified price discovery methodologies and academic/scientific impact pathways. Independence is the degree to which an initiative is free from being grounded in political or specialty interest groups preferred pricing (which is far less likely to capture the true impact).

A closer look

Step one of the analysis revealed that at least seven IMV practices scored high on these prerequisites (see Appendix 2, Table 1). The majority of practices scored well for neutrality which remains an important consideration to mitigate the influence of vlitical or specialty interest group preferences in the results (far less likely to capture true impact). The results for specificity and robustness were more mixed.

In Step two of the analysis, we mapped the seven selected IMV practices to these criteria and identified significant gaps among even the highest ranked initiatives from step one, indicating the lack of an existing suitable initiative tailored to the functionalities of the banking sector and its stakeholders. Three approaches offer analysis specific to the banking sector – 2 Degree Investing Initiative, Science Based Targets, and United Nations Environment Programme Finance Initiative (specifically the Portfolio Impact Analysis Approach of the Principles for Responsible Banking (PRB)). However, two of them - the 2 Degree Investing Initiative and Science Based Targets - focus solely on climate change, thus narrowing the scope for examination.

The gaps became most apparent, however, when unpacking their guidance on important elements such as valuation, attribution, and aggregation.

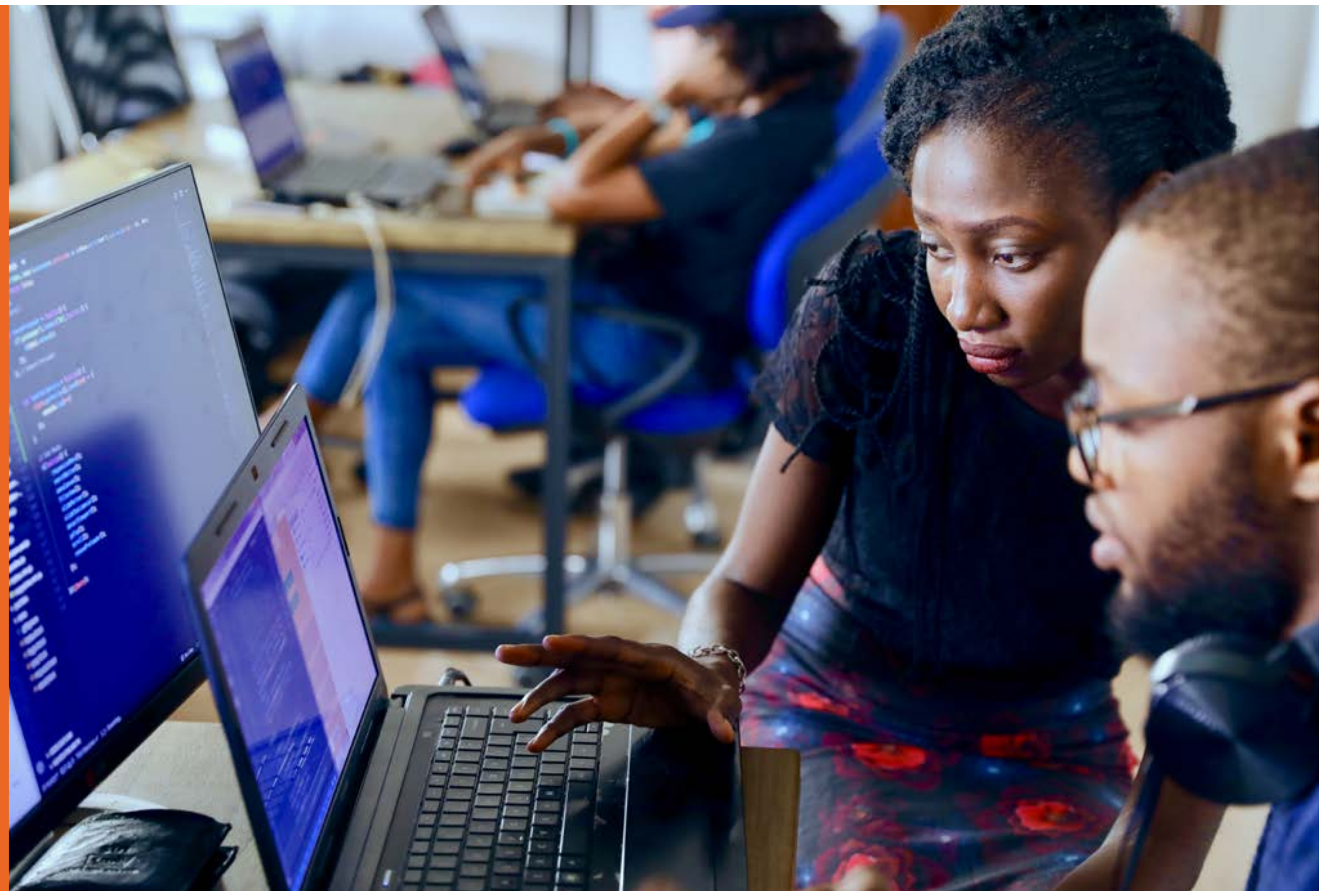
Although 7 out of 8 approaches provide a quantitative assessment of impact, not all frameworks value impact, and those that do, appear to do so in monetary terms and assess these impact figures relative to traditional financial accounts (impact-weighting). The three approaches in our selection that provide monetary valuation techniques and cover a wide variety of capital types are the Impact-Weighted Accounts Initiative (IWAI), the Value Balancing Alliance (VBA) and the Framework for Impact Statements (FIS). The IWAI provides a sector-specific approach that could be developed for application to banks. Both the VBA and the FIS explicitly factor in upstream and downstream impact across the entire value chain, although only the FIS provides an approach for attributing this impact to the bank in scope. Aggregation is an important element of both the IWAI and FIS approaches. Finally, the UNEP-FI (PRB), IWAI and FIS approaches all embrace a multi-stakeholder perspective.

Or should we extend current IMV approaches for a better solution?

This analysis indicates that the UNEP-FI (PRB), IWAI and FIS approaches would form a sound basis for developing an open-source robust, data-driven, quantitative IMV approach that is fit for the financial sector. That said, the feasibility of such an IMV approach will require high quality and reliable data. As a result of this pre-requisite a data protocol will also be required.

The greenhouse gas emissions associated with financing the wider economy, through investing, lending and underwriting activities, are more than 700 times higher, on average, than the direct emissions of banks.

CDP (2020), CDP Financial Services Disclosure Report 2020



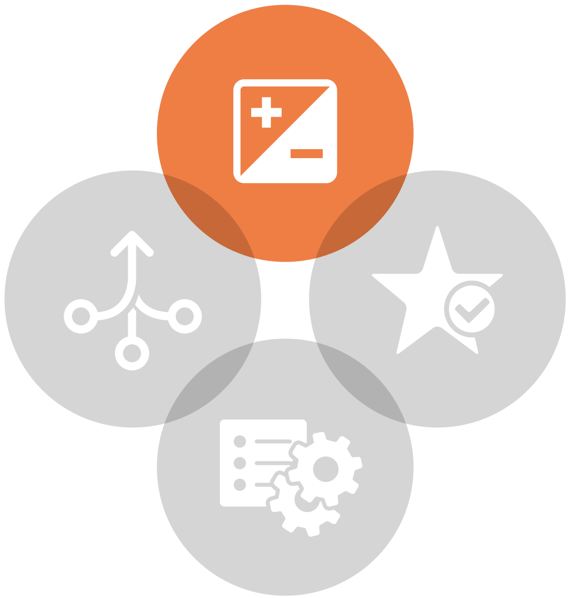
Our Proposal

To be effective, an IMV method must be tailored for the financial sector

Today, approaches for measuring and managing impact cater to a wide range of industries. For financial institutions to have a cohesive picture of the effects of their lending, financing, and investing decisions, they require specific guidance throughout their value chain.

Impact must be included as a driver of economic profit and factors like job creation, climate change, quality of life, and human rights must be considered.
To capture the full scope of impact along the value chain, Banking for Impact proposes a tailored four-pronged approach to create meaningful impact measurement and valuation (IMV). This includes four critical elements: quantification, valuation, attribution, and aggregation.

12 Aggregation can occur up to the level at which positive and negative impacts to a stakeholder group or the welfare dimension become obscured.

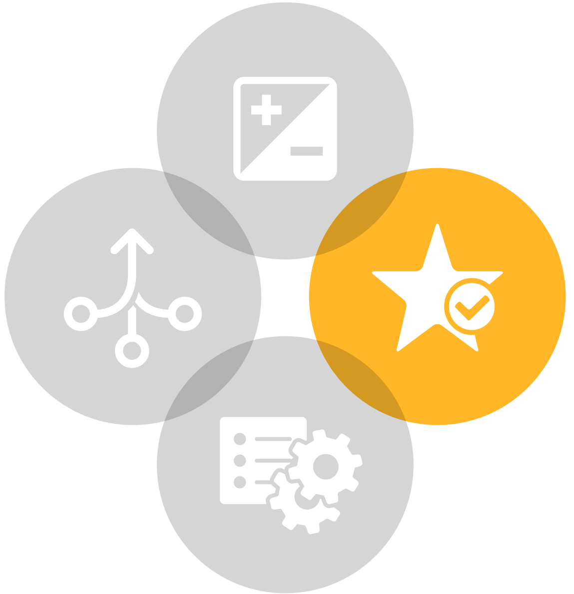


1. Quantification

For financial firms to manage impacts, it will be key to quantify them. Quantification is the process of measuring the outcomes of activities in quantitative units. Many impacts can be easily and naturally measured, such as the number of jobs created, or amount of CO_2 emitted. Others may require more work to quantify, like the well-being created from employment. By tackling quantification, it will be possible to measure, track, manage and report on all types of impact in a clear and consistent manner.

Real-world example

When it comes to emissions, phrases like "a lot of carbon," "4/5 rating," and "high risk" can refer to one, 10 or even 100 kilotons of carbon. If client A reports a lot of carbon while client B reports a modest amount of carbon, it may be that client B is actually the larger emitter of carbon.



2. Valuation

After quantification, impacts are translated into monetary values so they can be evaluated in relative terms. This valuation places different types of impact into the same context (monetary) so that they may be compared. When comparing alternatives (be they an investment, policy, or client related) some decisions are positive for certain impacts (e.g., jobs or biodiversity), but negative for others (e.g., climate and healthcare). Valuation can reveal whether the gains outweigh the losses.

Real-world example

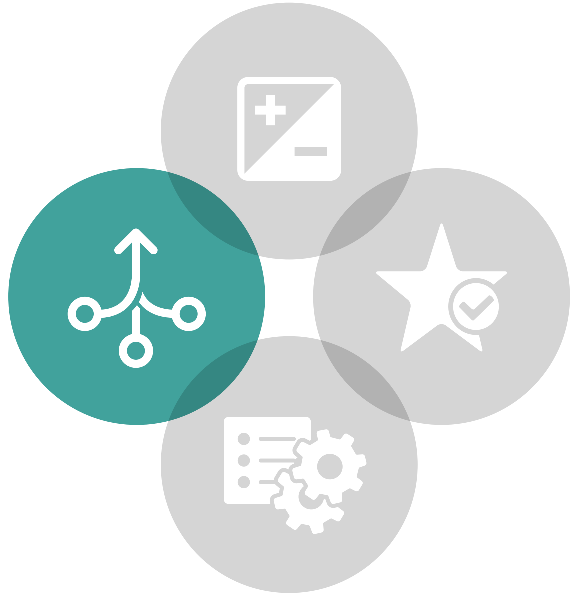
It may be difficult for a company to decide which is better – reducing water usage by 100,000 m^3 or reducing CO_2 emissions by 1,000 tonnes. Converting these numbers in a single unit representing the costs (or value) to society of the impact allows a company to make a better-informed decision. In this case the costs to society of 100,000 m^3 of water would be around EUR 130,000, whereas the costs of 1,000 tons of CO_2 would be around EUR 150,000.

3. Attribution

While financial institutions do create some impact directly (e.g., paying staff and ensuring buildings are energy efficient), by in large, the majority of their impact is indirect, through the facilitation of client activities (e.g., lending, financing or providing investment advice). Financial institutions are still partially responsible for this indirect impact. Determining how responsible the firm is and transferring a portion of impact from client to firm, is called attribution.

Real-world example

If a financial firm invests in a coal plant, it's supporting the burning of coal to produce electricity. Thus, the firm is partially responsible for the climate change impact of the coal plant. Having a clear attribution approach, allows for determining exactly how much impact should be attributed to the financial firm.



4. Aggregation

The final step in the IMV approach is aggregation, wherein impact information is combined to be made suitable for comparability and decision-making (i.e., about the entirety of a company rather than its individual practices). Aggregation can be tricky even for non-financial companies because when certain factors are combined (i.e., child labour and CO_2 emissions), the actual impact my not be accurately reflected. Therefore, care must be taken to avoid loss of information during the process and standards need to be set for what types of impact can be aggregated and how.

Real-world example

If a large company weighs job creation as positive impact, it's possible that they could be tempted to think this outweighs a smaller negative impact in something like child labour. If aggregated to a net positive this would imply that child labour is acceptable as long as job creation remains higher then child labour which is not the case. However, according to the UN Guiding Principles on Human Rights, businesses have a responsibility to remediate negative impacts such child labour. Just like certain assets and liabilities cannot be netted on the balance sheet, similarly certain negative impacts cannot be netted against positive impacts and should be minimised.

Closing Remarks

As a result of gaps in current and future impact measurement approaches the Banking for Impact working group (BFI) proposes to create an impact measurement and valuation (IMV) method specific to financial firms. We believe that defining and standardising this approach across the industry is the only way we'll move forward in the transition to an impact economy.

Already, our world is realising the need for a different type of economy and many sectors are advancing in creating this. If the financial sector doesn't act now, it faces the risk of being left behind. The industry needs standardised guidance as to how it will measure environmental and social impacts and be willing to use this information to make decisions that benefit share-holders, clients, employees and communities equally.

From mapping the landscape to forging the way ahead to advancing IMV for the sector, success will be contingent on the achievement of certain goals. In particular:

- collaboration between organisations with cross cutting elements of current impact-related initiatives (i.e. UNEP-FI (PRB), IWAI and FIS) to find common ground and share expertise
- development of a pragmatic methodology that is rigorous and scalable to the size and stage of a financial institution and that improves decision-making
- access to high quality and affordable data for impact measurement

The long-term vision of the BFI is to have an open-source standardised impact measurement and valuation (IMV) approach and data protocol that are widely adopted and comparable across financial firms. The data-protocol will be developed to allow for multiple data providers that (i) can be used together and (ii) are highly correlated.

To succeed, industry collaboration will be required as iterative testing and improvements to the methodology will be required to ensure the IMV is fit for purpose. We invite banks to join our group to test this methodology and provide constructive feedback as it's being created. We encourage the sector to embrace its opportunity to lead the path for an impact economy that benefits society and the environment and includes all key stakeholders.

Over 220 banks have committed to the Principles for Responsible Banking, leading the way towards a future in which the banking community makes the kind of positive contribution to people and the planet that society expects.

UNEPFI (2020)

Contributors and Observers

Six organisation currently collaborate as members of the BFI. The BFI is governed by a steering committee which comprises one member from each organisation. Additionally, a number of observers to the BFI lend external expertise.

Current members

- Tjeerd Krumpelman, ABN AMRO
- Mikkel Larsen, DBS
- Kristina Øgaard, Danske Bank
- Angela Wiebeck, UBS
- T. Robert Zochowski, Harvard Impact-Weighted Accounts Initiative
- Adrian de Groot Ruiz, Impact Institute

Observers to the BFI

- UN Environment Programme Finance Initiative (UNEP FI), Principles for Responsible Banking
- Singapore Management University
- University of Oxford Saïd Business School
- MUFG Bank

Appendix

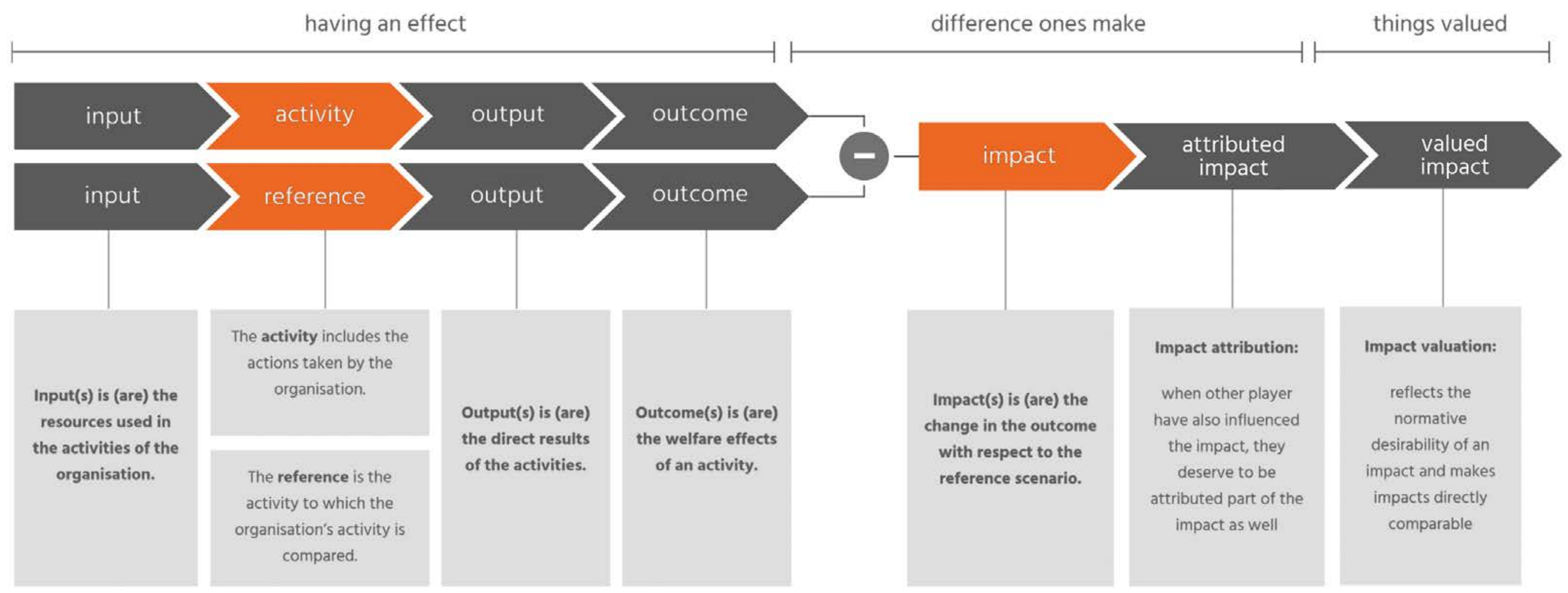
Appendix 1: Definitions

Financial institution/firm: any institution involved in lending, financing or investing activities, includes retail banks as well as wealth and asset managers

Banking: all activities (including advising, developing offerings, driving capital, lending, financing, and investing) performed by a financial institution on behalf of clients

Externality: a (negative / positive) involuntary impact on a stakeholder due to an organisation's activity which isn't offset by (positive / negative) impact of at least equal value.

Impact: the difference one makes in the world by having an effect on the things valued by one's key stakeholders. This definition shows three properties of impact (which are also illustrated in the figure below):



1. **Impact is about 'having an effect'.** Impact goes beyond the simple inputs and outputs of a business; it is about effects and outcomes, not intentions. The nature of banks means that they have effects beyond their own operations, through their relationships with their clients and suppliers.

2. **Impact is about 'the difference one makes in the world'.**

That means that a comparison should be made between the current world and how it would have been had the bank not carried out its activities.

3. **Impact is about 'things valued by one's key stakeholders'.**

Impact results in a change in aspect of well-being – either in a positive or negative way. What matters most drives the selection of impact classes included in impact models. Furthermore, the degree to which these things are valued can be made explicit through impact valuation. This facilitates a like-for-like comparison of different types of impacts.

Direct impact: the impact that follows from the own operations of the organisation in scope.

Indirect impact: the impact that arises outside of the organisation itself as a result of the organisation's actions; where the organisation in scope has a form of direct or indirect influence on the occurrence and/or size of that impact.

Indirect impact within the value chain (or 'value chain impact'): the impact that is generated somewhere in the organisation's value chain; either upstream or downstream.

Indirect impact within the system (or 'system impact'): the impact that is generated outside of the organisation's own value chain.

Impact aggregation: the process of combining the values associated with multiple impacts into a single number.

Impact attribution: the process of re-distributing the (direct) impact of several organisations between them. Direct impact of one organisation can be attributed to another organisation if it (the other organisation) has a direct or indirect influence on the occurrence and/or size of that impact.

Impact management: the ongoing practice of assessing and improving impacts through decision-making and steering.

Impact measurement: the backward-looking process of quantitatively measuring impact to understand the past and current impact of an organisation's activities.

Impact valuation: an assessment of the normative desirability of an impact from the perspective of a stakeholder in a common quantitative unit that reflects that impact's value to that stakeholder; the common unit is often monetary.

Netting: the process of aggregating (positive and negative) valued impacts that belongs to a different welfare dimension.

Value chain: the combined upstream, downstream, and own operations activities used to produce all products and services to which the organisation contributes.

Upstream operations: the activities of suppliers, including purchased energy.

Own operations: all the activities over which the business has direct control.

Downstream operations: the activities relating to further processing, purchase, use or disposal of any products or services produced by the organisation.

Value chain responsibility: the view that some impact is the responsibility of multiple organisations in a value chain, even if the impact directly occurs as a result of the operations of just one of them.

A welfare dimension: a fundamental concept such as wellbeing, respect of rights, equality, or fairness that a decision maker considers valuable and uses as highest-level criteria in decision-making.

Appendix 2: Gap analysis of IMV approaches

The table below is a selection of IMV approaches based on expert knowledge. We acknowledge that all approaches are continuously working on developing their methodologies, so it is good to note that the analysis is based on publicly available information as of February 2021. To assess effectiveness and credibility, we look at three important prerequisite criteria:

- **Specificity** refers to the degree to which an initiative is specific in providing insight into an actual process instead of being a high-level position or theory paper.
- **Robustness** refers to the degree to which the presented method is based on verified price discovery methodologies and academic/scientific approaches.
- **Neutrality** is the degree to which an initiative is free from being grounded in political or specialty interest groups preferred pricing (which is far less likely to capture the true impact).

Against each of these criteria, a relative score is assigned ranging from low to high. A selection was made of initiatives with a high score on specificity and at least a medium or high on robustness and/or neutrality. We view specificity as the most important criteria as the purpose of the BFI is to work towards a practical and specific approach on impact measurement and valuation for banks. This selection of approaches is further analysed in a gap analysis on page 27 (Table 2). To conduct the gap assessment, we identified a taxonomy of elements and qualities that a standardised method needs to have to produce reliable, relevant, comparable, and consistent impact information.

Table 1. Long list of IMV approaches

Approach	Specificity	Robustness	Neutrality
Impact Weighted Accounts	1. High	1. High	1. High
2 Degree Investing Initiative	1. High	1. High	1. High
Science Based Targets	1. High	1. High	1. High
Total Impact Measurement and Management	1. High	1. High	3. Low
Greenhouse Gas Protocol	1. High	1. High	1. High
Value Balancing Alliance (VBA)	1. High	1. High	2. Medium
United Nations Environment Programme Finance Initiative	1. High	2. Medium	1. High
Framework for Impact Statements	1. High	2. Medium	2. Medium
Capitals Coalition	2. Medium	1. High	1. High
The Economics of Ecosystems and Biodiversity framework	2. Medium	2. Medium	1. High
Global Reporting Initiative	2. Medium	2. Medium	1. High
International Integrated Reporting Council	2. Medium	2. Medium	1. High
Sustainability Accounting Standards Board	2. Medium	2. Medium	1. High
IFC Operating Principles for Impact Management	2. Medium	2. Medium	1. High
Impact Management Project	2. Medium	3. Low	1. High
Taskforce on Climate-related Financial Disclosures	2. Medium	3. Low	1. High
Total Value	2. Medium	3. Low	3. Low
True Value	2. Medium	3. Low	3. Low
SDG Impact	3. Low	2. Medium	1. High
Reporting 3.0	3. Low	2. Medium	1. High
Platform Carbon Accounting Financials	3. Low	2. Medium	1. High

Table 2. Gap analysis on selection of IMV approaches

			Impact Weighted Accounts	2 Degree Investing Initiative	Science Based Targets	Framework for Impact Statements	UNEP-FI (Portfolio tool + PRB)	Total Impact Measurement and Management	Greenhouse Gas Protocol	Value Balancing Alliance (VBA)
I. Steps in scope	**1. Assess impact**	Impact identification	✓	✓	✓	✓	✓	✓		✓
		Qualitative impact assessment					✓	✓		
		Quantitative impact assessment	✓	✓	✓	✓		✓	✓	✓
	2. Value Impact	Impact weighting	✓			✓	✓	✓		✓
		Impact valuation	✓			✓	✓	✓		✓
		Impact monetisation	✓			✓		✓		✓
	3. Attribute impact	Attribution to involved stakeholders in the value chain		✓		✓		✓		
	4. Aggregate impact	Aggregation of types of impacts	✓			✓				
		Aggregation at organisation level				✓				
		Aggregation at portfolio level				✓				
	5. Report impact	Internal reporting	✓			✓	✓		✓	
		External reporting	✓			✓	✓		✓	
II. Scope	**1. Sector**	No specific sector focus				✓			✓	✓
		Corporations (not specific sector within corporation)	✓		✓			✓		
		Financial Institutions		✓	✓					
		Banks		✓	✓		✓			
	2. Type of capital	Financial	✓			✓	✓			✓
		Manufactured	✓			✓	✓			
		Intellectual	✓			✓	✓			
		Social	✓			✓	✓			✓
		Human	✓			✓	✓			✓
		Natural capital	✓			✓	✓	✓		✓
		Natural capital - climate change only		✓	✓				✓	
	3. Value chain	Own operations	✓		✓	✓	✓	✓	✓	✓
		Value chain		✓	✓	✓	✓		✓	✓
		Downstream	✓	✓	✓	✓				✓
		Upstream	✓			✓				✓
	4. Stakeholders	Shareholders			✓					
		All groups	✓			✓	✓			
		Selection								
III. Other	**1. Credibility**	Government endorsed		✓						✓
		Multi-stakeholder		✓	✓		✓	✓		✓
		Market uptake	✓	✓		✓	✓		✓	
	2. Feasibility	Concrete guidance	✓	✓	✓	✓	✓	✓		✓
		Builds on available data and tools	✓	✓	✓	✓	✓		✓	✓

ABN AMRO
www.abnamro.com

Danske Bank
www.danskebank.com

DBS
www.dbs.com

Harvard Impact-Weighted Accounts Initiative
www.hbs.edu/impact-weighted-accounts/

UBS
www.ubs.com

Impact Institute
www.impactinstitute.com

Contact person
Arjan Udding
arjan@impactinstitute.com