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We identify the rising stars among charity professional advisers

charity banking survey 2015 • divestment from fossil fuels • effective board reporting • charity 250 index • English Heritage

Rising to the challengers

With the large high street banking groups splintering and new players eyeing their customers, the UK banking sector looks set for another shake up, finds Diane Sim.

Charity Banking Survey 2015

SINCE OUR survey of the charity banking scene last year, there have been a number of restructuring moves aimed at creating new – or strengthening existing – so-called ‘challenger banks’, with a view to increasing competition and choice in the UK banking sector.

Since demerging Lloyds TSB in 2013, Lloyds Banking Group has sold a 50 per cent stake in TSB Bank and plans to sell its remaining 50 per cent holding to Spain’s Banco Sabadell, whose takeover bid for TSB Bank was accepted in March.

Meanwhile RBS Group is in the process of combining 308 RBS branches in England and Wales, and the six NatWest branches in Scotland, under the Williams and Glyn brand. The new bank, which will have 1.7 million customers, is expected to separate from RBS and float by the end of next year.

Both sales have been mandated by the European Commission as a condition of these institutions’ entitlement to state aid: Lloyds Banking Group has until the end of this year to divest itself fully of TSB Bank, while RBS Group has until the end of 2017 to sell off Williams and Glyn.

Another move signalled but yet to complete, which involves two major players in the charity banking market, is the proposed sale by the Co-operative Bank of a 27 per cent stake in Unity Trust Bank, which is likely to be offered first to existing shareholders – namely trade unions, which hold the remaining 73 per cent of Unity Trust.

The recent upturn in the UK equity market has also prompted a wave of IPO activity, with Virgin Money and OneSavings Bank floating last year, and Aldermore Bank and Shawbrook Group floating earlier in 2015. Should market conditions remain positive, other banks thought likely to seek a stock market listing include Santander’s UK business and Metro Bank.

> “Challenger banks are increasing competition in the UK banking sector”

While none of these banks can currently boast widespread primary banking relationships with charity clients, many enjoy secondary banking relationships with them – particularly in the area of deposits – as charities seek to maximise their cover from deposit protection for balances up to £85,000.

Climate ripe for change

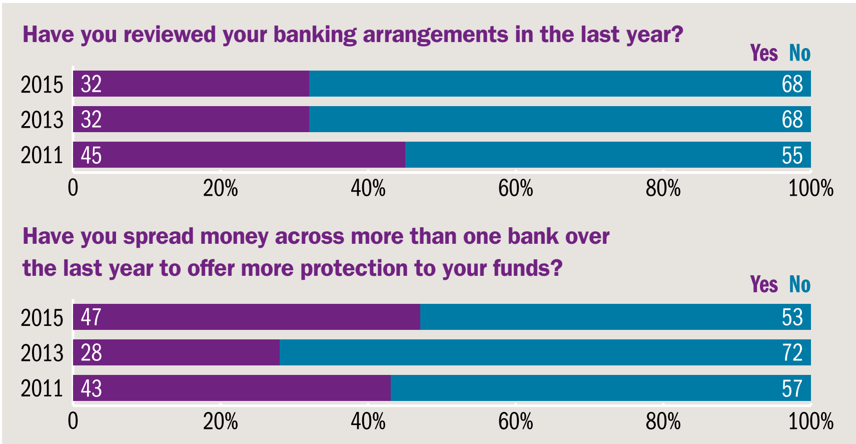
Almost 10 per cent of charities surveyed this year say that their bank has experienced – or is about to experience – a change of ownership and, for the most part, they are happy with the way in which the change has been communicated.

However, with new players eyeing the space and ongoing change among the incumbents, many charities may judge it a good time to shop around: a quarter of charities say they are likely to review their banking arrangements over the next 12 months and half of these say that they expect to switch their main banking provider (see figure 10).

It is against this backdrop of increased competition that many banks active in the charity sector are increasing their efforts to develop tailored, value-added propositions, aimed at attracting and retaining their charity customers.

Just over 400 charities participated in *Charity Finance’s* 2015 banking survey. Small charities with annual

figure 1: Banking arrangements



income of under £1m are well represented and make up 43 per cent of the survey sample. The remainder is split between charities in the £1m-£5m income bracket (32 per cent); charities in the £5m-£20m income bracket (15 per cent), and large charities with income over £20m (10 per cent).

We have supplemented these survey responses with data sourced from the UK's largest 350 charities, which are routinely tracked for the purposes of compiling the *Charity Finance* Charity 100 and Charity 250 Indexes.

Figure 2 shows the primary bank used by charities participating in the survey and by charities that are members of the Charity 100 or Charity 250 Indexes. While it does not purport to represent the charity banking market as a whole, it provides fairly comprehensive coverage of large charities with annual income of over £20m and more selective coverage of small and medium-sized charities.

Market share

The large charity segment is dominated by the main high street banks – namely Barclays, HSBC, Lloyds Banking Group (comprising Lloyds Bank and Bank of Scotland) and RBS Group (comprising NatWest, RBS and Coutts).

Together, these four act as main bank to 90 per cent of charities with annual income of over £20m.

Barclays has the most primary banking relationships in this income bracket, with a 28 per cent market share, with RBS Group having a 30 per cent share split between NatWest (21 per cent), RBS (4 per cent) and Coutts (5 per cent).

Lloyds Banking Group has a 19 per cent share of main banking relationships with charities in this segment, split between Lloyds Bank

figure 2: Primary bank by charity income bracket 2015[1]

Number of clients	Charity income < £1m	Charity income £1m – £5m	Charity income £5m – £20m	Charity income > £20m	Total
Allied Irish Bank[2]				4	4
Bank of Scotland[3]	11	5	1	6	23
Barclays	10	18	29	79	136
C. Hoare & Co.				3	3
CAF Bank	21	7	2	1	31
Clydesdale Bank/ Yorkshire Bank[4]	3	3	1	1	8
Co-operative Bank	27	27	9	17	80
Coutts[5]		1	4	14	19
Handelsbanken			1	1	2
HSBC	12	9	6	34	61
Lloyds Bank[3]	9	10	16	47	82
NatWest[5]	12	16	21	59	108
RBS[5]	5	7	37	11	60
Santander	5				5
Triodos	10	4			14
Unity Trust Bank	51	23	5	2	81
Other	2	3	0	3	8
Total	**178**	**133**	**132**	**282**	**725**

[1] Based on data provided by 350 members of the Charity 100 and Charity 250 Indexes, plus 410 survey respondents (minus the overlap) [2] Part of AIB Group [3] Part of Lloyds Banking Group [4] Both part of National Australia Bank [5] Part of RBS Group

figure 3: Ethical banking

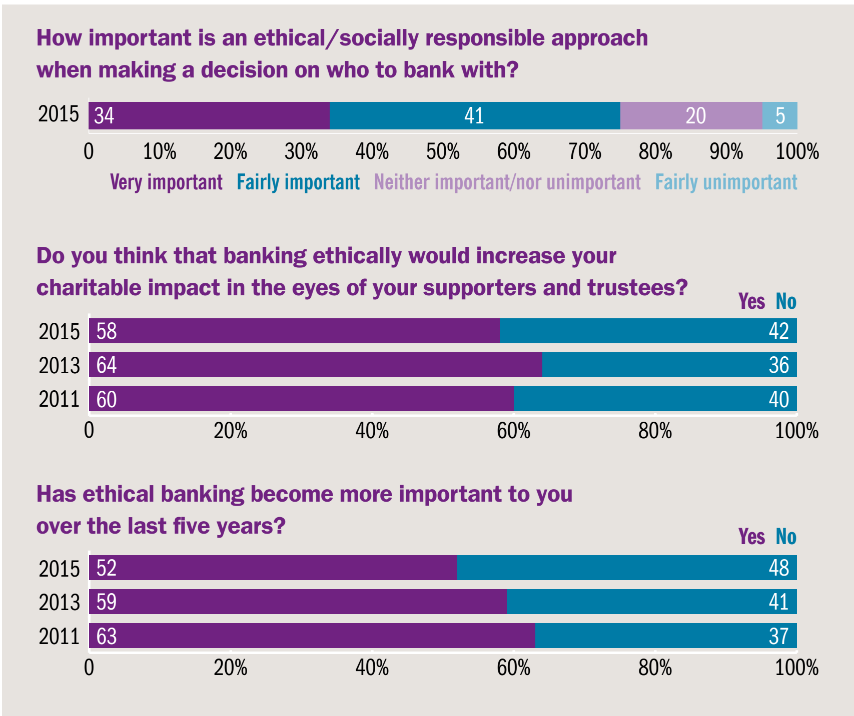


figure 4: Bank review

How often do you review your main bank?

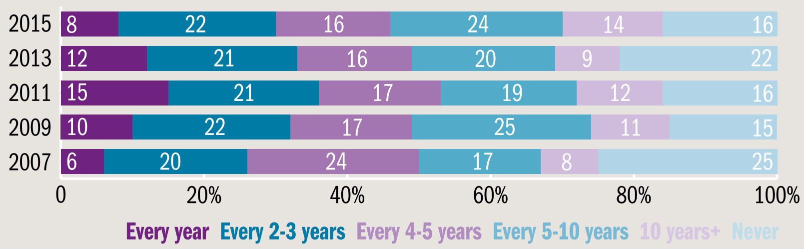
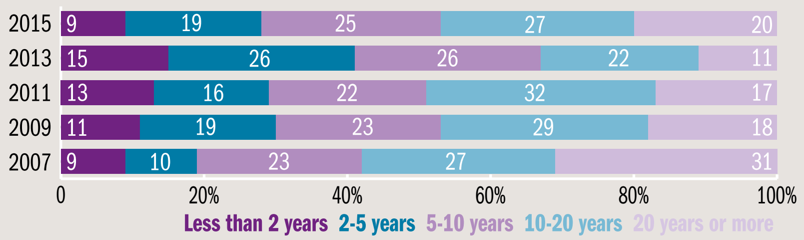


figure 5: Length of service

How long have you been with your main bank?



(17 per cent) and Bank of Scotland (2 per cent), while HSBC has a 12 per cent share.

The most significant provider outside the big-four high street banks is the Co-operative Bank with a 6 per cent share.

Ethical banking

The concept of ethical banking suffered a blow at the end of 2013 when the formerly mutual Co-operative Bank sold a 70 per cent stake to private investors – mainly hedge funds – to plug a £1.5bn capital shortfall. This was followed by the arrest of its chairman Paul Flowers in connection with a drugs supply investigation.

As a leading proponent of ethical banking, it was perhaps inevitable that its difficulties would have wider repercussions and the importance placed on ethical banking, which rose in the wake of the banking crisis, has fallen back slightly (see figure 3).

figure 6: Important factors when choosing a bank

Good reputation in charity sector	39%
Ethical/socially-responsible approach	30%
Existing relationship	28%
Competitive fees	26%
Internet/online banking	24%
Ease of access	23%
Offers specialist charity services	14%
Range of services	13%
Recommendation	13%
Attractive interest rates on cash deposits	10%
National representation	5%
Credit rating	2%
Sponsorship/support	2%
Other	5%

Respondents could choose more than one category.

Ethical banking is clearly important to charities but there is a growing awareness that this cannot be at the expense of strength and stability, as well as the appropriateness of the core banking proposition.

figure 7: Additional banks

Banks used in addition to the primary banking relationship

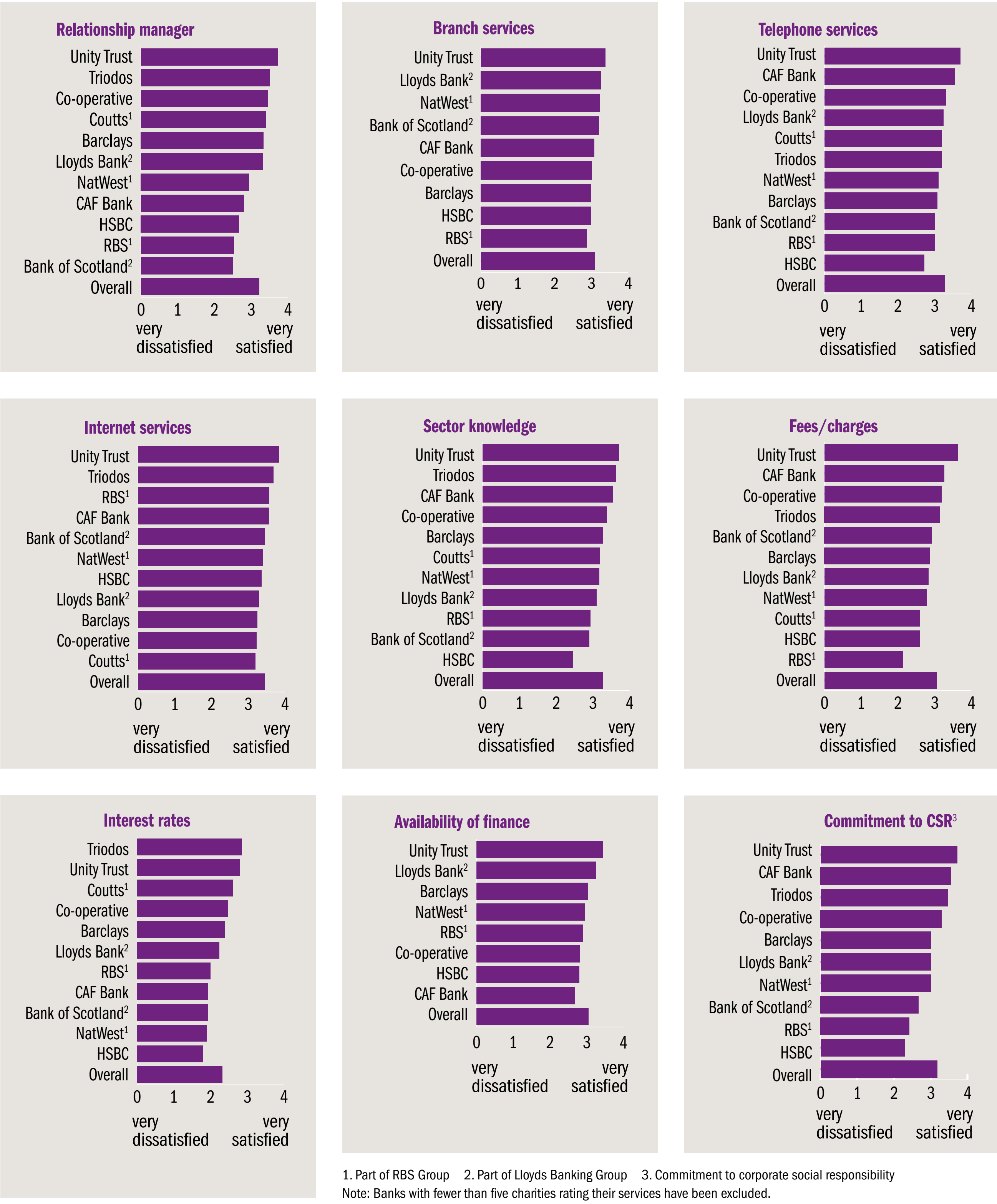
Barclays	10%
CAF Bank	8%
Lloyds Bank[1]	8%
Co-operative Bank	7%
NatWest[2]	6%
Triodos	6%
Santander	5%
Virgin Money	5%
CCLA	4%
HSBC	4%
Clydesdale Bank/Yorkshire Bank[3]	3%
RBS[1]	3%
Unity Trust Bank	3%
Bank of Scotland[1]	2%
Charity Bank	2%
COIF	2%
Nationwide	2%
Scottish Widows Bank[1]	2%
Close Brothers	1%
Metro Bank	1%
United Trust Bank	1%
Other	15%

1 Part of Lloyds Banking Group
2 Part of RBS Group
3 Both part of National Australia Bank

figure 8: Biggest complaint about main banking provider

Low interest rates	19%
Fees	10%
Call centre/back-office support	7%
Internet/online services	6%
Lack of dedicated contact	6%
Understanding needs of charities	6%
Inadequate services/facilities	5%
Change in relationship manager	3%
Errors	1%
Ethics	1%
Security	1%
Other	6%
No complaints	29%

figure 9: Customer-satisfaction ratings



1. Part of RBS Group 2. Part of Lloyds Banking Group 3. Commitment to corporate social responsibility

Note: Banks with fewer than five charities rating their services have been excluded.

Conflict zone

Banks active in the charity sector have come under fire in the last year for withdrawing their services from several international NGOs in a bid to comply with regulatory requirements, designed to minimise money laundering and the funding of terrorism in conflict zones.

Criticism has been pretty much across the board, with HSBC slated for closing the accounts of three Muslim charities, including the Finsbury Park Mosque; Barclays and the Co-operative Bank reported to the Financial Ombudsman Service for closing the accounts of Islamic advocacy organisation Cage and CAF Bank censured for reportedly withdrawing accounts and donation services from several Muslim charities.

Accusations levelled at the banks involved have ranged from Islamophobia to disproportionate levels of risk aversion. Following a meeting with the charities involved, Elizabeth Chamberlain, policy manager at NCVO, commented: "We understand banks may sometimes find it simpler to end relationships with customers, rather than carry out the complex compliance work required to satisfy themselves that their risks are at a satisfactory level."

Over the last few months the Charity Finance Group (CFG), commissioned by the British Bankers' Association, has undertaken a review of the impact of banks' de-risking activities on charities. Its report gives guidance to banks, charities and government to ensure that actions taken by banks – and their correspondent banking partners – to comply with anti-money laundering and counter-terrorism legislation are based on due diligence and are proportionate to the risks involved.

Banks we contacted in the course of this survey were unable to comment on specific cases, but stressed that their actions were prompted by compliance with the regulatory requirement to 'know your customer'.

Several banks interviewed have taken steps to help their charity customers comply with the requirements.

High-risk jurisdictions

CAF Bank, for example, has developed "a questionnaire to help charities understand the financial and anti-money laundering risks that they may be exposed to when operating in high-risk jurisdictions", says CAF Bank CEO Peter Ostacchini.

Similarly Hugh Biddell, head of charities and not-for-profit at RBS and NatWest, observes: "When charities are sending money to countries where there is heightened risk, we have a duty to play our part in preventing the facilitation of proceeds of crime and stopping terrorism.

"Although this process brings additional cost, we recognise the vital role many of these charities play and work with them to counter the risks attached to international money transfers," Biddell concludes.

The Co-operative Bank has acted quickly to reassure its customers that it is still governed by a customer-led ethical policy, which since 2013 has been incorporated into the bank's constitution.

"We are still the only bank on the high street with a clear ethical policy, which ensures that customers' money won't be used to finance businesses or organisations which go against their ethics and values – be they environmental, human rights or animal welfare," says Paul Martin, national manager of charity, co-operative and social enterprise banking at the Co-operative Bank."We have also strengthened the list of companies that we won't finance, to include three new areas that our customers have concerns about: irresponsible gambling; payday loans and companies that do not pay tax responsibly in the UK and elsewhere," he adds.

Moreover the bank will be publishing an annual, independently audited values-and-ethics report intended "to ensure that the bank does what it says", says Martin.

Social economy

Unity Trust Bank, which describes itself as "the specialist bank for the social economy", also positions itself as an ethical provider. In its second report on the social impact of its lending, issued on its 30th birthday in 2014, the bank reported that, in the space of a year, it had more than doubled its loan volume to social economy customers, who have used the proceeds to fund various community development initiatives.

"Unity Trust was also the first UK bank to become accredited for paying the Living Wage and is also a pioneer of the Fair Tax Mark, which shows it is transparent and responsible in matters of taxation," says Peter Kelly, business development and marketing director at Unity Trust Bank.

Neil Hewitt, social and cultural team manager at Triodos Bank, figure 10: Changing banks

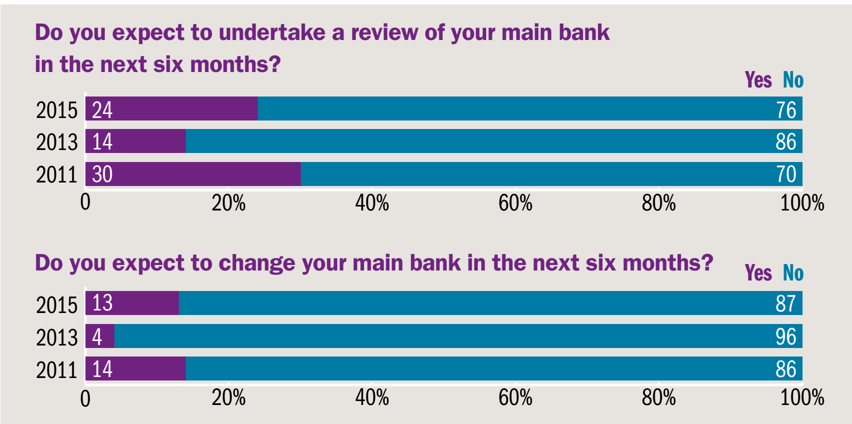


figure 11: Transaction charges

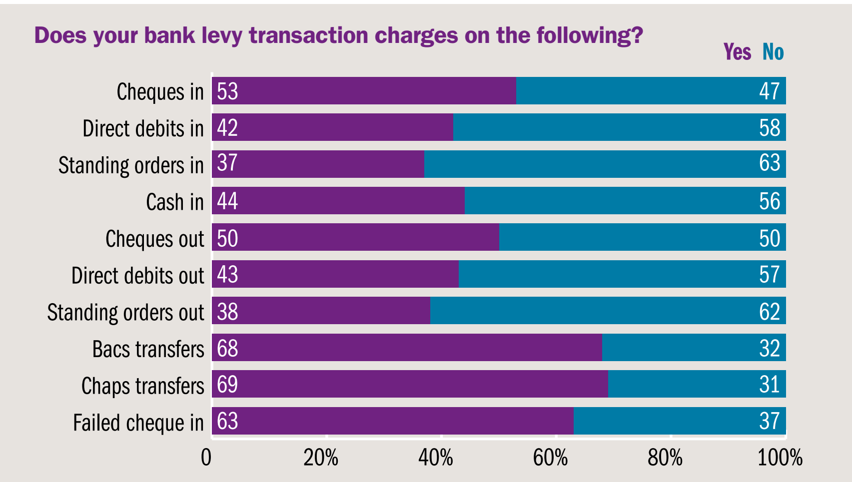
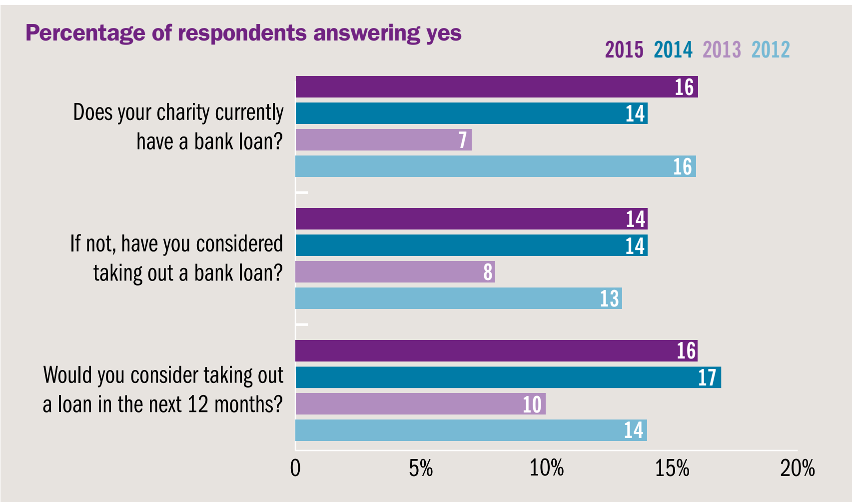


figure 12: Bank loans



which only lends to organisations delivering social and environmental benefit, says that the change of emphasis which enables charities to demonstrate a social return, as well as a commercial return, has been boosted by the CC14 investment guidance issued by the Charity Commission four years ago.

Even without that spur, however, "momentum had been gathering throughout the sector, and charities are now recognising the importance of transparency and demonstrating how their funds are being used", he says.

Owned by the Charities Aid Foundation, CAF Bank occupies a pivotal position in the charity banking sector. "The fact that all surpluses from CAF Bank are gifted to the foundation has been highlighted by both new and existing customers as a major driver in moving their accounts to us," comments CAF Bank CEO Peter Ostacchini.

Areas of innovation

A key area of innovation for banks developing services for charities is a collection facility to support fundraising activities.

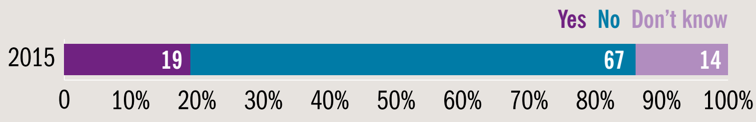
In the last year CAF Bank has launched CAF Donate, "an online donation processing service which gives charities the tools to fundraise through their own websites, mobile devices and Facebook account", says CAF Bank's Ostacchini.

CAF Bank has also been "an integral part of the team developing a contactless debit card donation terminal for charities", he adds. The facility, which is currently being piloted by Save the Children, is effectively an electronic collecting box, which accepts contactless card payments rather than coins.

Barclays has also been utilising contactless technology to develop new ways for charities to receive

figure 13: Social finance

Have you considered social finance as an alternative option to a bank loan?



donations. These include payment facilities accessed via smartphones and other mobile devices. It has recently developed a wristband with a contactless chip that can be used for payments.

"The technology has been used successfully at large festivals and has huge potential for use by charities organising large fundraising events," says David McHattie, head of charities, corporate banking, at Barclays.

Barclays has also enjoyed a very positive reception for its smartphone payment app called Pingit, which enables charities to receive donations and gift aid from consumers via a Quick Response (QR) code, advertised by the charity.

"The app is now used for most large telethons such as Sports Relief and Comic Relief," says McHattie. It was used earlier this year to receive donations from the public via statues of well-known comedians located in major UK shopping centres, as part of Comic Relief's fundraising activities.

Loan demand

Loan demand, which has never been very widespread in the charity sector, does at least seem to be holding up. Some 16 per cent of charities surveyed have a bank loan, up from 14 per cent last year, and a comparable proportion are considering taking out a loan in the next 12 months (see figure 12).

"There has been a general increase in loan demand from charities over the past 12 months. Notable areas of demand are for the acquisition of freehold premises, working capital facilities for treasury or liquidity purposes and for investment in shop or enterprise activities," says Hugh Biddell, head of charities and not-for-profit at RBS and NatWest.

> "Social finance gets far more attention than its importance justifies"

"Some charities are taking the opportunity afforded by low interest rates to borrow and invest where they anticipate a greater return," he adds.

CAF Bank's Ostacchini observes "a significant increase in the demand for loan finance, particularly from the social housing, faith and disability sectors. We have also seen an increase in the size of loans requested, with facilities of between £1m-£5m sought by charities, generally in relation to property or social housing schemes".

Hewitt at Triodos Bank, where the loan book has grown by 16 per cent over the last year, notes "increasing demand for borrowing, especially in our core sectors of housing and health and social care".

Triodos has recently launched "a Referral Partner Scheme involving six Community Development Finance Institutions (CDFIs) across the country, to whom lending requests that fall outside of our own remit can be referred. These CDFIs have access to local, national and European grants and funding, which may be more suited to the borrower's needs", he adds.

Kelly, at Unity Trust Bank, says that loan enquiries have increased by 76 per cent over the last year, though not all of these will develop into actual loans. "Many of these enquiries come from first-time borrowers, who may decide after discussion with their relationship managers that it's not the best option for them," he says.

Early days for social finance

Charities were asked for the first time in this year's survey whether they had considered social finance as an alternative to a bank loan. It is clear from their responses that there are uncertainties about social finance and concerns over its complexity, risks and relevance (see page 43 for more on this).

"Social finance works best for those delivering direct services and where commissioners can underwrite and reward social investors," comments Andrew van Doorn, deputy CEO at housing innovation charity HACT. "It is a marginal part of funding in the sector that gets far too much attention for the actual value that it delivers," he says. ■

Diane Sim is a research analyst at Charity Finance