

Complacency Sets In

by Staff Reporters

When it comes to LatAm bank compliance with international standards on sustainability, mid-cap financial institutions are improving, but only a small group achieves high marks. Large cap banks are meanwhile ossifying at prior years' levels. Both lack innovation and bankers fail to fully quantify the benefits to shareholders, according to a *LatinFinance* study in association with Madrid-based consultancy Management & Excellence (M&E).

The detailed assessment of ethics, corporate social responsibility (CSR) and corporate governance (CG) at the region's top banks shows the usual suspects maintaining leadership. They include Bradesco, Itaú Unibanco, BBVA Continental, MiBanco and BicBanco.

"Banks treat sustainability in a "me-too" manner with no bank going its own way," says William Cox, managing director at M&E. "Sustainability is being administered by sustainability departments rather than strategic managers. Compliance checklists are becoming standardized."

He adds that financial institutions are still failing to engage shareholders. "Banks, like most other large companies pay lip service to governance but seem to look away from uncomfortable areas, such as giving shareholders the ability to actively give input on executive remuneration or explaining to shareholders what they are getting for the billions spent on sustainability," says Cox. "Secondly, it is surprising that banks – with a competence – do not take the care to calculate the financial returns on hundreds of millions of investments each in sustainability projects."

According to M&E, mere compliance with sustainability, governance and social standards seems to be losing its effectiveness as a way for banks to

LatAm banks show a distinct lack of innovation in sustainability and corporate governance. Mid-caps are improving, but all banks fail to value investment in compliance.

Large Cap Leaders

Brazilians on top

| | |
|---|------------------------|
| 1 | Itaú-Unibanco |
| 2 | Bradesco |
| 3 | BBVA Banco Continental |
| 4 | BBVA Colombia |
| 5 | Banco do Brasil |
| 6 | BCI Chile |

Source: *LatinFinance*

Mid Cap Leaders

Argentine strength

| | |
|---|---------------------|
| 1 | Banco Hipotecario |
| 2 | Mibanco |
| 3 | BicBanco |
| 4 | Indusval Multistock |
| 5 | ABC Brasil |
| 6 | Banco Compartamos |

Source: *LatinFinance*

distinguish themselves. All are adhering to the same standards, like membership in the Global Compact and obligatory training for sustainability, for example. "The top banks will soon become blueprints of each other with respect to sustainability," says Cox.

Even so, there were surprises and differences between the banks. Over 24 percentage points separated first place Itaú Unibanco and last place Banco de Chile. Among mid-caps, the performance spread

was even bigger: over 28 points among just six banks. "Mid-caps are thus still lagging in sustainability to a much greater extent than their bigger counterparts, despite easier criteria," says Cox.

A 90% score in the mid-cap study would be equivalent to less than 80% in big bank points, says Cox. Nonetheless, ABC Brasil and Hipotecario are undertaking systematic efforts to improve their sustainability compliance, notes Cox.

Inconsistency From Spain

BBVA in particular fails to maintain consistent standards throughout its operations. Both it and Santander have been working to integrate their LatAm banks into common operating structures. However, while BBVA gets two banks into the final ranking, the performance spread between Peru and Mexico is a large 13% in the total ranking and 30% in sustainability, the most heavily weighted area.

In sustainability, significant differences exist between BBVA's first ranked Continental and last ranked Bancomer units in areas such as compliance, including environmental certifications, transparency on intellectual assets, environmental risk assessments, equity price stability, improved volume in long term credits, and measuring financial returns in sustainability projects.

"A good bank should have more or less equal scores in all three areas because it shows a balanced management of all areas," says Cox. He notes that of all banks, Itaú Unibanco has the smallest variance,

only 1%, between all three areas. “Banks with a less well-balanced sustainability scorecard, such as BBVA Bancomer with 24 percentage points, can be expected to have imbalances throughout their management,” says Cox.

For Santander, its Brazil operation ranks first in social responsibility with a perfect score of 100%. Yet no other Santander bank ranks highly, revealing weak central management, according to Cox.

Buyer Beware

According to M&E, there are only a few governance standards with teeth. Most are mere formalities that did nothing to prevent the banks from investing in bad assets in a blind search of returns, leading to Lehman’s implosion.

“Investors need to look at executive compensation packages,” says Cox. “Are they being compensated for a balanced scorecard involving a healthy mix of financial parameters along with developing personnel, gaining market

share and avoiding risk?”

He adds that the audit committees need to be invested with real powers. And investors should find out whether all shares have equal voting rights, and if minority shareholders are represented on the board.

“Dilution of ownership remains a key weakness in shareholder control over management,” says Cox. He notes that this is not a problem at mid-cap banks such as MiBanco and BicBanco, since the IFC owns 6.5% of Mibanco and Accion about 15%. “These big institutional investors are more likely to control management than an annual meeting attended by hundreds of shareholders,” says Cox.

According to M&E’s analysis, the Dow Jones Sustainability Index beat the MSCI World benchmark by 607 basis points in dollar terms, effective end-2009. It adds that investors appear to like sustainability as a safe haven. “These sizable spreads are increasingly being considered the sustainability spreads,” says Cox.

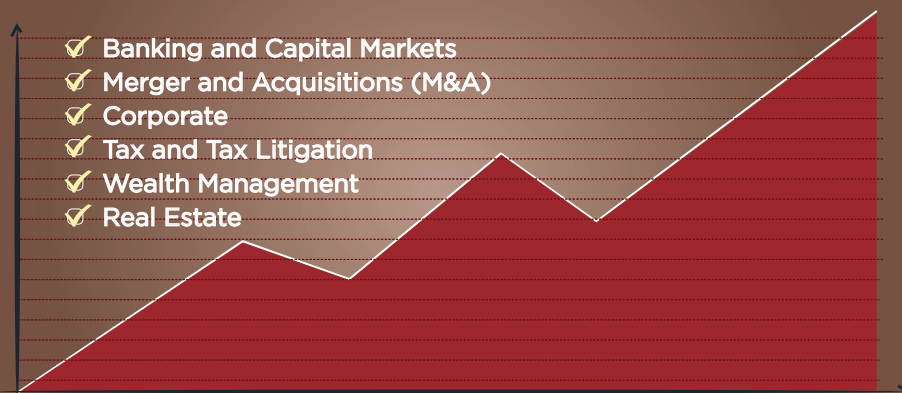
However, Cox concedes that a true link to sustainability cannot be proven. “At such a consolidated level, any number of factors could coincide to produce these results. The only accurate approach is to measure the net present value of all sustainable projects and add up their free cashflows,” says the analyst.

M&E notes that LatAm banks and blue chips in general still hold the view that sustainability investments cannot be assessed according to such standard return methods as NPV or IRR. “With Bradesco spending an estimated 600 million *reais* on sustainability-related expenses, not including major IT investments, shareholders deserve to see returns for these expenses,” says Cox.

M&E estimates that \$2.24 billion of Bradesco’s \$59.24 billion market capitalization effective end-2009 can be attributed to sustainability, or 3.8%. And according to M&E, sustainability investments, properly managed, have strongly positive cashflows. **LF**

VELLOZA, GIROTTO E LINDENBOJM

Advogados Associados



www.vgladv.com.br

São Paulo
Av. Paulista, 901 – 17º / 18º Andares
CEP 01311-100 – São Paulo – SP
Tel. (5511) 3145-0055
Fax (5511) 3145-0050
OAB/SP nº 2.360

Rio de Janeiro
Rua da Assembleia, 10 – Sala 1601
CEP 20011-901 – Rio de Janeiro - RJ
Tel. (5521) 2509-0055
Fax (5521) 2509-1566
OAB/RJ nº R.S 014.890/2001

Brasília
SRTV Sul, Quadra 701,
Cj. D, BL C, nº 100, Sala 234
CEP 70340-000 – Brasília – DF
Tel. (5561) 3323-8848
Fax (5561) 3426-7306
OAB/DF nº 772/01 – R.S.