Avon Mutual
Ethical | Social | Regional

# Bristol City Council – Cabinet Update

*13th November 2020*

**Background**

In 2014 the reform of the industrial & provident society legislation by the Co-operative and Community Benefit Society Act allowed co-operatives to hold a deposit-taking licence for the first time, clearing the way for full service high-street retail banks to be funded by their customers as shareholder-members.

In response to this new law, in 2015 a long-serving RSA Fellow of the Royal Society for the Arts (RSA) paved the way for a network of regional co-operative banks across the UK, a move backed in 2017 by the RSA's Inclusive Growth Commission. As an active Fellow of the RSA, Avon Mutual's Founder and local resident Jules Peck followed these initiatives closely and started the process of creating the first of the 18 mutual banks by setting up Avon Mutual in the West of England region.

**Our progress**

Three years on and Avon Mutual is making good progress towards its aim of becoming a regulated retail bank. Key to this is raising start-up funds and our final capital, and progressing the regulatory process.

In terms of funding, having already raised £1m in our first investment round we are currently in the process of raising a first stage additional £500k of our required £2.4m second round investment needed to reach launch. Interest in this £500k raise has been strong and, with £100k invested by BCC, we expect to reach that target soon.

Investors have been a combination of individuals and BCC, Stroud DC and Wilts CC. In addition we have had a £200k grant from Thirty Percy, the foundation of the Gloucestershire based family who sold Ecover, a £20k grant from St Johns Foundation Bath and a £200k investment-readiness grant from George Soros' Open Societies Foundation's Economic Justice program who are exploring investing several million to help us launch and then capitalize the bank.

In terms of the regulatory process, the team has spent considerable time and effort completing our Regulatory Business Plan, creating a meticulously researched business and financial model totalling more than 300 pages. Having reviewed this RBP the FCA and PRA have now given us their feedback and allowed us to step into the second of three key stages of the regulatory process.

**Overview of RSM due diligence process**

An important milestone in these developments was the commencement of due diligence, conducted by RSM Corporate Finance LLP ("RSM") and commissioned initially by Bristol City Council and other LAs with a particular interest in the proposition, to examine our business plan, investment case, and impact opportunity. RSM's written and verbal reports were highly positive of Avon Mutual, identifying no new areas of unidentified risk, and supporting

the validity and rigour of the bank's methodology in creating its business case and financial model.

One area identified for further work was the bank's impact framework, which, having now completed our core Regulatory Business Plan we are now focusing on progressing. The rest of this paper summarises the work done on the impact framework to date, and lays out the process being taken and management expectations for this work as it takes shape.

**Broad Impact Pillars (Economic, Social, Environmental)**
There are three key 'pillars' of impact that Avon Mutual is concerned with, and which the bank was founded with the purpose of generating a positive contribution towards. Throughout the bank's development we have announced various commitments and aspirations to generate positive impact in a number of areas, all of which sit under these three key strategic areas:

- **Economic Impact:** Improving the economic conditions of our region so that businesses are better served and more able to provide jobs, growth, and opportunity

- **Social Impact:** Generating positive impacts for individuals, particularly those that are vulnerable and/or suffering from financial exclusion and detriment

- **Environmental Impact:** Contributing to the sustainability and viability of human civilisation, by accelerating the journey to a carbon-negative economy

Avon Mutual recognises that each pillar of impact is complex, multifaceted, and interconnected, and that our approach to each will develop over time. We believe that contributing to these impact pillars is not only a moral duty but also a business imperative, and note the growing base of evidence that suggests that values-based banks consistently outperform their incumbent competitors across a number of key indicators.[1]

**Approach**
Avon Mutual also recognises the wealth of excellent resources, actors, and initiatives that exist in the impact space. The bank is keen to integrate and build upon this work, rather than reinvent the wheel, and furthermore as a mutual is committed to the principle of collaboration, co-operation and community engagement wherever possible and mutually beneficial. Consequently, this ethos forms a core tenet of our approach to delivering impact.

Specifically, the bank is keen to leverage and integrate existing frameworks, proven techniques, and established methodologies into its impact framework. There are a number of advantages to this approach, including enhanced credibility and external validation of the framework; established evidence bases; case studies and peer learning; and benchmarking.

[1] See for example "Real Economy – Real Returns: The Business Case for Values Based Banking", GABV (2020), and similar papers from 2019, 2018, 2017, 2016, 2015 and 2014.

In addition to integrating recognised frameworks, the bank will also seek to develop partnerships with reputable organisations that can improve our activities and who have a stake in our work. This is likely to primarily consist of consultation and review partnerships, though in some circumstances may also extend to service delivery, customer referral, and/or evaluation partnerships. We anticipate developing such partnerships with service providers, charities, housing associations, utilities companies, private sector businesses and local authorities.

We will work with BCC and its key stakeholders as well as referring to the BCC One City Plan and Inclusive and Sustainable Economic Growth Strategy, post-Covid Recovery and Resilience Planning, West of England Strategic Economic Plan, Local Industrial Strategy, and other relevant plans and taskforces.

In order to best build a product and service which fulfils the needs of the region, its organisations, businesses, community groups and its citizens we are also undertaking on-going assessment and examination of local demand and needs through a combination of market research and community engagement.

Finally, the bank intends on reporting its impact performance openly and transparently. The bank will regularly publish updates on its impact performance, including a dashboard of metrics to illustrate our contribution to the three impact pillars. This may include an Integrated Annual Report, as well as regular impact reporting to stakeholders and investors.

**Impact pillar 1: Economic**

One of the core functions of a retail bank is to provide intermediation between capital owners and capital seekers. By providing a safe store for deposits and the opportunity to borrow money through loans, banks are able to facilitate economic activity and growth through the balancing of these two activities. However, significant research and experience since the financial crisis[2] has shown that the incumbent banking sector has not performed this function well, particularly for smaller businesses, smaller loan principals, and for regions outside of London and the Southeast.

By contrast, Avon Mutual has been designed to serve small businesses and to fill the gaps in provision left by the incumbent banking sector. We aim to reinvigorate local high streets, deliver for underserved customers, and improve regional economic conditions for everybody.

As well as providing additional services to customers that incumbent banks currently exclude or underserve, a key tenet of our economic impact is the positive effects that displacing business from the incumbent banking sector can provide. These effects are derived from Avon Mutual's geographically-bound regional structure, which ensures that deposits, loans and profits circulate within the regional economy, rather than being extracted outwards or redirected to other areas. This "local multiplier effect" is a key and

[2] See the Avon Mutual Regulatory Business Plan for extensive discussion of this evidence base

recurring concept from emerging new economy and systems thinking, including inclusive growth, community wealth building, circular economies, and doughnut economics.[3]

To quantify, track, and improve our efforts in these areas, Avon Mutual has identified a number of external sources that it aims to integrate into its economic impact framework:

| Name | Description | Originator | Benchmarking |
|---|---|---|---|
| Local Multiplier 3 (LM3) | Comprehensive methodology for measuring the local multiplier effect. Quantifies the additional economic value of local procurement, spend, and investment for a local or regional economy. | New Economics Foundation | Social investment projects (various) |
| Balance Sheet Composition | Measuring what proportion of the bank's assets are dedicated to small business loans versus other asset classes. A measure of how well the bank serves SMEs and how much it prioritises these customers. | New Economics Foundation | Competitors (Big 5, Challengers)<br><br>Alternatives (Credit Unions, CDFIs) |
| Real Economy Assets | The proportion of the bank's assets that are dedicated to supporting the production of real goods and services, rather than merely supporting activity in financial markets. | Global Alliance for Banking on Values | Values Based Banks<br><br>Competitors |
| Jobs Created and Supported | Reporting on the number of jobs either created or retained as a result of the bank's financial support. | Responsible Finance | Alternatives |

As well as these external frameworks, Avon Mutual has identified a preliminary set of additional key impact areas that could monitor and report on. The exact metrics and methods of measurement are currently being developed, but the bank aims to assess areas where it has brought additionality through things such as:

- Measuring and reporting its performance on advancing lending to underserved businesses, for example by monitoring when we are advancing loans where other banks have refused to do so, in particular to start-up businesses, social enterprises, community groups and others delivering to inclusive and sustainable development
- Monitor the number of "edge cases" where loans are advanced. This would indicate the bank's greater use of "soft information" and management judgment over centralised algorithms, where the latter tend to exclude some viable businesses. The performance of these "edge cases" will also be monitored at the product, branch, underwriter, and customer levels
- Measures of business confidence and perception of economic conditions in the region, particularly in relation to accessing finance
- Measuring the bank's support of key sectors and business types, including "feast-to-famine" businesses, start-ups, scale-ups, and target industries such as technology
- Measuring the bank's impact on recirculating local money to local lending – for instance our region's SMEs deposit approximately £6.65bn into the banking system

[3] For more information on how Avon Mutual contributes to the Doughnut Economics agenda, please see our short paper "Avon and the Doughnut".

but only get £3.6bn lent back to them, leading to a leakage of £3.05bn out of the region's economy

- Measure and report on estimates of numbers of jobs created by our lending and banking provision
- Our role in the continued development, growth and flourishing of an alternative financial ecosystem in the region with blended finance through partnerships with bodies like BBRC, BCU, Quartet, City Funds and others

**Impact pillar 2: Social**

Financial services are essential for facilitating modern economic life, and for enabling people to participate in markets for goods and services that can improve their lived experience. Yet because of their ubiquity, financial services also have the ability to disadvantage, exclude, or cause significant detriment to people through poor service, inappropriate products, and institutional cultures that prioritise profit and shareholder gain over customer wellbeing. This is particularly true for more vulnerable and excluded groups, who are often both more susceptible to detriment and also less resilient to its negative impacts.

Avon Mutual understands the critical role that finance plays in peoples' lives, and the potential that financial service providers have to create both negative and positive impacts through the design of their products, services, processes, and operations. We believe that this confers a special responsibility on financial service providers to strive to alleviate rather than cause suffering through its provision of financial goods and services, and to take a proactive, conscious, and deliberate approach to generating positive social impact within its purview in the financial services space.

In particular, retail banks have a critical role to play in facilitating financial inclusion (to both products and financial infrastructure), enhancing the financial resilience of their customers, and ensuring responsible and compassionate conduct with their most vulnerable customers. As well as designing all our products, services, and operations with these aims in mind, Avon Mutual has also identified a number of measures of social impact that it aims to integrate into its own impact framework, including:

| Name | Description | Originator | Benchmarking |
|---|---|---|---|
| The Poverty Premium | People on lower incomes tend to pay higher prices for goods and services. Key products for particularly vulnerable groups, such as current accounts for the unbanked, can help to alleviate these costs. | University of Bristol | Customer |
| Sustainable Development Goals | A collection of priority goals for the social and economic advancement of people everywhere, ratified by the UN and international governments worldwide. B Corp, the movement for sustainable and social enterprises, has developed a tool to track a business' contribution towards the SDGs. | United Nations<br><br>B Corp | Competitors<br><br>Comparable Financial Service Providers |
| National TOMs Framework | Guidelines for local government that help steer and monitor procurement decisions so that they deliver social impact and the Social Value Act. | UK Government | N/a |
| Financial | Comprehensive review of evidence on how to | Financial | Customer |

| | | | |
|---|---|---|---|
| Capability Outcomes Framework | improve financial health, and how to measure it. | Capability Strategy for the UK | |
| Building Blocks of Financial Capability | Framework for understanding financial capability, including financial skills and resilience, and how to improve and develop them. | Money Advice and Pensions Service | Customer |
| Vulnerable Customers | Extensive experience with vulnerable customers, and deep knowledge base of debt collection, resolution, and intervention strategies. | Citizens Advice | N/a |
| Triple Bottom Line Lending | Ensures the exclusion of lending to socially irresponsible or damaging businesses, and gives a measure of a bank's commitment to supporting socially beneficial projects and companies | Global Alliance for Banking on Values | Values-Based Banks<br><br>Competitors |

As well as these external frameworks, Avon Mutual has identified a preliminary set of social impact areas that could monitor and report on. The exact metrics and methods of measurement are currently being developed, but the bank aims to assess areas where it has brought additionality through things such as:

- Monitoring and reporting on the number of previously excluded individuals, in particular the unbanked and other vulnerable customers, who we have brought into the banking system and who are using our various products – we estimate there may be around 38,000 unbanked citizens in our region
- Measure the potential economic productivity improvements from bringing people out of the poverty premium, helping them gain a credit rating and become economically active - which could be worth billions of pounds annually across the UK
- Monitor the number of "edge cases" where loans are advanced. As with businesses, this would indicate the bank's greater use of "soft information" and management judgment over centralised algorithms, where the latter tends to exclude some viable applicants. The performance of these "edge cases" will also be monitored at the product, branch, underwriter, and customer levels
- The number and locations of bank branches and ATMs, particularly in areas of low provision, deprivation, or greater social need for financial infrastructure
- The performance of the bank in preventing, and ameliorating bad debt, and its performance in dealing with customers who slip into arrears
- Become accredited as a socially beneficial and responsible employer, for example through Living Wage Foundation accreditation and reporting on pay ratios
- Modelling the potential for differential banking fees for the unbanked citizens including zero fees
- Increased economic activity, employment and enterprise supported by the bank in disadvantaged communities

**Impact pillar 3: Environmental**

The scale and urgency of meeting the challenge of climate change is difficult to underestimate. The UN has announced that the world has around 10 years left to reverse the climate emergency, or else face runaway climate change above 1.5ºC warming and

irreversible "tipping points" that will accelerate the demise of habitable conditions on our planet. Finance in particular has a huge role to play in the transition to a climate-safe world, with the International Renewable Energy Agency estimating that an additional $27 trillion capital must be mobilised by 2040 just to limit global heating to 2ºC.[4] Unlike other businesses, the climate impact of banks and other financial institutions extends beyond simply their own activities, as it also includes the activities they enable through their financing.

Thankfully, global and regional leaders are acting on this urgent imperative, with cities around the world recognising the climate emergency that we are in, and announcing ambitious plans to accelerate the drive to becoming carbon neutral – including Bristol City Council. Successfully meeting these targets will require huge effort and significant behaviour change from everyone, including individuals, businesses, and the public sector.

Avon Mutual recognises the role that it has to play in facilitating and encouraging these changes, and in addition as a bank is in the privileged position of being able to direct or refuse to advance capital to projects and businesses on the basis of the applicant's climate impact. We will take a proactive approach to catalysing positive environmental change in the region, and aim to leverage our balance sheet, operations, and credit providing capacities to catalyse and accelerate the transition to a sustainable economy. External frameworks that we have identified that could help us in this process include:

| Name | Description | Originator | Benchmarking |
|---|---|---|---|
| Partnership for Carbon Accounting Financials | Banks' environmental impact extends beyond just their own activities, and also includes the activities that they enable through lending. Reporting the carbon intensity of the bank's loan book helps illustrate this impact. | Partnership for Carbon Accounting Financials | Competitors<br><br>Values-Based Banks |
| Taskforce on Climate-Related Financial Disclosures | Global drive to increase transparency and investor confidence in banks' exposure to climate change risks, the TCFD seeks to standardise and improve information disclosure | Taskforce on Climate-Related Financial Disclosures | Competitors<br><br>Values-Based Banks |
| Principles for Responsible Banking | Global movement of banks committing to monitor, report, and improve their social, environmental, and governance impacts, including their contribution to the SDGs and the Paris Climate Agreement. Also provides peer and community support for best practice and improvement. | United Nations Environment Finance Initiative | Competitors<br><br>Values-Based Banks |
| Triple Bottom Line Lending | Ensures the exclusion of lending to environmentally damaging projects and businesses, and gives a measure of a bank's commitment to supporting environmentally beneficial projects and companies | Global Alliance for Banking on Values | Competitors<br><br>Values-Based Banks |
| Doughnut Economics Action Lab | Community of practice working to integrate and promote Kate Raworth's "doughnut economics" approach into operational business as usual. Includes environmental sustainability and promoting social wellbeing | Kate Raworth<br><br>Doughnut Economics | N/a |

[4] International Renewable Energy Agency, Global Energy Transformation: A Roadmap to 2050, 2018

As well as these external frameworks, there are several areas of environmental impact that the bank is keen to pursue. The exact metrics and methods of measurement are currently being developed, but the bank aims to assess areas where it has brought additionality through things such as:

- Reporting on the number and proportion of loans that are used for environmental transition purposes, such as organic farming transition and low carbon transition lending, and to promote best practice and opportunities for environmental transition across our customer base
- Report on the environmental impact of our own operations, including emissions, energy use, supply chain, and waste
- Report on the number and proportion of 'Green Mortgages' that are used specifically for environmental purposes, such as eco house builds, energy efficiency, and retrofitting

**Data Sources & Collection**

This ambitious approach to monitoring and reporting our economic, social, and environmental impacts will rely on collecting a wide array of accurate and reliable data. Broadly speaking we anticipate having to collect three different types of data to enable accurate impact monitoring and reporting:

| Passive | Surveying | Active |
|---|---|---|
| Data sources and metrics that are easily extracted directly from our internal systems | Perception, attitudinal and personal data sources that need to be self-reported or acquired sensitively | Insights that need investigation and research from staff in order to report |

As our impact framework develops we will refine exactly which metrics we will be tracking, and what their collection methods will be. This will in turn have a knock-on effect on the resourcing needed to establish, monitor, and report on our impact framework, and the reporting that we will deliver on an ongoing basis.

**Operations & Integration**

Similarly, the impact framework will influence the way we operate, from contributing to loan decisioning, branch locations and customer communication, to collaborating with partners, reporting to stakeholders, and improving our systems and processes. Consequently, our operational processes, infrastructure procurement, product design, institutional policies and more will all need to be integrated with and aligned to the social impact framework.

Avon Mutual is cognisant of this challenge and committed to integrating impact throughout our organisation. As we advance through the regulatory process and enhance our

operational capacity, we will integrate our impact framework throughout the business so that we are ready to deliver and report on our impact aims from day 1.

**Targets**
Due to the early stage of development of our impact framework we have not yet determined targets or benchmarks, as these will be highly dependent on the impact metrics chosen, the methodology required, and the benchmarks selected (where applicable). That said, we will always endeavour to better our established incumbent competitors on all impact metrics after controlling for size (for example, comparing proportions of lending rather than volume), and to match or better our peers in the values-based banking arena.

**Preliminary Indicative Impact for Bristol**
Given the above, we are unable to provide impact targets or projections for Bristol City Council across the full suite of intended impact areas. However, we are able to share some preliminary and indicative metrics for Bristol, based on the work completed so far on our business and financial model.

**Next Steps on this impact framework**
Our next steps are to hone and refine our impact framework, in consultation with the community, businesses and citizens of the region and to advance integration of the impact framework into our operational capacities, procurement activities, and institutional design. This will include clarifying resource, reporting, and technology requirements, as well as benchmarking, targets, partnerships, and potential branch locations.

As part of this process Avon Mutual will conduct a rigorous analysis of the expected impact in Bristol City Council and other local authority areas within the West of England. From this we will work to create an estimate of the social return on investment for investor councils, and to complete the second stage of the due diligence process with RSM.

**Our next steps overall**
In addition to finalizing our impact framework we are now focusing on growing our core team, including currently recruiting a CEO, undertaking more granular market research product and service development, developing our technology, capital and liquidity plans and the next iteration of our Regulatory Business Plan.

This will allow us to complete the process of regulatory authorisation, and to complete the infrastructure build and preparations to take us to launch, planned for late 2021 or early 2022. We anticipate that a final round of c£20m of funding in 2021-2022 will be required to support operations post-authorisation.

Once licensed we will build to lending around £0.5bn local money to the local economy with 24 staffed branches, 97,000 personal and small business members and 200 staff.

## Timeline for licensing and investment

| Financial year: | Pre-application 2019/20 | Application 2020/21 | Mobilisation 2021/22 |
|---|---|---|---|
| Activities / milestones: | ✓ Informal meetings with PRA/ FCA<br>✓ Fundraising<br>✓ Refine business plan<br>✓ Build team | ✓ Formal application<br>✓ Maximum 12 months<br>✓ Rigorous due diligence<br>✓ Authorisation of key personnel | ✓ Provisional licence gained<br>✓ Operations go live<br>✓ Restriction on amount of deposits for up to 12 months |
| Investment: | **Round 1 - £1m**<br>Bonus shares + dividends<br>IRR c18%-20%<br><br>**Round 2 stage 1 - £500k**<br>Bonus shares + dividends<br>IRR c10% | **Round 2 stage 2 - £1.9m**<br>Bonus shares + dividends<br>IRR c10% | **Final - £20m**<br>Dividends, IRR c5.5%-6% |