European Ethical Bank

powered by fintech

Whitepaper

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Glossary

Antifragility - is a property of systems that increase in capability to thrive as a result of stressors, shocks, volatility, noise, mistakes, faults, attacks, or failures.

Assets - Goods or activity owned by a company or an investment fund.

Balance sheet - statement of the assets, liabilities and capital of a business at a particular point in time; it is usually presented in the form of two opposing columns of assets and liabilities.

Business ethics - Business ethics is defined as the process of evaluating decisions, either before or after, with respect to the moral standards of society. In practice, business ethics means choosing the good over the bad, the right over the wrong, the fair over the unfair, the truth over the liel. Public attention has lately turned towards debates about business ethics, as the social responsibility of the individual and the collective.

Clearing - The business of brokerage through a party who guarantees the derivative contracts exchanged between market traders.

Common Good Matrix - is a framework for the organisational development and evaluation of business activities and the common good. It describes 20 common good themes and gives guidance for evaluating contributions to the common good.

Community acceptance - refers to the acceptance of specific projects at the local level, including affected populations, key local stakeholders and local authorities.

Compounded average growth rate - The percentage that shows the average growth rate of an item over a defined period of time. It is used to calculate the profitability of an investment (for example, a set of shares).

Cooperative banking - Cooperative banking developed according to two main organisational schemes, that of the urban cooperative bank, and that of the rural credit union; these two models were applied in different contexts. Cooperative banks met the need of the poorest classes to have access to credit and adapted themselves to specific local circumstances. Above all, cooperative banks developed in urban centres, becoming banks of business owners, artisans and professionals.

Core ethical values – Core ethical values include honesty, integrity, fairness, responsible citizenship and accountability.

Derivative – A derivative is a contract that derives its value from the performance of an underlying entity. This underlying entity can be an asset, index, or interest rate, and is often simply called the "underlying." Derivatives can be used for a number of purposes, including insuring against price movements (hedging), increasing exposure to price movements for speculation or getting access to otherwise hard-to-trade assets or markets. Some of the more common derivatives include forwards, futures, options, swaps, and variations of these such as synthetic collateralized debt obligations and credit default swap.

Engagement - Synonymous with active shareholding. It is the activity of raising awareness on issues of corporate sustainability or responsible finance carried out by an organized group of shareholders in institutions,associations or management companies and whose culminating moment is in annual general meetings.

Ethics - The word ethics is derived from the Greek word 'ethos', which means character. Ethics is a branch of philosophy that is concerned with human character & conduct. It is a discipline dealing with that which is good & bad with moral duty & obligation.

Ethical banking - Ethical banking, at its core, is a banking system that follows practices that have a positive environmental and social impact. This can range from the products a bank offers and the businesses they fund to the relationships they build with their customers, but should maintain the following:

1. Recover the social role of banks: Banks have a social role, which is to create wealth by investing adequately the capital of savers and facilitating credit for families and businesses. Failure to comply with social function would cause a devastating effect not only on businesses but on all economic activity and society as a whole. Therefore, social function should be reprioritized and placed at the heart of bank's decision-making processes.

2. Transparency beyond the law: banks must provide relevant information beyond what's minimally required by legislation.

3. Intelligent administration of funds: banks´ funds are not the property of the executive board. There are many small shareholders and savers that can be affected by poor board decisions, and the board must bear in mind how their decisions will affect all these small actors.

4. Know where credits go: when giving credit banks must not only take into account profitability and solvency, but weigh up the activity to which the credit is assigned and the social value of such activity, i.e. an ethical bank must deny credit to unethical activities (pollution, denying human rights, war, etc.).

5. Do not abuse dominant position of banks in society and do not take advantage of other's necessities.

6. Use "moral imagination": always look for ethical solutions that replace current or easy solutions.

7. Don't condone or cooperate with unethical practices or behaviours: fiscal paradises, collaboration with money laundering etc regardless of the client's importance should be excluded from business practices.

8. Sense of civic responsibility: banks have to act and be seen as a social player and become a valuable part of the community.

9. Integrity: it is important to have a shared culture of integrity beyond regulation. It is not enough to comply with the rules, moral integrity is imperative.

Italian legislation defines these 5 requirements for the bank in order to be defined as ethical:

1. Must evaluate that loans are disbursed according to internationally recognized ethical rating standards;
2. Guarantee maximum transparency on the loans disbursed;
3. Contribute at least 20% of the credit portfolio to non-profit organizations; not distribute profits, but reinvest them in their business activities;
4. Adopt a democratic and participatory governance system,characterized by a widespread shareholding;

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5. Limit the gap between average and higher remuneration to withina ratio of 1 to 5.

Flight to quality - Flight to quality is the phenomenon for which traders sell the riskiest securities to invest in so-called shelter assets (triple-A bond, gold, etc.). Flight to quality typically penalizes emerging areas, generating an outflow of capital from the latter to mature economies (US, Western Europe, Japan, etc.).

Fossil free portfolio - A portfolio without the stocks and bonds of companies that operate in the production and marketing of fossil fuel sources. Not all funds defined as “ethical” or “sustainable” or “responsible” are automatically fossilfree.

Global systemically important banks - a group of 30 banks globally (13 in the European Union) whose size, complexity and international presence make them capable of causing severe problems for the entire financial system and for economic activity in the case of crisis or bankruptcy. For this reason, since 2011they have been subject to more stringent capitalisation criteria, which have been established by the Financial Stability Board to ensure that they are able to absorb possible losses.

Governance - The set of rules, principles and procedures that generally govern the management of a company’s or organization’s activities

Green bond - Bonds issued to finance an initiative characterized by compliance with a series of environmental sustainability criteria. Projects funded by green bonds generally involve energy efficiency, energy production from renewable sources and sustainable land use.

Impact Measurement - is a process of understanding how much social change occurred and can be attributed to an organization's activities. The integrity of the process is usually bolstered by an impact statement and a clear impact-driven, stakeholder-focused strategy.

Non-performing loans (NPLs) - Loans whose recovery on the part of banks is uncertain. The term covers a broad category of transactions, which includes loans with various degrees of performance: past due or overdrawn loans,unlikely-to-pay exposures, and bad loans (the most serious category for a financial institution).

Return on assets (ROA) -The ratio of net income to total assets; it measures the profitability of a company’s operations.

Return on equity (ROE) -The ratio of net income to equity; it measures acompany’s ability to generate revenue from its equity.

Social enterprise - is an organization that applies commercial strategies to maximize improvements in financial, social and environmental well-being—this may include maximizing social impact alongside profits for external shareholders.

Socially responsible investment - The activity of investing in production or financial transactions that take into account not only the prospects for profit or returns but also the transaction’s compatibility with respect to ethical principles and the direct or indirect impact of the investment in social and environmental terms.

ZEF – Cooperative for Ethical Financing

1. Introduction

The global financial crisis put under spotlight all deficiencies and weaknesses of the global economic model which was for decades focused only on short-term financial profitability. No consideration was paid to the impact which was exercised on social and environmental issues and on achieving long-term sustainability. In the world facing massive climate changes and increased global wealth distribution inequality, the need for a different kind of finance including rising awareness of the impact that financial institutions have on economic development, has never been more compelling.

People demand more transparency, decentralisation and democratic participation in the management of their own funds and resources. Financial technology solutions are enabling inclusion of aforementioned demands into sound and robust business models of the financial institutions of tomorrow, having much lower costs than existing banks of today.

Financial technology, often shortened to fintech, is technology and innovation that aims to compete with traditional financial methods in the delivery of financial services. It is the brand new emerging industry that leverages technology to vastly improve financial activities. The use of smartphones for mobile banking, investment services and cryptocurrency are examples of technologies aiming to make financial services more inclusive, decentralised and accessible to the general public.

As society's expectations change, banks and financial institutions need to become transparent and clear about how their products and services create value for their customers, clients, investors as well as for society in general. The Principles for Responsible Banking drafted by UN Environmental Programme Financial Initiative help any bank – whatever its starting point – to align its business strategy with the society's goals.

Photo 1. 17 Sustainable Development Goals (SDGs)[1]

The Principles provide a framework for a sustainable banking system, and help the financial industry to demonstrate how it can make a positive contribution to society. They are accelerating the banking industry's contribution to achieving society's goals as expressed in the United Nation's Sustainable Development Goals and the Paris Climate Agreement.

Currently, 132 banks from five continents, jointly representing more than USD 47 trillion in assets, have come together to sign up to those principles and have started their implementation.

But this move in our opinion is not going far enough. Only fraction of assets of signatory banks are actually activated to achieve social development goals. A social good is something that benefits the largest number of people in the most poignant way, focusing on basic human needs such as clean air, clean water, healthy food, clean energy, affordable housing, healthcare, and education. There is an urgent need to make a paradigm shift and create banks that are fully committed to use 100% of their assets and their leverage potential for achievement of goals specified above and making a positive impact on people, communities and the planet. Everything else would increase risk of keeping business as usual dominating the world's economy, which is currently the risk that we as a society cannot afford anymore. We are looking for partners to create the first European, continental-wide 100% impact-oriented bank and become champions of new sustainable approach in banking.

[1] Source: https://www.un.org/development/desa/disabilities/envision2030.html

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2. Definition of ethical (impact) bank

An ethical bank, also known as a sustainable or impact bank, is a bank concerned with the social and environmental impacts of its investments and loans. Ethical banking is the term that encompasses any banking system that embraces environmentally and socially conscious practices 100% from its DNA - in all segments of its business - from ownership and strategy to operations and relations with the widest group of its stakeholders.

An ethical bank transparently transfers it assets on the balance sheet to projects of real economy with positive social and environmental impact (so-called triple bottom line principle). An ethical bank does not speculate, does not participate in activities with market instruments and does not charge unreasonable and unnecessary fees. An ethical bank thinks long-term and is committed to the creation of long-term value and is not driven by short-term profitability goals.

Credit portfolio of an ethical bank is deeply rooted in the local community where bank has capacity to understand community needs, can assess and verify the credibility of its customers and can monitor its investments in order to reduce risk.

Those banks would also have a large role in the replication of the models to new geographic areas and would be able to support existing entities with good practices, newest technologies and shared funding and collaboration mechanisms.

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3. Market opportunity

By far the largest part of the financial sector is still driven by the short-term financial profitability goals and is not taking into account long-term effects of its operations. All procedures from strategic planning, over risk assessment and risk management, treasury operations to the implementation of credit procedures and communication channels with the clients are optimized with the ultimate goal of achieving maximisation of profitability in the company's quarterly and annual reports. As EY study shows short-termism deteriorates firms' competitiveness, increases systemic risk, and reduces the long-term potential of the entire economy. Therefore, it is particularly dangerous in financial sector, considering its size, interconnection with virtually all economic activities and leverage effects.

Climate change, social inequality, issues with access to clean air and water, healthy food, accessible housing, affordable healthcare, decent income and safe life are growing in importance every day. People demand decisive actions that will bring progress in mentioned areas. Consequently, impact investment, green investments and social, collaborative and solidarity economy are topics that are developing very fast. However, the ecosystem supporting those topics is still largely underdeveloped. Many stakeholders - from policy makers to investors are recognizing its importance and are shifting its focus to those topics but are struggling to maximize the effect of their investments due to the inadequate infrastructure to leverage its effects.

Mainstream financial and risk models, procedures and assessments are outdated and not able to take into account long-term negative financial effects of environmental and social impact of their activities. Consequently, impact investors are faced with higher cost of capital, inadequate support of other financial institutions and restrictions to leverage and follow-up on their investments.

According to the research of Global Impact Investing Network (GIIN), organisations around the world currently manage around US$502 billion in impact-related investments. It is just a fraction of total size of world's assets amounting to staggering US$300 trillion invested in other mainstream investments. This means that there are almost 600 times more investments in which impact is not considered as a factor then impact-related investment! This fact demonstrates the dire need and opportunity for the development of financial institutions that will be 100% focused to impact, will be able to expand and replicate and will try to turn the tide.

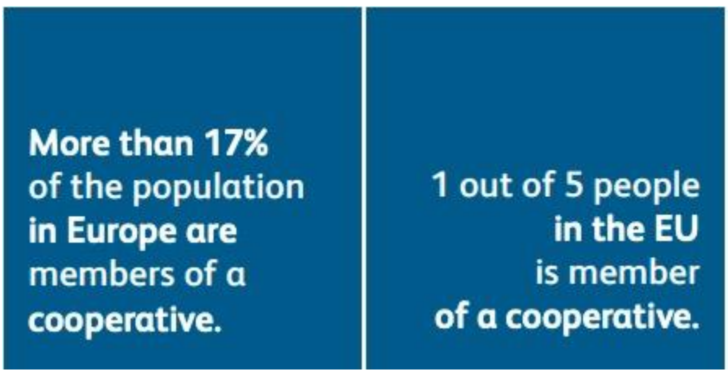
3.1. Cooperatives in Europe

Cooperatives are active in every sector and come in all shapes and sizes – from bakeries and wind farms, to banks and football clubs. They are ethical businesses that work for the benefit of the community now and in the future. Whether it is the emergence of new economies, integration of youth in job markets or leading energy transition, cooperatives, as key actors of social economy, offer solutions to many of Europe's challenges by responding to people's needs.

Cooperatives range in size from micro enterprises to large companies working at the international level. In their way, they contribute to the economic and social dynamism of the EU. Cooperatives are key competitive players in a wide range of economic areas. Cooperatives in Europe represent 140,000,000 members, 4,707,682 employees and 180,000 enterprises.

Photo 2. - Cooperatives Europe statistics [2]

This is why cooperatives have been recognized as key partners for achieving the Sustainable Development Goals (SDGs). Their unique position in transforming lives through democracy, education and self-help puts people and communities in charge of their own livelihoods.



[2] https://coopseurope.coop/sites/default/files/The%20power%20of%20Cooperation%20-%20Cooperatives%20Europe%20key%20statistics%202015.pdf

3.2. European energy cooperative market

It is a story of the past where a small number of big energy companies control the market in which electricity is generated from carbon-intensive, centralized sources, far from the end users who have no control over the power source, environmental impact, or the price they pay.

Individuals, communities, cities and local authorities are at the vanguard of Europe's energy transition: they are increasingly controlling and producing their own renewable energy, and fostering the transition to fairer, democratic and decentralised energy. It was citizens who built Europe's first wind turbines by joining together in cooperatives. At the beginning of 2019 Europe had more than 3,400 Renewable Energy Sources Cooperatives.

REScoop.eu is the European federation for renewable energy cooperatives (REScoops), a growing network of over 2,000 cooperatives and their 1,000,000+ members, leading the way of energy cooperative model promotion as well as legislation efforts at the EU level. Among its full members it has national or regional federations of REScoops or individual REScoops.

REScoop Federations

- Union Renovables - Spain (17 REScoop members)
- REScoop.Vlaanderen - Belgium (13 REScoop members)
- REScoop.Wallonie - Belgium (12 REScoop members)
- DGRV - Germany (850 REScoop members)
- ODE Decentraal - Netherlands (56 REScoop members)
- SEV - Italy (20 REScoop members)
- Community Energy England - United Kingdom (198 REScoop members)
- Energy4All - United Kingdom (23 members)
- Energie Partagée - France (153 members)
- Confcooperative Consumo e Utenza - Italy (661 members)
- + 40 individual members

In January 2019, the REScoop and five of its members announced the foundation of a European Mutual for Energy Communities Investing in a Sustainable Europe (REScoop MECISE) which will pave the way for an even larger growth in renewable energy investments from cooperatives.

3.3. Agriculture sector in Europe

The agricultural sector is one of the major land users in Europe and thus shapes landscapes in rural areas. It has various direct and indirect impacts on the environment and is itself dependent on natural resources.

World food production needs to double by 2050 to cater for population growth and evolving food habits. It faces the impacts of climate change on biodiversity, soil and water quality, and the demands of the global marketplace. Agriculture and food related industries and services provide over 44 million jobs in the EU, including regular work for 20 million people within the agricultural sector itself. Thanks to its varied climate, fertile soil, the technical skills of its farmers and the quality of its products, the EU is one of the world's leading producers and exporters of agricultural products.

Agricultural land plays an important role in land use patterns across the EU. Grassland and cropland together make up 39 % of Europe's land cover (EEA, 2017a). The agricultural sector is a major user of natural resources and has a complex relationship with the environment (OECD, 2017). The following data reflect the performance and impacts of the agricultural sector in the EU:

- Around 94% of ammonia emissions in Europe stemmed from agriculture in 2015, mainly from activities such as manure storage, slurry spreading and the use of inorganic nitrogen fertilisers;
- CO2 emissions from peat soil that is drained for agriculture make up 100.5 Mt CO2 per year, while for forestry the figure is 67.6 Mt CO2. With a total of 173 Mt CO2 emissions from drained soils, the EU is the second largest hotspot for peatland CO2 emissions (after Indonesia) (Berge et al., 2017);
- Through irrigation, agriculture exerts major pressure on renewable water resources. Seasonally, the sector consumes more than 50% of the water used in Europe;
- Agriculture is one of the main sources of nitrates in surface and ground waters. In several regions across Europe, often those with intensive agriculture, nitrate concentrations are still too high;
- Around 9% of agricultural land is part of Natura 2000 sites — an EU-wide network of nature protection areas;
- Agriculture contributes 25 million tonnes of oil equivalent (12.3%) to renewable energy production (2015), which is an increase of 15% from 2013 to 2015 (DG AGRI, 2017);
- Agriculture is an inherent part of food systems and the range of food produced in the EU is diverse;
- The EU is broadly self-sufficient in most agricultural primary commodities. It is also the single largest exporter of agri-food products, which include processed food (EC, 2016a).

The development of the agricultural sector is strongly influenced by the EU's Common Agricultural Policy (CAP)[3].

[3] https://www.eea.europa.eu/themes/agriculture/intro#tab-news-and-articles

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4. Investors and partners

In order to launch this project, we seek investors and partners willing to work together in the establishment of the first European Ethical Bank 100% dedicated to work on the resolution of UN Social Development Goals.

4.1. Investors

Investors are entities willing to contribute their investments on a long-term basis to the creation and development of the European Ethical Bank. For investors we offer non-voting shares of the bank and guarantee that their funds will be used to support solutions helping achievement of Sustainable Development Goals on local and global level.

Investors expecting return from their investments will be able to invest in specific financial instruments developed by the bank with the maximum amount of investment 9 times larger than their investment in the bank's capital.

4.2. Partners

We see three types of partners in the project: community partners, financial partners and technological partners. Partners will be organisations that will become members of new European Cooperative Society (SCE) - the majority shareholder of European Ethical Bank.

European Ethical Bank is a unique project that links all EU countries. Plan is to bring together those partners who have a common interest in developing the social economy, who want to make a positive impact on society and the environment, but also who know how to transfer that impact to the real sector. The aim is to gather at least 5 partners from EU countries to be able to execute all planned business operations. In order to ensure sufficient resources and capital for the smooth running the European Ethical Bank.

➔ **Community partners**
  - are organisations with deep roots in local communities, able to identify and support creation and management local credit portfolios in the regions in which they operate. Typical examples of community partners are cooperatives, professional and business associations, chambers of commerce, clusters, municipalities and similar. Community partners will be link between bank and bank customers and will represent customer interests in the governance and ownership structure of the bank. European Ethical Bank will create specialised credit lines and financial models to support the development of communities served by community partners.
  - through European Ethical Bank we can achieve that each territory in the EU has access to the services of an ethical bank. Our main strength stands on the ability to

build knowledge over different experiences in EU countries, such as risk and impact evaluation methodologies, technology platforms, specialization capabilities in human resources, among others

➔ **Impact-oriented financial institutions**
- ◆ are existing financial institutions (banks, credit unions, microfinance institutions, crowdfunding and crowd investment platforms, impact investment funds, etc.) active in the field of impact investment, willing to:
  - get access to the newest Fintech solutions,
  - to lower capital and transaction costs,
  - to utilise EU and international development funds
- ◆ all those services will increase efficiency and profitability of their operations. European Ethical Bank will serve as a shared service centre for those financial institutions, working actively with them to support them in their own financial activities.

➔ **Fintech companies that work in line with ethical values**
- ◆ Fintech companies offering new groundbreaking technological solutions with clear application in impact investment, looking for a banking institution that will partner with them to create compliancy layer for their IT solutions and will work together with them to bring those solutions to European Ethical Bank partners and customers
- ◆ The only way that challenger banks can truly disrupt banking is through ethics, transparency, honesty, and accountability. Newly emerging financial technology companies – Fintechs – have already started to fill the gap by providing faster, more transparent services, enabled by information and communications technology and new business models. The triple-bottom-line impact analysis of Fintechs is a new emerging area.

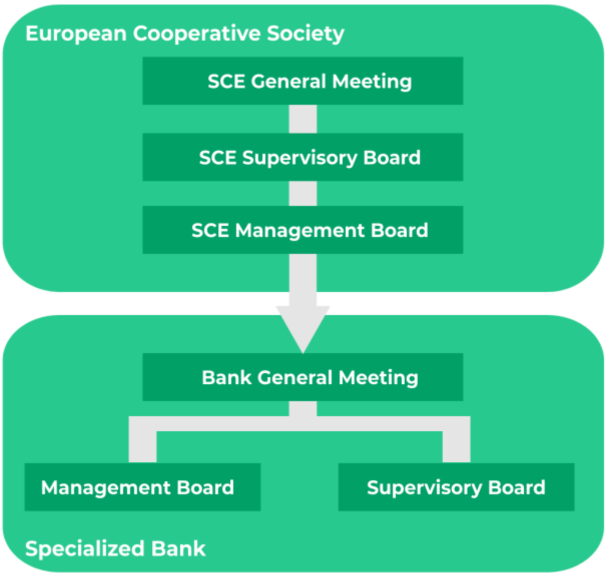
5. Governance

All project partners will form a European Cooperative Society (SCE). SCE is a legal person regulated by the COUNCIL REGULATION (EC) No 1435/2003 on the Statute for a European Cooperative Society[4]. The SCE is an EU regulated subject in a form of an umbrella cooperative. The SCE may be formed by five or more natural and/or legal persons resident in at least two Member States

The SCE will be founded with a primary mission of establishing and governing an European Ethical Bank. The SCE will have three main governing bodies - General Meeting (Assembly), Supervisory Board and Management Board. Partners will govern an SCE in a General Meeting based on a *one member-one vote* principle. Each partner will be represented by an equal number of nominated members within the SCE Supervisory Board.

European Ethical Bank will we registered as a joint-stock company. The SCE will we sole (100%) or at least a majority (75% + 1 vote) shareholder and owner of the European Ethical Bank. Minority shares may be distributed to external (non partners) investors.

Partners interests will be represented by their representative(s) at the European Ethical Bank General Meeting, nominated by the SCE Management Board. Those nominated members (i) will follow binding instructions when executing their voting rights within the Ethical Bank General Meeting and (ii) will have the majority in nominating the European Ethical Bank Supervisory Board members. The European Ethical Bank Supervisory Board elects the European Ethical Bank Management Board members.



[4] https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32003R1435

Primary goal is to ensure that SCE entity is initially well capitalised. Furthermore, additional capitalisation by SCE members is strategic intention and responsibility of each partner is to ensure adequate capital needed to cover their segment of operations. Transparent, well-defined and robust mechanisms of recapitalisation in case of need are necessary for compliance reasons towards the regulator and will need to be established on the level of SCE.

In the initial phase, SCE will demonstrate capital availability by opening an ESCROW account with sufficient funds for capitalisation of the bank as well as with letters of commitment for further bank's capitalisation by all SCE members.

6. Business strategy

The bank will follow this strategy principles:

- ➔ Full digital banking;
- ➔ Partners are the members of SCE;
- ➔ Continuous recapitalisation:
  - ◆ Reinvestment of profits
  - ◆ Acquiring new capital through new SCE members
  - ◆ Recapitalisation by existing members,
- ➔ Avoidance of market risks;
- ➔ Launchpad for new business cases of members;
- ➔ Limiting risks by acquiring of new licenses and separation of successful business cases into separate entities within common ecosystem.

6.1. Operational design

Paramount concern of all banking activities is solid and adaptive risk management, ability to reach adequate asset size and regulatory compliance. Banks today are extremely expensive to operate, largely because of high capital requirements and extensive and complicated regulatory framework. However, there are techniques and mitigations that could be used in order to make new banks surprisingly competitive and viable businesses even in their start-up phase.

6.1.1. 100% digital and technologically advanced

Regulatory and compliance costs are mostly consisted of costs associated with the collection, processing and reporting of various data sets that are describing all segments of operations of banking institutions. In the environment in which regulatory framework and industry standards are frequently changed and updated as it is in the banking sector, the most efficient way to mitigate the effects of changes in the regulatory framework is to design processes that could be automated and use IT frameworks flexible enough to support modification of business processes without or with minimum additional development cost.

At the same time, traditional banking which is focused on the physical branches and (paper) cash management is becoming more and more expensive and digital channels are emerging and becoming dominant way how banks communicate with their clients. This is the reason why European Ethical Bank will be 100% digital bank, without branch offices and with full orientation to usage of latest technological solution to maintain its operational efficiency (digital archive, collaboration tools, project management tools, CRM, etc.). Digitalisation will also enable physical dislocation of personnel in different countries in the EU, allowing us to work with the best professionals in the field without need for their physical relocation to another member state and ensuring true pan-European culture of the bank.

6.1.2. Centralized common shared service operations

Basic services such as:

- transactions,
- reporting,
- treasury,
- KYC,
- AML,
- internal audit,
- IT infrastructure and development,
- card management,
- compliance,
- other back office operations,

will be managed centrally by bank professional teams. With this approach the bank will be able to achieve economy of scale and high degree of operational efficiency offering competitive pricing of its services to the customers. Services will be designed in the most flexible way, allowing the bank to easily modify and adjust them in accordance with market developments and regulatory requirements.

Bank is using workflow management applications to automate all possible processes to minimize manual work and to implement set of controls able to detect any anomaly in its operations and is able to automatically generate all reports needed by the regulator. However, one of the principles that will be followed is that all crucial decisions will always be made by people and not algorithms.

6.1.3. Localized credit portfolios

The core of ethical banking is in banking for local communities - “banking for the people by the people”. This means that credit policy of an ethical bank necessarily needs to be grounded in communities where it needs to serve local development needs, can take into account deep knowledge of reliability of beneficiaries within local community and can more easily manage supervision and monitoring of invested projects.

European Ethical Bank will generally not finance projects in geographies where it does not have a strong presence in the community through one of the SCE partners. The role of the SCE partner is to:

- support credit application analysis and assessment by provision reliable information about applicant, community acceptance of the investment and professional-technical analysis of the project;
- perform marketing and promotional activities for the bank;
- support in project monitoring;
- participate in social and environmental impact measurement of bank activities;
- support local customers with access to banking services and collection and preparation of the documentation.

European Ethical Bank’s exposure to certain geographic or thematic area of business is limited by capital contribution to European Ethical Bank through SCE of respective SCE partner covering that particular area and its monitoring capabilities of associated portfolio. With this approach European Ethical Bank will more easily ensure capital adequacy requirements of that particular portfolio and in general. In other words, the maximum size of the individual localized portfolio will be determined by the capital contributed to the bank by an SCE partner possibly leveraged by additional hybrid capital funds invested by development financial institutions or private investors.

All portfolios need to be in line with the general credit policy of the bank - financing only projects of real economy with positive financial, environmental and social impact and from sectors that are listed as follows:

6.1.4. Incubation of tailor-made financial instruments

With the development of the economy and various industries in general, financing needs and demands are becoming more and more complex and challenging for traditional investment models and instruments. Need for new financial instruments tailor-made and dedicated to achieve specific goals is larger than ever and requires up to now unprecedented flexibility and level of involvement of financial institutions willing to support their clients. Many mainstream banks are struggling to answer to the demands of clients due to their internal legacy procedures and infrastructure and fear of increased risks and short-term profitability impacts of stepping into the unknown or uncharted territory. Therefore, a novel approach is needed in which financial institution will partner together with domain expert entities in the development of new financial instruments at a level not seen before.

Domain expert entity who has need for the development of new financial instrument will be invited to become a member of SCE and consequently partner in the strategy planning of the European Ethical Bank’s business model. With its own capital contribution and assets transferred to the European Ethical Bank through SCE, domain expert will finance development of required financial instrument that will be performed by bank’s expert teams. New financial instrument would provide new financial leverage to the domain expert entities helping them to run their operations more efficiently and with broader impact.

Naturally, the responsibility of the management and supervisory structures of the European Ethical Bank is to ensure that new financial instruments pose acceptable and containable risk in the balance sheet of the bank. Once instruments become large enough and prove to be sustainable, strategic decision will be made whether should they remain part of the balance sheet of the European Ethical Bank or whether should they be spinned-off to separate licensed entities within European Ethical Bank's ecosystem.

For examples of tailor-made instruments - see case studies in a chapter below.

6.2. Triple-bottom line approach

Sustainable development means the economic model in which needs of people today are met without compromising the ability of future generations to meet their needs. This means that in the accounting of economic actors we need to include not only short term financial assets but also financial consequences of long term effects arising from social and environmental impacts of present-day economic activities.

Major problem in this approach is that it is difficult to quantitatively measure the value of social and environmental impact since those are extremely complex and involve a variety of different factors, many of which are not known fully at the moment of business decision. Therefore, in order to be able to include an impact measurement methodology in operational decision making

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in the process of a credit application in the bank or some other financial institution, the impact measurement methodology needs to have the following characteristics:

- be quantitative and measurable,
- be composed of several components to ensure transparency,
- be easy to use without extensive training,
- doesn't require too much work effort,
- does not require long time for measurement,
- can be supported and improved based on statistical evidence,
- can be integrated in Value at Risk calculation methodology.

Looking for methodologies that will meet the aforementioned criteria, we have selected Common Good Matrix methodology developed by Austrian Genossenschaft für Gemeinwohl cooperative, modified for needs of European Ethical Bank and described in the chapter below.

6.3. Impact measurement

The Common Good Balance Sheet measures success by new standards: increasing the common good becomes the main goal, not only financial gain. The contribution to the common good is assessed and scored through the Common Good Matrix. It allows a systematic examination of all activities from a 360° perspective and really focuses on these essentials:

- What impact are economic activities having on the general quality of life, today and for future generations?
- What attention is being paid to human dignity?
- Is social justice being promoted?
- Is environmental sustainability assured?
- Are business goals achieved democratically and through cooperation? How transparent is the process?

The Common Good Matrix is a framework for organisational development and evaluation of business activities and the common good. It describes 20 common good themes and gives guidance for evaluating contributions to the common good[5]. The Common Good Matrix is the basis for creating a Common Good Report, a comprehensive account of an organisation's standing in relation to the common good.

[5] https://www.ecogood.org/en/our-work/common-good-balance-sheet/common-good-matrix/

6.4. Capital stability and continuous recapitalization

European ethical bank should be designed to plan long-term strategically, should be antifragile in its operations, solid in capital and adaptive in its risk management approach. One of the most important indicators of the stability of every bank is a measure of capital adequacy. Ethical banks generally are banks with strong capital base, grounded in capital of its owners in local communities. European Ethical Bank will follow the whole set of principles in order to ensure its own good capital position and comfortable margin for capital adequacy. This will be implemented through 5 strategic capital pillars:

1. Limit on payout of dividends to owners

European Ethical Bank will be governed and run as a social enterprise. According to the criteria of social enterprises widely accepted in European Union - social enterprises are "those whose profits are mainly reinvested to achieve its social objective". This means that European Ethical Bank will mainly reinvest its profits to the increase of the capital and improvement of its services. Reinvestment of profits is the first pillar of strengthening of the capital of European Ethical Bank.

2. Recapitalization of European Ethical Bank by existing members of SCE

The sole purpose of SCE is to organise partners who are interested to design and support operations and development of European Ethical Bank. One of the most important tasks in this management is to ensure stable and predictable capital accumulation for recapitalizations of the European Ethical Bank in order to increase its capacity, stability and scope of operations. Each of SCE members (partners) is responsible to ensure capital required for European Ethical Bank's operations in their geographic area or services domain. Without adequate recapitalization from that source, European Ethical Bank will not develop new or extend existing services to the business area of interest to SCE's member. In other words, financial exposure to each individual partner is clearly limited by the ability of that partner to cover it by required capital. This mechanism represents the second continuous source of recapitalization of European Ethical Bank.

3. Recapitalization of European Ethical Bank by new members of SCE

The second main purpose of SCE is to attract new members (and consequently partners in the governance of the European Ethical Bank) and to expand its operations to new geographies and/or to introduce new financial products of interest to that partner. Each new partner is required to ensure required capital contribution to European Ethical Bank as a precondition for the establishment of new operations initiated by that partner. This is the third regular source of recapitalization of European Ethical Bank.

4. Capital contribution by minority shareholders - development financial institutions

European Ethical Bank will offer a junior/minority shareholder status to various national and international financial institutions, national development banks, European Investment Bank, European Bank for Reconstruction and Development, European Investment Fund, Council of Europe Development Bank etc. All of the mentioned institutions are interested to support social and economic development and vision and mission of European Ethical Bank is very much aligned with their visions and missions. Presence of such shareholders in the structure of European Ethical Bank will ensure additional degree of stability and ability to raise capital required to successfully run all operations of European Ethical Bank. Participation of development banks represents 4th pillar of capital stability of European Ethical Bank.

5. **Solidarity capital instruments by Federation of European Ethical and Alternative Banks (FEBEA), Global Alliance for Banking on Values (GABV) and various Impact Investment Funds**

The 5th pillar of capital stability in the structure of European Ethical Banks is defined through collaboration with other financial institutions within the ecosystem of impact, social and solidarity economy. European Ethical Bank will actively work on the international scale with its partners to identify, solidify and expand capital instruments supporting the work of the whole ecosystem and ensure its further development.

With the utilization of those 5 pillars European Ethical Bank will strive to maintain high total capital adequacy ratio above 20%.

6.4.1. Partnership with development financial institutions

Economic, social and environmental development of local communities is the main reason for the foundation of European Ethical Bank. This vision is very much in line with various programmes of many national and international development oriented institutions that are active in the EU. Therefore, establishment of partner relations with those institutions is one of the high priorities of European Ethical Bank. Those partnerships would enable European Ethical Bank to increase its capital through direct or hybrid instruments and to translate this capital increase into widening of its operations, extending its reach and deepen its impact. On the other side, public development oriented financial institutions will have reliable and transparent partner, fully committed to implementation of its development policies, able to create portfolios large enough to be supported by international development mechanisms in order to lower down the capital and transaction costs as well as to manage risks more effectively.

There are various instruments and programmes that are of particular interest to European Ethical Bank on the short and medium term:

- European Investment Fund (EIF)
  - Employment and Social Inclusion (EaSI) financial instruments - aims at contributing to the implementation of the Europe 2020 strategy by supporting the EU's objective of high-level employment, guaranteeing adequate social protection, fighting against social exclusion and poverty and improving working conditions.
  - Social Impact Accelerator (SIA) - SIA operates as a fund-of-funds managed by EIF and invests in social impact funds which strategically target social enterprises across Europe. In the context of the SIA, a social enterprise shall be a self-sustainable SME whose business model serves to achieve a social impact.

- EFSI equity instrument - Under the newly created Expansion and Growth Window of EFSI, EIF provides equity investments to or alongside funds or other entities focusing directly or indirectly on later stage and multi-stage financing of SMEs and small mid-caps. Furthermore, for the first time, EIF provides investments with the intention to generate a social impact, targeting social enterprises and social sector organisations established or doing business in EU Member States.
- Mezzanine Facility for Growth - The purpose of this particular asset class is to provide alternative financing to support, for instance, shareholding reorganisation or expansion for more mature businesses and late stage or expansion technology companies. It can be tailored to meet the specific financing requirements of these companies and in the current market situation where bank lending remains limited, it is well adapted to long term financing.
- The Single EU Equity Financial Instrument supports European enterprises' growth, research and innovation (R&I) from an early stage, including seed, up to expansion and growth stage.

- European Investment Bank (EIB)
    - EIB equity Environmental Funds
    - Credit Enhancement for project finance - subordinated financing, funded or unfunded guarantees and contingent credit lines designed to enhance the credit quality/credit rating of the senior debt.
    - Guarantees in support of SME portfolios
- European Bank for Reconstruction and Development (EBRD)
    - EBRD Green Economy Transition (GET) financial instruments
    - EBRD Economic Inclusion financial instruments
    - EBRD Food Security financial instruments
    - EBRD support for local currencies
- Council of Europe Development bank
    - Long-term loans to establish and grow European Ethical Bank
    - Collaboration on European Ethical Bank's project in the areas of:
        - social housing,
        - environment,
        - cultural heritage,
        - MSMEs,
        - living conditions,
        - health,
        - education.

Other partners considered to be approached for partnership in the equity and quasi-equity, mezzanine and guarantee capital structure of the European Ethical Bank are:

- KfW Group
- Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)
- FMO Entrepreneurial Development Bank

- Development Bank of Austria
- British Business Bank
- Bank Gospodarstwa Krajowego (BGK) of Poland
- Banque publique d'investissement, Bpi, France
- Bulgarian Development Bank
- Caisse des Dépôts et Consignations
- Cassa Depositi e Prestiti
- Croatian Bank for Reconstruction and Development
- Eurasian Development Bank
- Hellenic Industrial Development Bank
- Hungarian development bank
- Instituto de Crédito Oficial
- Institut Català de Finances
- Norwegian Industrial and Regional Development Fund
- Slovenská záručná a rozvojová banka - Slovak Guarantee and Development Bank.

6.5. Risk profile

Due to its strategy, risk appetite of its founders and implemented policies, European Ethical Bank will have risk profile which is uncommon in the majority of commercial credit institutions. This particularity will be especially visible in the context of significantly lower exposure to different types of market risks, since bank will have policy of not investing in any but the most necessary market instruments in order to maintain high liquidity and stable capital position. At the same time, credit risk portfolio of the bank will be focused to businesses with no exposure to retail except in targeted loans for housing, health and education purposes or exceptional emergency loans (mostly given through intermediaries).

6.5.1. Credit risks

Risk is a measure of the unknown. According to the research done by German Institute of Economy "alternative banks are significantly more stable (in terms of z-score) than their conventional counterparts. The results are robust to different estimation methods and data specifications. Alternative banks also have lower loan to asset ratios and higher customer deposit ratios than conventional banks". Additional research performed by GABV and Institute for Social Banking also demonstrate that ethical banks have lower non-performing loans (NPL) ratios and are less susceptible and affected to consequences of financial crashes and economic recessions.

The main reason of those results is due to closeness of ethical banks to their beneficiaries in local communities where they are able to collect much more data about entrepreneur or organisation seeking financing than just standard credit application data collected by classical commercial banks. Consequently, ethical banks are able to attract more loyal customers, create higher quality portfolios and manage risks with much more tools at their disposal than other commercial banks. That's why European Ethical Bank will offer credit only in geographies where it has good presence in local communities through its partners and where it is able to implement high-standards for customer identification, individually based assessment of the applicant and financed project and monitoring and supervision infrastructure for early detection of possible default events.

Because of its tailor-made approach, this process would normally be very costly and difficult to implement in any classical credit institution, but European Ethical Bank will increase its efficiency and optimize costs by:

- externalizing all functions that do not have direct financial-impact (marketing, customer support, professional-technical analysis, measurement of social acceptance, part of the project monitoring) to local partnering organisations already present in local community and with the required credentials.
- digitizing and automating monitoring framework in which real-time or near-real-time key performance indicators will be monitored for all investments, future cash flow simulations will be run and will enable credit controller of the bank to detect possible warning signs for inability of repayment BEFORE they occur.

With measures described above European Ethical Bank will proactively manage risks of its credit policies on the more individual level than industry benchmarks and will have spread of localized geographic credit portfolios each covered by its own source of capital contribution, additionally spreading risks of systemic events on already better-than average local portfolios.

6.5.2. Market risk

By its strategic and operational design, European Ethical Bank will avoid investments in all but essential financial instruments, keeping market risk very small within its balance sheet. Due to the mechanisms of functioning of modern financial system, treasury operations of the bank need to be able to invest in certain financial instruments in order to maintain liquidity, currency and capital positions of the bank, but those instruments will be carefully chosen and used only when necessary.

European Ethical Bank will seek, develop and implement investment strategies that are ensuring that most of its available capital is invested in financial instruments supporting implementation of UN Sustainable Development Goals, or instruments backed by collaterals deeply grounded in real economy and used by European Ethical Bank's customers.

6.5.3. Operational risks

European Ethical Bank will implement various strategies to reduce its operational risks. As a bank that aims to achieve the highest possible degree of transparency, it will implement all required control mechanisms to ensure not only compliance required by the regulator but also high expectations of its other stakeholders.

Cornerstones of the successful operational risk management of European Ethical Bank will be as follows:

- Creation of accountability, responsibility, collaboration and transparency culture among employees and all stakeholders of the European Ethical Bank
- Clear definition of roles and responsibilities
- Identification of Key Risk Indicators and decision-making points
- Co-working and co-deciding principle - none of the key decisions cannot be made by just one decision maker and there shouldn't be single-person risk at any of the critical procedures
- Avoidance of manual data management through advanced and sophisticated IT solutions
- Design of databases with required immutability of operations and full-history principle - no records should be erased, but only updated with relevant information
- Use of distributed ledger technologies wherever possible
- Basel-II compliant initial design of procedures
- Periodic Evaluations Based on Internal & External Changes
- Implementation of risk control self-assessment (RCSA) procedures
- Strong Internal Audit
- Consistent and timely operational risk management information and reporting capabilities
- Sustained risk-smart employees and work environment
- Ensured continuous risk management learning
- Scenario planning for risk identification and mitigation measures
- Awareness of possibility for black-swan risk events
- Active policy of risk dispersion and avoidance of concentration risks in all operational aspects
- Evolved and enabled efficient allocation of operational risk capital.

With adequate follow-up of mentioned techniques, European Ethical Bank will build institutional capacity to manage all aspects of operational risk.

6.6. Remuneration policy

Remuneration policy of European Ethical Bank is rooted in awareness that fair living wage based on the quality and long-term effects of someone's work is essential for the good functioning of any business organisation. Ethical banks consider excessive salaries of top executives to be one of the major sources of moral hazard in the financial industry. Bonuses paid out on the basis of quarterly and annual financial performance indicators are often incentivizing short-term strategies and unnecessary risk-taking than sustainable improvement of excellence and operating procedures. Furthermore, too large discrepancies between lowest and highest salary are creating rifts within the organisation and suppressing collaborative and collegial relations among employees.

Therefore, European Ethical Bank will have remuneration policy will follow these principles:

- minimum salary paid out by European Ethical Bank should be high enough to cover living costs of employee without need of additional income
- maximum salary paid out by European Ethical Bank should not be more than 4 times higher than minimum salary
- bonuses should be paid out only for long-term positive results achieved by the organisation and not related to short term financial indicators
- in case of bonus payouts, they should be paid to all employees in the organisation
- European Ethical Bank should actively work to find and offer non-financial benefits to its employees as a positive alternative to purely financial remuneration (extra vacation days, education, workplace improvement, etc.).

6.7. Growth strategy

European Ethical Bank does not have imperative of indefinite continuous organisational growth. Moreover, we believe that organisational growth necessarily leads to increased inflexibility of the organisation as well as to other negative consequences such as loss of information, reduced ability to change and innovate, additional management complexity and increased risks. Studies show that information loss is one of the major problems in highly hierarchically organised entities. This problem would be even more visible in an ethical bank that relies on the closeness of its strategic planning and management procedures to the needs of beneficiaries and requires short information loops.

Therefore, our strategic decision is that the growth of European Ethical Bank will be performed through replication and functional separation of its activities to new entities when they reach sustainable size. For example, when credit operations in certain geographic area reach a certain size, operations of that entity will be moved to a newly established autonomous entity that will be operating under its own license but that will remain part of the European Ethical Bank's

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ecosystem (i.e. will operate in accordance with the same values and principles, will use the same IT infrastructure, will have compatible processes, will use shared services, will participate in mutual funds etc.). This will have a slight impact on the increase of operational costs, but will increase the quality of services provided to customers, will reduce systemic risk and will still use benefit of economy of scale by joint investments and mutual sharing of technologies, best practices, some funding instruments etc.

In the initial phase primary focus is growth in EU and European region, but there are no strategic limits of expanding partnership and business model throughout the world.

7. Geographic presence

European Ethical Bank will open across EU. Since the bank will be headquartered in Lithuania and founded by SCE, in the first phase bank's credit operations will be focused to Lithuania and Members States in which SCE partners have established deep local presence in local communities. At this moment, SCE partners are covering the following countries:

- Belgium
- Catalonia (Spain)
- Croatia
- Italy
- Lithuania
- Poland

Transaction services, deposit accounts and private banking services will be offered to all EU citizens very quickly after the start of operations. The medium-term ambition of the bank is to become recognized and reliable partner across the EU and to support the development of other ethical and impact-investment institutions in the rest of Europe and around the world.

European Ethical Bank initiative is currently negotiating establishment of strategic partnership with Banca Etica Latinoamerica, an continent-wide initiative to set up ethical banking operations in Latin America to set up an intercontinental backbone for banking collaboration and sharing of IT infrastructure, best practices and capital in order to strengthen financial position and efficiency of ethical and impact investment institutions around the world.

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8. Products and services

Our clients will use the following products and services:

1. INDIVIDUALS - Technology friendly individuals, aiming to have transparent control through mobile banking over their assets in a bank (with underlying objective that all their investments will be supporting projects with positive social and environmental impact):

⇒ Digital Onboarding (KYC)
⇒ Digital Bank Accounts
⇒ Debit Cards
⇒ Crowd-investment
⇒ Remittances
⇒ Foreign Currency Exchange
⇒ Accepting Deposits
⇒ Mobile Banking
⇒ Saving Account

2. SME's - looking for a bank that would support their businesses, operations and investments by reasonably priced loans, with thorough understanding and support to their individual business models while facilitating their expansion and growth on local and international markets. Special focus will be given to SME's from sectors of:

INVESTMENT AREAS	SECTORS
EDUCATION & CULTURE	Quality education; includes initial education, schools and colleges, training, re-schooling, higher education, among others.
	Creative industry; cinema, theatre, festivals, music, architecture, heritage, among others.
	Sustainable tourism; eco-efficient hotels, transport, community tourism, cultural exchange, among others.

DEVELOPMENT AND SOCIAL INCLUSION	Cities and habitats; social and sustainable housing projects, urban renewal, electric transport, public infrastructure, among others.
	Social inclusion; social reinsertion projects, migrations, overcoming poverty, among others.
	Health and quality of life; health and wellness centres, sports, outdoor life, among others.
ENVIRONMENT AND PRODUCTION	Food systems; ecological agriculture, peasant family farming, sustainable packaging, neighbourhood businesses, among others.
	Renewable energy; energy efficiency at household and industrial levels, energy poverty, community and distributed energy, among others.
	Sustainable production; circular economy, fashion industry, local or indigenous production, conservation, among others.

Products and services to SME's in the sector of real economy willing to have tailor-made support for their businesses:

⇒ The First Digital Bank for Business
⇒ Overdraft for Liquidity
⇒ Discounting of Bills of Exchange
⇒ Bank Guarantee
⇒ Payment Services
⇒ Access to Eu Programmes
⇒ Tailor-made Services
⇒ Loans

3. FINTECH COMPANIES - with aim to launch their services with a bank who understands technology and is able to support them with required regulatory services

⇒ Sepa And Swift Transfers
⇒ AML
⇒ Compliance
⇒ Reporting
⇒ Open API

⇒ Cloud Infrastructure
⇒ Blockchain Support

4. FINANCIAL INSTITUTIONS - active in the field of impact investment willing to have products and services which will increase efficiency and profitability of their operations

⇒ Access to Funds
⇒ Lower Transaction Costs
⇒ Digitalisation of Services
⇒ Fx Hedging
⇒ Eu Wide Operations
⇒ Access to Eu Financial Instruments
⇒ Impact Measurement
⇒ Risk Mitigation

9. Case studies

9.1. Disease research foundation

Disease research foundation is collecting funds from citizens and institutional donors to invest in the scientific research aiming to find a cure for that particular disease. Foundation supports research at its earliest stage which poses the highest risk for investors. However, a certain number of supported research activities lead to cures and medicines that have prospect of becoming commercially viable products. In that stage, usually big pharmaceutical companies become interested to invest and take over research either by direct investment, either through associated VC funds. Often this involvement of VC funds and pharma companies lead to rapid commercialization of the product, but not necessarily with the geographic and price availability initially desired by disease research foundation, diminishing effectiveness of their initial investment.

European Ethical Bank will be willing to partner together with disease research foundation to create specialized credit line able to finance companies coming to pre-market or early market phase in order to support them financially in positioning themselves on the market without pressure of the highest possible short-term profitability, improving their geographic and price availability to increase social impact of their business.

This credit line will have tailor-made risk assessment model in line with business demands and regulator requirements but with deeper than usual understanding of the specifics of medical/pharmaceutical research business.

9.2. Real-time clearing Fintech

Fintech company is making blockchain based real-time clearing solution for financial institutions. The company needs references and compliance expertise in order to scale-up its business. European Ethical Bank decides to partner with Fintech company to improve its IT infrastructure and to become corresponding bank and offer real-time clearing services to other financial entities of social and impact economy worldwide. With its mutual real-time multi-currency clearing system, European Ethical Bank will improve capabilities of other banks to manage their FX and capital positions, reduce transaction costs and offer better services to its clients. Fintech company will get required references and support enabling them to come to the market more quickly and develop their product in real-world conditions. European Ethical Bank will through such partnerships gain access to the most advanced and innovative Fintech solutions, enabling it to continuously improve its operations, efficiency and introduce new services for its customers.

9.3. Local business cooperative

A cooperative in an EU member state country has larger number of business members who have various financial needs. Cooperative has different tools and mechanisms on its disposal to identify financial needs of its members, to support them in structuring their business plans and documents required for financing and to monitor their business and execution of the projects. A cooperative joins SCE in order to become a shared owner of European Ethical Bank and to develop financial instruments suitable for the need of cooperative members.

A cooperative is getting access to new powerful financial instrument for their members and European Ethical Bank is getting ability to create a prudent credit portfolio in geographic location covered by cooperative activities.

European Ethical Bank, its management and operational structures are autonomously assessing all requests and credit applications received in line with regulations and deciding about approval or disapproval of the request. Members of the cooperative have no direct influence of any kind on the operations of the bank since cooperatives work on the 1 member = 1 vote principle regardless of the invested capital. Also, the bank will follow all regulations on the identification and proper monitoring of concentration risk and risk of connected entities.

9.4. Microfinance organisation

Microfinance organisation is supporting financial inclusion through issuing of unsecured loans of small amounts to people who usually do not have access to traditional banking services. Statistics show that non-performing-loan (NPL) ratio of microfinance portfolio usually outperforms NPL ratios of traditional secured loan portfolios. Nevertheless, microloans are still considered to be high-risk product contrary to the extensive statistical evidence. This means that traditional risk assessment methodologies are not able to accurately predict risk of microloans requiring more work on the identification and standardisation of non-classic collaterals related to the process of microfinance and implementation of those collaterals in the risk assessment procedures of financial institutions through compliant and evidence-based procedure. Work on those methodologies will significantly reduce the price of capital for many microlending institutions.

The other problem for microfinance institutions is high transaction cost which makes their loans unnecessarily expensive. Support of Fintech powered banking institution with mobile applications, electronic wallets and loan assessment, disbursement and monitoring tools can dramatically reduce transaction costs for many microfinance institutions.

European Ethical Bank will work with interested microfinance institutions and their associations on the development of joint tools and tailor-made financial instruments on reduction of capital and transactional costs of microfinance.

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10. IT infrastructure

Modern banking is facing a challenge in the form of a very agile and customer-centric market, in the constant demand for new, faster services focused on the financial space experience. Banks are often forced to enter into expensive and time-consuming projects that ultimately cannot properly address what the market requires.

Modern architecture, cloud ready, microservice-based design with open API interfaces and combination of relational and non-relational databases can dramatically reduce costs, improve operations and create quick modifications of banking services in accordance with market needs.

IT infrastructure will support the following key features:

- Use of cloud-based modern infrastructure with distributed ledger
- Fully AML compliant digital onboarding
- Flexible assembly of financial contracts in credit application
- Integrated KPI monitoring for loans
- Proactive risk mitigation through predictions of future cashflows
- Application layer designed as a set of modular micro services
- Open API, compliant with PSD2
- Maximum viable automatisation to support human decision-making
- Near real-time financial overview of individual entities, portfolios and the entire system
- Automated credit scoring with regard to more than financial history and available collateral.

Using existing CORE banking systems and channels, in most cases, it is not processually different from traditional banking processes, which makes it incompatible with market needs.

On the other hand, the introduction of new services and services to existing systems is very often a project of size and complexity too complex due to the large number of dependent systems parts and the inability to upgrade existing systems.

Customers are slowly turning to agile digital banks and Fintech startups that are increasingly customer-friendly, as they are tailored to the modern consumer with their innovative approach and services, and are increasingly likely to become the standard of banking.

Software solution is a multilayer application with a thin client. The client is a Web browser (Google Chrome, Safari, Mozilla Firefox, Internet Explorer...). A very large percentage of the functionality is parameterized so that it can be customized without coding or with very few changes to the application code. If there is a need for a major change, it is possible to add functionality in all layers.

Digital banking solution is powered by blockchain technology, with the aim of providing traditional banks and new banks with an easy solution to enter the digital banking world while reaping the benefits of blockchain and AI technology. Security, data integrity and immutability of the data are made possible by the implementation of a private blockchain based on the Ethereum platform. We can also use the public Blockchain Ethereum network to send and share data.

10.1. Core banking on the blockchain

The immutability, irreversibility and data integrity of the blockchain are the main pillars of the basic legacy that comes from banking. For this reason, our solution uses blockchain and smart contract technologies in its core segment: General Ledger, Client Parenting, and Security for Authentication and Authorization for Mobile Clients. Every transaction that is made remains recorded in the blockchain (private blockchain), making it arguably secure, auditive and private.

The system uses a private blockchain based on the Proof-of-Authority algorithm that enables fast transactions through a consensus mechanism based on identity as a stake. The private chain is based on Geth's implementation of Go Ethereum.

IT software offers a unique feature of the blockchain based authentication mechanism. Combining the security of a private blockchain with wallets like the features of generating a private key and creating an address. This way, each user will have a unique address and private key associated with their user ID, with a simple redistribution mechanism, without compromising security (nothing will be stored against the background of the system).

Automated microloans are based on an internal scoring index. Microloans and overdrafts will be automatically secured through interaction with an artificial intelligence powered chatbot, which will offer the best end-user solution, based on credit scores and purchasing habits recorded in the system. With this module, each system user will be offered a fast and convenient micro-credit, with just a few steps within the mobile application.

The mobile application supports wallet (ERC-20) which will allow the end user to have all their financial assets in one application. The wallet itself will support all ERC-20 based tags, existing and custom. ERC20 is an official protocol for proposing improvements to the Ethereum (ETH) network and can be understood as a standard for tokens that are created on the Ethereum blockchain. For example, many ICO tokens are ERC20 tokens.

Customers will also be entitled to a personalized private banking service. Accepting the challenges of modern life, this service can be easily offered through a mobile platform, using features such as video calling, live chat and automated financial tools.

The Private Banking Module will include a platform of tools to provide top end advisory services. The mobile application will have a portfolio management platform and the administration interface will have a client portfolio advisory module.

IT infrastructure is planned to be physically located in Croatia (in DataCross data centre) on the infrastructure certified with BASEL II, ISO27001 and Solvency II standards as well as with NATO security certification.

10.2. Platforms

Banking solution supports a wide range of platforms from which we recommend:

- Operating Systems - Linux RHEL, AIX, HP-UX
- Databases - PostGreSQL,
- Application Servers - RedHat JBoss

10.3. Financial management

Each individual financial change in the business system is recorded in a transaction record, which consists of a unique transaction reference, reservation date, currency date and identification data, or global application circles that tell us where, when and by whom the transaction was made. A booking date is the time of processing of transactions within a financial institution when the transaction ends in the general ledger and according to which it ends within a specified reporting period.

Currency Date is the preferred transaction execution date that is further used to recognize exchange rates and interest rates, if any. According to double-entry rules, a financial change consists of two or more financial movements that may be debited or credited to a client's account and must be in balance at the level of the transaction in local currency on the day of the currency. In addition to the amount of debt and credit, each financial movement consists of a client account, a bookkeeping account, and a currency. At the end of the day or at the beginning of the next, all posted transactions are marked with a special general ledger flag and from that moment forward are part of the ready-to-report transactions.

Deleting or updating existing ledger records is not possible, since it is implemented on Blockchain technology. It is possible to cancel or add new general ledger entries until the closing date of the general ledger regulated by the accounting department.

11. Analysis of establishing of a bank in Lithuania

Advantages and Challenges of establishing a specialized bank European Ethical Bank in Lithuania according to European Cooperative Society (**SCE**) model.

ADVANTAGES	CHALLENGES
All operational funds/assets are invested in an SCE co-owned by all partners. In this way the partners have complete control over the invested funds	Human Resources - Find experienced banking industry staff who are willing to join in an uncertain environment.
Lower threshold for raising bank capital (1M EUR)	Raise significantly more capital than the legal minimum of +5M EUR
A very clear and transparent way to raise capital for a bank	Will we raise the required capital for a bank from all partners
A very clear and transparent way to raise operational funds for an SCE business	Will we raise enough operational funds for the SCE business
Specialised Bank can provide all traditional banking services: • Lending (including credit agreements relating to immovable property); • Payment services; • Issuing and administering travellers‘ cheques, a bankers‘ drafts and other means of payment; • Receipt of deposits and other repayable funds; • Currency exchange; • Issuing of e-money; • Issuing guarantees and commitments; • Fund administration; • Financial leasing; • Financial intermediation; • Creditworthiness assessment services;	Specialised Bank is restricted: • to provide investment services; • manage investment and pension funds; • provide other services related to securities issue. This disadvantage can be dissolved by registering separate Brokerage and Investment Management company or getting full-service Bank license.

• Safe-deposit box rental.	
Direct penetration into the EU market. Once licensed within the EU, each partner has access to all EU markets. Direct access to Single Euro Payments Area (SEPA) and EU/EEA financial markets	
Collaborative and forward thinking regulator – enhanced focus on FinTech.	
Client deposits up to the amount of EUR 100 000 ensured according to EU regulation	
Licensing documentation can be submitted in English and amended “on the go”	
Fast licensing process. Issue of the license within period of 6 months	
No regulatory sanctions for the first year of operations for minor infringements - „Sand box“ regime.	
4th lowest corporate income tax in EU	

12. List of people

Several esteemed professionals have expressed their willingness to participate in the project by signing the Declaration of Availability in capacity yet to be defined.

Fabio Salviato is a founding member of Banca Popolare Etica, the first ethical bank in Italy, of which he has been the Chairman from the constitution in 1998 until May 2010, and founding member of Consorzio Etimos, a financial consortium that supports micro entrepreneurs and microfinance programmes in the South of the world. He has been Chairman of FEBEA (European Federation of Ethical and Alternative Banks and Financiers) from 2001 to 2017 and he is currently General Manager of SEFEA (European Company of Ethical and Alternative Finance).

Włodzimierz Grudziński is the Chairman of the Supervisory Board of TISE S.A. and member of the FEBEA Council (European Federation of Ethical and Alternative Banks and Financiers). He is also an advisor to the Management Board of the Polish Bank Association (ZBP) and member of the association's Ethic Committee. Between 1990 and 2007, he was CEO of Bank for Socio-Economic Initiatives S.A. and, as of 1997, Member of the Board of the Association of Polish Banks before becoming its Deputy Chairman in 2001. He has been a member of several Supervisory Boards such as First Mutual Insurance Company in Poland TUW and Ineco bank in Armenia. He is also a member of the Council of the Junior Achievement Foundation and a member of the Financial Committee of the Auschwitz-Birkenau Foundation.

Gabor Pozsonyi former CEO and present board member of Hungarian Magnet bank who is currently involved in the creation of continent-wide ethical bank in South America. (TBC[6])

Jef Tavernier graduated in 1973 as Master in Economics at the University of Ghent. In 1977 he graduated as Master in Town and Country Planning at the same University. During eighteen years he teached economics in a secondary school. After this period he became professional politician and was successively member of the Belgian Senate, member of the Belgian House of Respresentatives, Federal Minister of Public Health, Flemish Minister of Environment, Agriculture and Cooperation and Development, and member of the Flemish Parliament. He was from September 2009 to the end of 2013 Secretary-General of FEBEA (European Federation of Ethical and Alternative Banks). He is involved in the project for higher vocational education (HBO5) and lecturer 'social economy' for Erasmus-students at VIVES (University college in Kortrijk, Belgium), and chairman of the Ghent school for basic-education (school for adults). He is independent consultant and independent evaluator. Co-author of 'The atlas of good practices in the creation of employment trough social inclusion'

Goran Jeras is currently working as a Chief Strategy Officer at Cooperative for Ethical Financing in Croatia - an organisation that is initiator and inaugurator of European Ethical Bank project.

[6] To Be Clarify

After studying physics in Zagreb, Goran moved to The Netherlands and started working as a consultant for large financial institutions. Challenged by the behaviour and failure of commercial banks and economic system to ensure fair distribution of wealth, sustainable development and meet justly the needs of the people, he started in 2010 research and development of alternative financial and business models for local communities based on the principles of economic democracy, trust, collaboration, solidarity, protection of commons and sustainable use of resources. In 2013 he moved back to Croatia and together with a team of experts from various fields started the process of creation of an ethical bank based on innovative scalable and replicable open-source platform, aiming to become financial backbone of the solidarity economy and sustainable development in Europe. From 2015-2018, Goran was member of GECES (EC Expert Group on Social Entrepreneurship) and since 2016 Fellow of German Marshall Fund of the United States. In 2014 Goran was elected to be the first Cooperative Manager of the Cooperative for Ethical Financing after its foundation. Goran also works as an international consultant on topics of ethical banking, impact finance and digitalization strategies in finance. He has given over 100 speeches and presentations on professional conferences and events around the globe.

13. List of partners

Here are the list of the partners who have expressed keen interest in the partnership for the establishment of a European Cooperative Society (SCE), whose main objective is to set up a specialised bank in Lithuania:

EVPA - The European Venture Philanthropy Association is a lively community of organisations sharing the same vision and a common goal: creating positive societal impact through venture philanthropy. Since their launch in 2004, they have been building a community of organisations interested in or practising venture philanthropy (VP) and social investment (SI) across Europe. EVPA is a broad and diverse community. Their membership covers a full range of venture philanthropy and social investment activities including venture philanthropy funds, social investors, grantmaking foundations, impact investing funds, private equity firms, professional service firms, philanthropy advisors, banks and business schools. EVPA's community continues to grow, with an increase in membership of over 50% in the past five years alone. Currently, they have more than 275 members from over 30 countries, mainly in Europe, but also in the United States, the Middle East and Asia.

ZEF - Cooperative for Ethical Financing is an organization with over 1000 members, organizations and individuals, working together to develop a democratic, transparent, just and socially and environmentally responsible economy. The main mission is to establish a bank, together with partners, that would work on the principles of ethical banking as defined by the Federation of European Ethical and Alternative Banks. The members of the cooperative are also the co-owners of its assets and they democratically decide on all key issues regarding the cooperative and elect members of the governing bodies of the cooperative.

Bank of the Commons - is a cooperative banking service whose aim is to support alternative economy projects and social movements on both a global and a local level. "Our goal is to move towards a new societal structure by adopting FairCoin, a cryptocurrency using innovative and green blockchain technology, which can serve as a global social currency upon which to develop and implement decentralized financial structures for the Commons".

SEFEA Consulting - it is a consulting and technical assistance company operating in the social economy and ethical finance sectors. SEFEA Consulting was born to take advantage of the experience gained by SEFEA HOLDING SC through its financial activity and making it available to actors who intend to move closer to the world of the social economy and ethical finance. SEFEA Consulting's services include:

PARTICIPATION IN PROJECT PROPOSALS: SEFEA Consulting is available as a technical partner for calls for proposals where financial expertise specific to the social economy is necessary, taking care of the project design, creation of international partnerships through its network, implementation of project activities, partners co-ordination, relations with the European institutions.

TECHNICAL ASSISTANCE: SEFEA Consulting offers operational support to entities that need skills transfer or implementation of specific activities in the area of the social economy and ethical finance, benefiting from its international network, providing innovative models and solutions.

FINANCIAL ADVICE: SEFEA Consulting offers support in the analysis and preparation of financial plans for the development of the company's activities, proposing the most appropriate financial instruments.

Associació per la nova CAIXA CATALANA, Cooperativa de Crèdit - Caixa Catalana is a platform that aims to set up the foundations for the creation of credit institution for this popular local cooperative. It is linked to the work of grassroots civic associations and is a managed following democratic and transparent rule of commitment to the region and solidarity. They are an independent non-profit association devoted to this project. Promoters include small business managers, former workers of savings banks, high level academics and citizens who believe in the project. They intend to follow the commercial banking model, based on collecting money from savers via deposits and current accounts and giving loans to the most vulnerable sectors of society and to those interested in enhancing for modernization of the country.

Kolektyvinio vystymo paramos fondas - Organization “Kolektyvinio vystymo paramos fondas” was established in 2018 with a goal to introduce alternative housing provision models in Lithuania. Rationale behind the establishment of such models:

- Balancing real estate market, reducing speculation and price inflation
- Making housing more affordable for middle class families
- Creating an alternative for sub-urban villas
- Helping to tackle increasing segregation by income in Lithuanian cities
- Creating conditions for green technologies to be applied in the construction sector and promoting green lifestyles
- Making planning and construction process more inclusive
- Contributing to sleeping district diversifi cation strategy.

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14. Timeline and budget

We are looking for partners who are committed together with ZEF to run process of setting up SCE and acquiring specialized banking license from Bank of Lithuania. Therefore, we are hoping to expect your feedback in accordance with the following timeline:

Action	Date	Comment
Initial meeting with BoL[7]	3rd October 2019	The meeting was very successful. A new meeting with founding partners is planned.
Non-binding LOI from partners	25th December 2019	For co-founders that will be included in project immediately
Kick-off & prep meetings of all partners	Q1 2020	First kick-off meeting in January, and after that - ongoing through Q1. In addition to physical meetings, video meetings will also take place when needed.
Binding decision to participate in SCE and commitment to participate in budgeted costs	End Q1 2020	Confirmation by decision-making bodies of partners
SCE establishment	April 2020	The European Cooperative Society will be set up in April

[7] Bank of Lithuania

Structure of costs for investment needed for operational purposes are[8]:

Activity	Estimated budget
Initial business plan preparation & GAP analysis	100.000 EUR
Development/translation of documentation	200.000 EUR
Software development	700.000 EUR
IT infrastructure	100.000 EUR
Legal services	100.000 EUR
HQ office & employees (5 FTE[9], 1-year, prelaunch phase)	350.000 EUR
Travel & accomodation costs estimate	50.000 EUR
Lead partner (coordination and 3 FTE, 1 year)	150.000 EUR
Other costs (SWIFT, card processor,...)	200.000 EUR
Total	1.950.000 EUR

The total paid, running and remaining costs for completing the above steps, continuing the engagement of experts in each area, administrative and translation services are expected to amount up to approximately € 2M.

[8] A detailed budget will be worked out with partners in another iteration

[9] FTE - Full time employee

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Structure of operational cost

Overall operational cost estimate	**€ 2M**
Cost contribution estimate per partner [10]	up to € 400k

The advantage of cooperative model is the possibility to share those costs among cooperative members i.e. partners in the project of European cooperative bank for social good. In order to follow cooperative principles and distribute costs evenly, all partners will participate with the same amount in the cost distribution.

Structure of share capital

Overall share capital requirement	**€ 5M+**
Share capital requirement per partner	€ 1M

The key feature of a specialized bank is the minimum capital requirement of € 1 million, while for a traditional bank it is EUR 5 million. However, a bank's operations require a much higher capital investment. According to Council Regulation (EC) No 1435/2003 on the Statute for a European Cooperative Society (SCE), a minimum of 5 or more natural persons or 2 or more legal entities, or a combination of 5 or more natural persons and legal entities is required to establish SCE. However, we believe that minimum of 5 partners is needed in order to run european operations of the bank. Therefore, the target for raising capital is a minimum of € 5 million, which would be € 1 million per member.

[10] Dependent on the number of partners in SCE, more partners, lower cost contribution per partner