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THE NON-RESIDENT IMAGE IS CHANGING

A modern investment strategy is changing the audience for non-resident services, says Ilona Guļčaka, Chair of the Board at Baltic International Bank.

I would assume that your new environmental, social and corporate governance (ESG) strategy was not adopted in just a few months. Why have you done this?
We began planning it at the end of 2015, and it is a shift in the focus of our operations until now. Our speciality is customised customer service, and investments are becoming increasingly important in this area. Therefore, we are also thinking of how to focus more attention on investments and consequently – what types of investments, so as to provide our customers with appealing solutions.
At the same time, we want to have a speciality without spreading out into several areas at once. That is why we chose the ESG approach, where “E” stands for the environmental, “S” is social aspects and “G” is governance, which is the managerial aspect, the practice of good governance.

I think in Latvia the “G”, meaning stricter governance of non-resident services, would be completely sufficient for your public image, because even the most socially oriented activists reproach non-resident service providers only for problems with this aspect. Does this mean that you are doing more than is currently expected of you, and why are you doing it?
We want to do more. If we look at how banks in general are changing today, we see that practically everyone is changing their business models. We used to just have banking services with a personalised touch, but this is the next step – a step in investment services.
Furthermore, we cannot only look at the “G” factor alone, although it is important. Governance means not only stricter regulation, but also transparency and openness, and we are doing this so that people can see and believe not only our words, but also the facts. The “E” and “S” factors also play an immense role in modern investments.
Normally with investments you assess the risks and take a decision. ESG allows us to include more factors in the assessment and thus provide our customers with what is called “alpha” in investments – more precise and higher return on investment against the risks. Of course, this is a long-term approach with a view to the future, and it is better to do it now and all at once to achieve better efficiency and profitability in future.

What does the ESG strategy mainly mean for you – future risk management or taking advantage of opportunities?

Both, because where there is risk, there are also opportunities. I want to emphasise that ESG is not only about environmental investments aimed at renewable energy, however, in the first years of the new strategy, to gain some momentum, we have selected investments in renewable energy as our focus – wind, solar power, cogeneration and geothermal power. Last year the majority (55%) of newly established power capacity was based in renewable resources. USD 283 billion were invested in these projects last year. Another significant point of reference last year pushing us to focus on this area was the UN Paris climate change agreement. The market for green or environmental project bonds grew significantly in 2016, reaching USD 83 billion, and it is expected to increase up to USD 130 billion this year.

We definitely see a place for ourselves within this trend, including the fact that investors are becoming increasingly more responsible towards what their money is actually doing. Therefore, the Baltic International Bank strategy is that we don't just invest funds, but do so with a view to the future.

So what you are saying is that demand for such a concept is coming from the customer side?

We see it in the market in general and we are communicating with our customers about it. Not all of them have embraced this concept yet, however some have already taken the initiative even before our offer came and invested in, for example, wind turbines and solar parks. However, for some this approach is still very far-fetched. And this is also our role as a bank – to explain and sometimes even educate our customers.

When you talk about investments – to what extent does that mean Latvia and the Baltics?

It includes Latvia and the Baltics, but this is a very limited market. Here, regionally, we are mostly looking at cogeneration projects as this market is well-developed here. Wind parks in Latvia are politically sensitive, while solar parks are not that popular, even though the level of solar radiation here is the same as in Germany, where this area is very well-developed. Although, it is true that it was heavily subsidised.

And that has basically destroyed the solar park industry in Germany.

I agree, however, in general, the price of solar panels has significantly decreased, while their efficiency has grown, and in the USA efficiency has reached a level where subsidies are no longer necessary.

In a previous publication (DB 23.02.) we wrote that over there solar power is already competing with natural gas.

And the same will happen in Europe. If not this year, then definitely next year.

The Baltics is, of course, our home market, which we look at for lending, as well as investment projects, but we also look at Europe, because our customers seek stable projects, and Europe is and will continue to be a stable market. For renewable resources – Germany, for solar power – it could be Italy and the UK. At the moment, these are the markets where we see our expertise. Of course, this expertise has to be worked up to.

How have you become experts in investments in solar power in Europe?

We analysed the Baltic market ourselves, but in Europe we of course have partners – long-standing and well-known investment consultant firms. Such partnerships have already been established, and consequently our competence is expanding. We have assessed and worked on these partnerships for a long time.

What is your target audience?

We are a bank focused on international customers. Traditionally, these have been customers from CIS countries, but over the past couple of years the number of our European customers has significantly increased. At the DB conference on financial prospects, it was interesting to hear European Commissioner Valdis Dombrovskis say that only 7% of Europeans have opened accounts in other countries. But the goal of the EU is to make cross-border financial platforms ever more interesting for the inhabitants, so that any EU inhabitant can easily open an account in another country.

This is an important trend – that Europeans are becoming more diversified in their choice of banking services and they are choosing services not only in their country of residence, and we definitely want to take advantage of this as well. I think that the Latvian banking system is very advanced in terms of technologies, as well as services offered, and with our strategy we want to reach not only our traditional CIS customers, but also

European customers. And, at the moment, the ESG topic is even dearer to European customers, than our previous main customer audience.
We are talking with partners who offer their customers services of several banks. This is the so-called family office, and this is an opportunity for us with our specific niche offer. We are not aiming for all of the money of their customers, but rather a part of it and targeted investments. Our offer is still personalised customer service, which has already been exhausted in parts of Europe, but that is because they don't always provide an actually personalised approach. These customers can hold their traditional investment portfolios in one bank, while trying out alternative options here. In the end, their cumulative investment portfolio could become more profitable, with a broader diversification of risk.

But how will you raise your competence to such a level that, say, an Austrian will invest in Italy through you, here in Riga, instead of doing it directly next door?
Only the quality of service and time will prove it. Of course, we are trying to improve our expertise through the partnerships I already mentioned, because these partners have already made a name for themselves in the industry. But it will just take time and achievements, which we will accumulate.

In essence, you are saying that you cannot not do this?
Yes, I believe it has to be done.

You, the bank and investor, cannot not be responsible?
Yes, you cannot not be responsible. We look at ESG not only as an approach to investments and lending, but in principle we also try to apply it to routine banking operations – to save resources, participate in social projects, support art and culture. We believe that if we have money, we are responsible for what we do with this money by investing it, as well as by using it in day-to-day operations.
It was also a major education process for the staff to explain why we have chosen the ESG approach, and some people were very sceptical: what – we're now going to be all green? But ESG isn't just about being green, it is a completely different approach to everything you do. I agree – it is a responsibility approach.

Geoffrey Mazullo, Head of the NASDAQ Baltic Market Awards, has also said (DB 02.02.) that regardless of his personal ethics, ESG is simply a direction where "money is going" and from where it will obviously return with profit.
Exactly. And even if we assess that we can continue investing just as we have done so far and gain the same result as by investing according to ESG standards, then why not do that which not only brings profit – and most probably even a higher profit, but is also good for the environment and society? This way we will leave our children a better place to live. Why not do better? Especially if it's also profitable.
At first, some employees were very sceptical that this initiative would either have zero returns or even bring loses. But reality has proven the opposite.

You are, in effect, talking about European investments back into Europe through Baltic International Bank. But aren't Europeans traditionally more interested in your competence in the other direction – towards the East and Central Asia?
Our current European customers are also interested in our current customer portfolio and business contact opportunities, because they want to move their business in that direction, but so far these markets are hard to understand for them. But with time, seeing our abilities, our customers start recommending us to their business partners, whose interests go beyond the Eastern markets.
People are becoming more open, and they want and, with such opportunities provided, they can use banking services within other systems.
Of course, Latvia still has a lot to do to improve its reputation. But I am glad that at the moment the industry holds a consolidated opinion on future development, and the current Financial Sector Development Plan is truly aimed at development, not just regulation and restriction. It is a real dialogue, and it's not only among banks, but also between banks and fintech companies and other players in the finance industry.
It is very good that the new management of the Association of Latvian Commercial Banks is very learned and future- and development-oriented. Overall, this is an interesting and hopeful time for the banking industry in

Latvia. If you were to ask me about it a couple of years ago or even just a year and a half ago, I would have been more pessimistic.

I agree – things felt much dimmer then.
Yes, but today there are many initiatives and ideas. I think that we, in Latvia, have found our banking system's strengths, which we can demonstrate and offer elsewhere.

Should the number of banks in Latvia be reduced?
Yes, but that is the case not just in Latvia. It's the same all over the world, and consolidation will most probably continue. Considering the news coming from various directions, this too will be a year of change for banks, but on a more positive note. It is and will be change aimed at future plans and challenges, not subversion. More strategic, rather than tactical changes.

You have experience in Central Asia, including bad experience with expropriated assets in Kirgizstan. Central Asia is one of Latvia's foreign policy objectives – that here lies our competence and we are an intermediary between Europe, the West and these countries and markets. What is your opinion of these markets?
It is a very interesting market – Azerbaijan, Kazakhstan and Uzbekistan. But it also has its own set of rules on how business is done and how they are used to working. Of course, we have customers from these countries, but there you have to carefully look at how they work, and we cannot take on just anyone, especially now with the heightened regulatory requirements.
Therefore, I don't think that this market has great growth potential, but if customers from these countries will be able to fulfil all the regulatory requirements that we have as a European bank, then it can be a good, interesting and potential market, which we understand. We also understand the risks there, and those arise from their business traditions. Therefore, the bank needs a specialist who can understand what and why a potential customer is doing in those markets, as well as explain our requirements and assess whether we can take this business on as a customer or not.
And it's not always because there's something dirty going on. Sometimes we may understand why certain things are being done, but it cannot always be backed up with documents sufficiently to comply with regulations.
Our strategy is compliance with regulations and screening potential customers from the outset. It is no longer the case – oh, look, customers! Take them all and then sort through them. No, the sorting has to be done from the very beginning – who is doing what and how is it documented. Bankers have to know and assess all risks that a potential customer can bring to the bank, and compliance with regulations is the next logical step.

Customer selection is clear. But are you looking in that direction with investments as well?
No, not right now. We are looking at Europe and the Baltics. We used to have investments in Ukraine, but we decided not to increase our risk exposure to those countries. The recent International Bank of Azerbaijan (IBAR) failure to fulfil its international loan commitments is an example. It is the biggest bank, and basically state-owned. That shows the level of risk.

Could this have been forecasted and calculated into the risks?
We have no investments in IBAR, but as regards forecasting this risk – I don't think it was possible, investors in this bank could not have forecasted this happening. But our balance sheet is very conservative, and we will definitely not invest in markets with risks such as these. Of course, customers can individually prefer and chose to do so, but then it is asset management outside of our own balance sheet. If someone is willing to take the risk, we cannot stand in their way, but we always give a word of warning.

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