All-member event blog

Navigating systemic risks – how to build a stable economic future

By Constance Johnson

Pensions for Purpose hosted an all-member discussion with experts to explore the need for a stable, sustainable economic system. The conversation highlighted the limitations of ESG, the vulnerabilities of pension funds to systemic risks, and how system change investing and stewardship can help drive meaningful outcomes

In a time of increasing environmental, social and economic uncertainty, investors are grappling with the challenge of securing long-term financial stability while addressing systemic risks. Traditional approaches to responsible investment have struggled to bring change, raising questions about how economic structures must evolve to support a sustainable future.

Richard Giles, Senior Director & Community Lead at *Pensions for Purpose*, invited the *University of Cambridge Institute for Sustainability Leadership (CISL)*, *Social Value International*, *System Change Investing* and *Willis Towers Watson* to discuss the urgent need for a stable, sustainable economic system that aligns with future investment objectives.

The structural challenge

Our economic, political, and cultural systems contain flaws that incentivise environmental and social harm. Externalities like clean air, water, fertile soil and a stable climate remain largely unvalued in financial calculations, yet they are essential for life and prosperity.

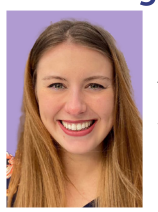
The shortcomings of ESG

Many argue the environment, social and governance (ESG) framework has not delivered, necessitating a shift from well-intended investments to actively driving systemic change. The tension between short-term profits and long-term sustainability persists, requiring investors to balance immediate returns with lasting impact. Public-private collaboration is crucial to achieving systemic transformation.

The vulnerability of pension funds

Pension funds face unique exposure to systemic risks due to their long-term commitments. Trustees must safeguard financial security for decades, with the financial well-being of retirees in 2055 relying on decisions made today. They are among the few actors with responsibility and capital to drive systemic change.

Defining systemic risk



Elizabeth Clark, Head of *CISL's* Investment Leaders Group, described systemic risk as the potential breakdown of an entire system, leading to cascading economic effects. Given the interconnected nature of global economies, disruptions in one sector can significantly impact others. Examples include the 2008 financial crisis and climate-related disruptions.

Elizabeth emphasised that systemic risk is not an isolated issue but requires a coordinated response from economic and government actors. She discussed *CISL's* paper 'Survival of the fittest: from ESG to competitive sustainability', authored by CEO Lindsay Hooper, which critiques the current ESG framework as inadequate. The paper calls for a shift to competitive sustainability, where businesses are incentivised to integrate sustainability into their core operations. For this to happen effectively, policy must design out the conflict between long-term sustainability and short-term commerciality, supported by critical engagement

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between public and private sectors.

System change investing as a solution

Frank Dixon, Founder of *System Change Investing (SCI)*, presented SCI as a method for financial organisations to address systemic risks effectively. He argued that many environmental and social challenges stem from flaws in economic and political systems rather than corporate actions alone. System change investing directs investments toward leaders driving systemic solutions rather than merely addressing symptoms.

Current responsible investing approaches have failed to resolve SDG issues, mainly because they focus on changing companies instead of the systems that largely control corporate behaviour. System change investing expands the focus of responsible investing to include system change and addressing root causes. The approach reduces investment risk and provides competitive short-term and long-term returns by identifying well-managed companies and strongly incentivising the system changes needed to protect investors, business and society.

Fiduciary duty & systemic stewardship

Roger Urwin, Global Head of Investment Content at *Willis Towers Watson* and Co-founder of the *Thinking Ahead Institute*, argued traditional definitions of fiduciary duty are too narrow and outdated. He advocated for a more flexible fiduciary framework that enables pension funds to engage in systemic stewardship and address broader societal impacts rather than focusing solely on short-term financial returns. Regulatory adjustments may be required to facilitate a more holistic approach to risk management.

Accounting standards

Jeremy Nicholls, Accountant and Adviser at *Social Value International* highlighted how accounting standards shape perceptions of systemic risk. Conventional accounting fails to capture many non-financial costs, such as environmental and social impacts, leading to a distorted view of profitability and risk. Directors should disclose these costs to provide investors with a clearer understanding of associated risks. The requirement for accounts to give a 'true and fair' view means directors can consider disclosure of these costs which would give investors a better understanding of those risks.

Takeaways from the discussion

- Systemic risk and system change should be priorities for pension funds but are not yet standard practice.
- The industry must improve systemic risk framing, measurement and mitigation strategies.
- Systemic stewardship requires longer time horizons, balancing short- and long-term measures.
- Backtracking on sustainability in some regions threatens pensions, necessitating financial and corporate sector leadership in system reforms.

For further discussion, please contact Richard Giles.

Watch the video of the event

Constance Johnson is an Intern at Pensions for Purpose

Help for asset owners

Pensions for Purpose **offers bespoke training for trustees and pension committee members. Our Knowledge Centre contains hundreds of articles on our strategic themes – System & Governance Change, Impact Integration, Place Lens, People Value, Climate Innovation, Biodiversity & Natural Capital.**

Feedback from the audience

What are the most pressing systemic changes needed and what practical steps should long-term investors take?

Group one
moderated by Claire Jones, *LCP*

- Investment professionals are often evaluated based on short-term benchmarks. New success measures, such as red-amber-green ratings, could assess systemic stewardship outcomes.
- A 'total portfolio approach' was proposed for strategic asset allocation, integrating uncertainty and long-term goals.
- Greater emphasis on financial materiality is needed. Emerging data on sustainability, such as climate change impacts, should inform investment decisions.

How feasible is it to deploy pension fund assets to tackle system change problems?

Group two
moderated by Harry Gladstone, *Stewart Investors*

- Coordination with consultants is essential; asset owners should challenge them to do more.
- Measurement methods must be refined to focus on meaningful metrics.
- Collaboration and lobbying are crucial to avoid confusing governments with inconsistent messaging.

What is role should pension schemes play in addressing and mitigating systemic risks?

Group three
moderated byAbi Lee, *EY*

- Defining the role of pension schemes in systemic risk mitigation remains complex. Discussions continue among regulators, *The Pensions Regulator (TPR)*, and industry groups like the *Trustee Sustainability Working Group*.
- While universal asset owners aim to deploy capital for long-term impact, measuring impact is challenging. Trustees must be careful when using metrics, as many focus on societal outcomes rather than financial risks.
- The idea collective pension action can influence government policy was debated. Engagement is valuable, but pension funds alone may struggle to shift global regulatory landscapes, such as US accounting standards.

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