TRANSCRIPT

PENSIONS FOR PURPOSE PODCAST, SERIES 2, EPISODE 11
REWIRING FINANCE – HOW TO CHANGE FINANCIAL SYSTEMS

Laasya Shekaran: So, hello, everyone and welcome back to the Pensions for Purpose Podcast. I'm your host, Laasya Shekaran

Laasya Shekaran: Today, I'm excited to be joined by Lindsay Hooper, CEO of the Cambridge Institute for Sustainability Leadership, which – I really like when you say the acronym, it's CISL ('sizzle'). So it's pretty cool. Lindsay, welcome to the show.

Lindsay Hooper: Hi! Pleasure to be here. Thank you.

Laasya Shekaran: My Pensions for Purpose co-host for today's episode is Richard Giles. This isn't just a coincidence, as Richard's actually just completed a course on sustainable finance from CISL. So Richard, welcome to the show.

Richard Giles: Hi, Laasya. Great to be with you again, and Lindsay, great to be speaking. I had a great time on the course, and learned a lot of things and made some great connections as well.

Lindsay Hooper: Pleased to be connected, and always good to be doing podcasts with one of our most recent alum.

Laasya Shekaran: Well, today, we've got some pretty big stuff to talk about. We're going to be discussing how to change financial systems so they better support the real world around us, and protect people and the planet. Now, sustainable finance has been around for quite a while, but we still haven't really seen enough progress to address the huge systemic challenges that we face.

Laasya Shekaran: So, Lindsay, my first question to you is an easy one. Why is that, and how does systems change help us actually address this?

Lindsay Hooper: Yes, this is the big question. I suppose, the easy response is, we're not making more progress than we are, because it still remains more profitable to trash the planet, to destroy natural systems on which we depend to undermine societies. It's more profitable to do that still than it is to protect them. And while the private sector is still incentivised to deliver focus only on short-term returns; while we're not pricing in the negative social and environmental impacts; and while we still have subsidies that are propping up damaging economic activity, it's hard for the private sector to tilt capital where it's needed. So that's fundamentally the challenge: we need to shift the rules of the game so we remove the competitive disadvantage faced by those who want to take action, and we create a level playing field so that the capital can start to flow towards cleaner, greener, fairer solutions.

Laasya Shekaran: I think you're absolutely right, it's more profitable to trash the planet than to protect it. Where I often come from is, do we need to focus on making it more profitable to support the planet? Or do we just need to value the planet more than we value profits, and maybe that's two sides of the same coin? However, I'm curious on your take on that.

Lindsay Hooper: Yes, it's an interesting debate and conversation, and I think there's a lot of conversation at the moment, but what are the biggest motivators of action? Is it our sense of purpose and values? Because those can be, and are, I think, a bigger human motivator than just financial performance and value creation. However, the challenge is that even though those are human drivers, we may individually care deeply about as we do about society, or about nature, or about the future that we're building, we've created market structures that don't really pay attention to that. We've created market structures that really do only value and not values.

So, I think we have a challenge in the at a human level. We care, but the constructs we've created don't care. So, I think that's the challenge we're going to have too, as we work within market economies to change the way that markets work. I'm optimistic that when markets are designed to deliver positive outcomes for society, they can do so.
The renewables explosion uptake we've seen has been, in part, because we design market incentives. So, when we design markets to deliver outcomes, they can do so. We just haven't yet applied ourselves to do that in a whole range of other ways.

Laasya Shekaran: I think there's a
point you make there, which is we've created these market structures. We've designed them. I think when you're working in the financial and investment industry, you sometimes forget these markets haven't been around since the Big Bang, or since the dawn of time. We, as humans have created them, which means we can also change them.

Lindsay Hooper: I think you were going to come in there, were you, Richard?

Richard Giles: I am indeed. I wanted to move the conversation on to the levers for change, understanding the problem statements. If we look at the levers for change, perhaps Lindsay could comment on three perspectives: that of Government, of business and of investors. Just to get practical about what the most significant things are those three participants could be doing now?

Lindsay Hooper: It's now, I think, a decade since we launched what for us was, for many years, a foundational paper rewiring the economy. We looked at precisely those actors, and looked at what the tasks are that they each need to, or the roles they each need to play if we're going to rewire economies. So, we looked at the role of Government effectively shaping the rules of the game, but also the role that they can play through procurement. For instance, we looked at the role of capital needed to fuel the economic activity, to be tilting capital to where it's needed and away from where it's damaging, and then recognise that real economy businesses, I suppose, where the practical impact takes place and where there's a need for real innovation and action there. So we laid out 10 tasks for the three actors, and I think, broadly speaking, theoretically, those are the tasks of the actors.

What we didn't pay enough attention to, and what we're increasingly focused on is, but how? How will we get to those, you know, in an ideal world, where all of those things are happening? How do we do that in today's quite challenging and polarised context, and recognise some of the barriers or flaws we're seeing are some of the mindsets we're seeing – which I see often – are quite complacent, underestimating the scale of the consequences of inaction mindsets of saying, we just want to do our bit or do the right thing, or looking at being incrementally less bad rather than recognising quite what scale of innovation and transformation we're going to need. So, I think quite a significant mindset piece is needed there. I think there's a need also for the private sector to be using its voice to advocate for a change to the rules in the game. Governments, as it seems, are not spontaneously going to take action. They won't take action. If the private sector is broadly saying, 'this is bad for the economy, it's bad for business,' and they won't take action without a belief that citizens care and citizens want them to take action. So, I think a strategy of just sitting and waiting and hoping the Governments will step up to put in place the conditions to enable us to respond to systemic risks is really quite a risky one. So, in terms of levers for private sector, whether that's economy or investors, I think there's an important role to use their voice and influence in support of enabling action by Governments.

Then, there is work needed within the private sector, particularly in finance, to build some of the necessary financial structures, to integrate understanding of risk, and to price things into existing models. We can talk a little more about that. There's also an important piece around shaping sentiment. We did, at one point, have political consensus and positive market sentiment. Those have really both hit the buffers, and there's a real risk if everyone is just sitting quietly in the corner, or sticking to their lane, and we don't have a sense of momentum, we're not rebuilding positive sentiment and a sense that this is happening. It's already underway. There are some tough choices ahead, but we're moving forward. There's a real risk we will continue to be somewhat paralysed, or even backslide. So there's an important lever to use voice in order to rebuild confidence and positive momentum.

Richard Giles: I'm so interested in the mindset comment. I'm so pleased you said that, Lindsay. We had an event at Pensions for Purpose last week on System Change, and one of the things I took away was the importance of the stories we tell each other, or even the stories we tell ourselves, in helping to create a sustainable system, and that narrative… I sometimes wonder whether we've got that narrative quite right, and whether we need to be… There was a bit of discussion last week about creating a more positive narrative, rather than one based on fear. And I just wonder what your thoughts may be on that, too.

Lindsay Hooper: Yes, I think we've relied predominantly on fear, and in some cases shame, as motivating factors, and they can be powerful. However, people need somewhere to go to, not just feel discomfort with where we are. At the moment, we had, through what I call the 'ESG hype bubble' period, some positive sentiment and some positive hope and belief this was going to be a virtuous circle. So there was a different sentiment being tapped into there, but that obviously hit the buffers. I think we do need to do some reframing. I think we need to recognise there are lots of positives, of course, for society. Of course, it's much better if we take action, but in the near term, it can feel for many people in society. So it's an elite project. It's not the biggest priority. It's not sufficiently relevant to other political imperatives. I think we have a challenge, a need, an opportunity to better integrate and link, taking action to address these systemic risks to near-term political and social imperatives, to talk about how it's a driver of resilience and prosperity and national strength, at a time when security has really risen up the agenda, to talk about an honest overview of what the landscape around jobs and livelihoods will be, what the implications are for, and the opportunities for competitiveness in a resource and a carbon-constrained world. There will be new opportunities emerging, and new industries will emerge to respond to those constraints. So I think there's some framing and reframing needed, to not to move it from being a slightly side of desk issue to demonstrate how it's relevant, but not to overplay it. To be clear, honest and transparent.

There's also a need to be to rebuild. I was saying that sentiment, that this is already underway. The progress is already happening, and to have more stories to your point, Richard, around just using examples of projects that have worked, what's underway, not just for corporate PR at an institutional level, but as proof points to reassure society and policymakers, this isn't a theoretical thing. This is a thing that's happening. It's absolutely doable. So, some reassurance and proof points there making it visible. However, we also need to tap into and engage more, I suppose, a wider range of emotions, a sense of how does it relate to people's aspirations of the future; a sense of progress, a sense of community, something people feel they've got a stake in. Broadly, I think the big challenge is also to move this from a polarised debate of action versus inaction, to a 'we don't have a choice'. We are going to have to act. But to be honest about we. These are political choices, and society needs to be involved and think about costs and benefits.

Laasya Shekaran: Lindsay, I want to pick up what you said about elitism, because there's this idea ESG and sustainability, are something for the liberal elite, or only a certain group of people. It's not down to Earth with the kind of issues people are struggling with every day, and this has resulted in it becoming quite politicised as a concept, and quite polarising. So how do we make this idea of ESG and sustainable finance more inclusive and relevant to a wide audience?

Lindsay Hooper: I think that builds on some of the points I was exploring, about the need to make this relevant to today's political and social priorities – so relevance to jobs and livelihoods, relevance to national prosperity, competitiveness, relevant to long-term cost of living. It's perverse this is currently framed as, or perceived to be an elite issue when really those most badly affected by our collective inaction are those that often are the most vulnerable in society, who can't afford to build their resilience, whether that's domestically or, around their jobs and livelihoods. That's something that I think that we – when I say 'we', I know many people actively work in this space, but I think much more work is needed by those, I suppose, in the sustainable business movement to really engage with the reality of those challenges, not to simply say, 'Yes, of course we need to get to them,' but to really engage directly, honestly with the reality of the choices that are needed, and to put a lot more focus on, how do we tackle some of those fundamental social challenges and growing inequality that haven't been tackled? Really, we won't make progress until we find fair and just ways forward. So I think there's a framing challenge to the previous conversation we were having about making this relevant to people's priorities. However, it's not just framing and language. It is about engaging with the reality that we do have growing inequality. Economies are not delivering for enough people, and we need to engage with that and not focus only on technical climate solutions, but really about how we can reconfigure economies, so they do deliver for everyone.

Richard Giles: What role do you think investors play in this, Lindsay, in terms of the mandate that they have, and how they can legitimise their involvements in this debate? Clearly they've got a powerful position. Many, institutional investors are acting on behalf of members and their long-term interests. However that question of how do they represent the investors in different institutions, and what legitimises their position, and what role should they therefore play.

Lindsay Hooper: To the earlier conversation about whether this is a values or a value piece, for those that clearly have a responsibility that is seen and interpreted purely through a value lens, it has to be legitimised on that basis, with a focus on value creation and resilience. It has to be self-interest: their own interest, that of their customers, and beneficiaries focused on that. Sadly, it's becoming increasingly easy to be able to make that case, as we see the direct consequences of inaction show up, and that's only going to grow. You can't future-proof a fund or a financial institution in a world of climate chaos or social instability. So, as systemic risks are material and growing, it becomes directly issues of self-interest, particularly in sectors and parts of the finance system where there's a long-term perspective, not just a short-term perspective. So, I think that gives the legitimate basis. A challenge is obviously one of timeframes, and we see a big gap between an acknowledgement of macro challenges, and we talk about gross domestic product (GDP) impact, which isn't necessarily the same as the direct impact any financial institution might be sitting with. However, it will start to translate, and I find communications from the finance system, like the Allianz board member quote around we're facing the prospect of a climate-induced credit crunch; that's really powerful in painting a picture of how this may show up with institutional level risk. So there's a legitimacy there through the direct impacts of inaction. I also think there's a responsibility to beneficiaries about contributing to a liveable world to ensuring capital is being allocated in ways that are contributing to building the world they want to live in, they want their children to grow up in. So I think values matter there too, because that shapes. what society are we ultimately building, and how is that steering the way in which capital is being directed now?

Laasya Shekaran: I think that's probably more true in the pension system than anywhere, where they are extremely long-term, and have beneficiaries that represent millions of people over those longer time horizons. So we've talked a bit about this idea of systems change. That's obviously a big area of your focus, Lindsay, and Richard also mentioned an event we did last week. How are you seeing attitudes towards this idea of systems change shift? Is the industry actually engaging with this idea more than they perhaps were in the past?

Lindsay Hooper: I think we need to acknowledge we're having this conversation against a backdrop of quite challenging pushback, and a dip in market sentiment broadly. I've come on to talk about, I suppose, sentiment around, or where we've seen positive signs around systems change, but I think we have to acknowledge we've seen a combination of, I suppose, economic headwinds. Some direct attacks by those who have got a vested interest in sustaining the status quo. We've got very polarised societal and political contexts, and we've got a level of people just saying, you know, 'I'll just keep my head down, we'll stick to our lane. Now is not the time for us to be speaking up, or stepping up our ambition.'

So I just want to acknowledge that is the context, certainly in the UK, Europe, and partly in the US. It's very different in Asia. But then, if we come to system change, I'm going to talk about market-wide change, because I think it's important to be focused on. What is it that needs to change? There's a real risk when we talk about systems change, it can also play into that kind of concern: this is very elite, this is very abstract, it's very theoretical. It's kind of boil the ocean. We're going to kind of reinvent everything and come up with a perfect solution, and I think that's unrealistic. Instead, focusing on transforming or shifting particular markets, particular sectors, particular regions, and getting quite granular and focused about, what is it that practically would need to change in order to create a level playing field, in order to remove that competitive disadvantage for action?

So to your question, what am I seeing in terms of trends? I'm seeing more recognition voluntary action won't get us to where we need to get to; we can't rely on the cumulative impact of individual enlightened institutions taking action, growing recognition. We will ultimately need changes to the rules of the game – that will take state action – and a growing recognition from organisations that in the past may have been in a position saying, 'we don't engage with policy, we don't engage with politics, we stick to our lane,' to recognising that if they want to build a pathway to the future, they have no option but to engage, and to find transparent, responsible ways to do that, which are good for their institution, good for the markets on which they depend and good for society. So I'm seeing more recognition of the need for this: more engagement either with the policy advocacy and a willingness to engage there; more coalitions working on, how do we actually get some of this onto the balance sheet? How do we build the infrastructure in order to be able to do that? More focus on the technology and the business models that are close to tipping point, or we'll need to tip so we can really build the industries of the future, and more on sector, regional, public-private collaboration, discussions, dialogues about, how are we actually going to roll up our sleeves and get that transition planning done and financed?

Richard Giles: It's so interesting to hear you say these things, Lindsay. Laasya mentioned the event we held last week, and there's a lot of common ground with what we were hearing. One of the things that I found was the level of interest in system change among the Pensions for Purpose network is higher than I've ever noticed it. And I think that's the reaction to the times we're in, and the discomfort – perhaps sometimes unspoken discomfort – that people are feeling about the speed of change we're feeling, and the desire to come together and try and find ways through this. It seems to me that's a heightened level, that level of interest in talking about this because of the changes we can now all see all around us.

Some of the things that you mentioned, around policy, advocacy and asset owners coming together to advocate for system change. Somebody said, last week, system health is market stability, which is an interesting concept that then focuses the mind on actors that depend on market stability: go back to what's going to lead to system health, and I think these connections are starting to be to be seen.

I just wanted to come to a close for me, which is about in practice. What can an investor do? And maybe just come back to the Rewiring finance report with some specific actions. But to focus on the investor community, which is a large part of our audience, Lindsay, what are the things you think investors should focus on?

Lindsay Hooper: Yes, we published our Rewiring finance report just a couple of weeks ago, and we've been really positively surprised about the traction and engagement that work has had. So, I think we're also seeing interest and demand and a recognition that we're going to need to rethink and to look at some of these wider structural and market shifts. Practically, our report highlighted three broad domains. One is around shifting policy frameworks, so specific recommendations in this space. It's recognising investors invest in the real economy and need to not in a vacuum. So, being at the table and engaging and supporting those necessary policy reforms to enable real economy shifts, which can then be financed, as well as stronger fiscal tools and public-private partnerships around transition planning. So a whole basket of things around policy frameworks.

Back to the mindset and narratives piece. We think there's some important practical actions needed there. This compliance, of course, is essential, but we won't, I suppose, comply our way through an industrial revolution. So we are going to need a greater focus on value, creation and innovation there. So, a mindset shift there, thinking about, just where do we stop and where are red lines? But what are we proactively enabling? What are we building? How are we contributing to positive market sentiment? Part of this is also capacity building, and capability building as well? So, there's a whole range of things we've outlined there in that practical mindsets, narratives, capacity, capability. Then within the finance sector, we've highlighted some of the structures that are needed there, the integration into financial models, valuation, risk assessments, capital allocation models.

We need to standardise some things. Some things are doable. There's appetite. It's just hard and quite complicated if you're doing it from scratch, and there's never a standardised approach. So, how do we get greater standardisation around some of the new financial instruments, or the transition planning frameworks, or the way around risk pricing?

Then how do we put in place some of the structures that are needed, to make sure we were able to mobilise capital towards emerging and developing economies. Some of the de-risking tools, the currency, risk mitigation, and so on, building a pipeline of bankable projects. So they're in those three categories: the policy, the mindsets and capabilities, and then shifting some of the core financial structures.

Laasya Shekaran: Thank you, Lindsay. That's absolutely fascinating. I think there's some brilliant calls to action there. And actually, the one that I think is the most challenging, maybe personally, is around shifting mindsets, and thinking more about behaviour and sentiment and human drivers. I think as an industry, we're a lot more used to thinking about frameworks and action plans and metrics, but thinking about how us, as humans that are working in this industry, shape what happens is quite challenging, actually. If there was one thing you wanted listeners to take away from this discussion, what would it be?

Lindsay Hooper: Oh, that's a really good question. What would it be? I think it would be we don't just need, and we can't afford to focus only on having more sustainable institutions. We need to focus on having more sustainable markets, and sustainable finance will always remain marginal if we leave it to just voluntary action. We can't leave it only to a small group of heroic, courageous, enlightened individuals. We're going to have to harness their time, talents, energy, to really help get the structural changes that we needed. So this is just to really harness the power of markets. That's where our institutional focus now is.

Laasya Shekaran: Brilliant. That's a good way to end it. Thank you so much for joining us today, Lindsay. Listeners, if you want to make sure you never miss an episode, hit the follow button, and remember, you can find us wherever you get your podcasts. Thanks for listening, and we'll see you on the next one.