Global capital market reform: pipe dream or achievable reality?

- Evan Harvey: Director of Corporate Responsibility, Nasdaq
- Edward Mason: Head of Responsible Investment, Church Commissioners
- Corien Wortmann-Kool: Chair, ABP Pensionfund
- Alderman Alan Yarrow: Rt Hon The Lord Mayor, City of London
- Chaired by Nick Robbins: Co-Director, UNEP Inquiry into Sustainable Financial Systems

Nick Robbins, Co-Director, UNEP Inquiry Sustainable Financial Systems:

The United Nations Environment Programme is currently undertaking an enquiry in many different countries around the world looking at how the financial system can be better aligned to long-term sustainable value creation. The question of investor engagement in system governance is becoming one of the new agendas.

Clearly, there are many issues in the wake of the financial crisis and concerns about unintended consequences. Here in Europe, we have the capital markets union and how that can mobilise long-term capital. At the international level, we have a new set of sustainable development goals coming this year. At the end of the year, we will have a new climate change agreement. In the enquiry, we’ve set out a number of steps in which policymakers can help mobilise long-term capital in terms of risk and prudential policy, capital markets reform, transparency and then financial culture and capability.

Firstly, I’d like to ask Alderman Alan Yarrow, the Lord Mayor of London, for his initial thoughts about why this issue is so important and how we can take steps to make the policy framework work for long-term value creation.

Alderman Alan Yarrow, Rt Hon The Lord Mayor, City of London:

Sustainability is not an aim in its own right, but it’s a way to maximise profits and benefit society. It’s probably fair to say that in the excitement of the Noughties, people forgot how the financial markets were going to be viewed by the vast majority of the people living in the world.

We were overtaken by greed; we had a number of failures, and not just failures of management. There were failures of regulators, there were failures all over the place. Until we recognise those failures took place and go through the process of disciplining those who misbehaved, we’re going to find it increasingly difficult to make more progress.

Most of you involved in compliance and law recognise the fact that only about 17% of market flows were regulated effectively. The equity market itself is a fully regulated market, with insider trading rules, reporting rules and sustainability. Everything is covered as far as I’m concerned – it always has been a very tightly regulated market.

I challenged the European regulators in the early 2000s, and said ‘Why, do you spend your whole time regulating equities? Why don’t you spend more time looking at foreign exchange, looking at the bond markets and so on’? They said ‘Ah, it comes down to ownership. It’s all about who actually owns the equity that’s important’. Well, can I just say how wrong they were?

The reality is that misbehaviour was taking place largely in those markets that weren’t properly regulated. I’m not saying for one second that regulators are going to make all the difference. If you go into a shop and steal something and there’s not a camera there, theft is
still theft. Now we’re focusing on people’s behaviour, whether they’ve got any real interest in behaving properly and looking after the end investor.

There’s no doubt that the client became a secondary feature in people’s minds. That was a problem, a mistake and a lack of good management. People shouldn’t hide behind that fact. We had inappropriate regulation and management itself was not doing its job properly.

Current regulation is insufficient, too expensive, too ungainly and always playing catch-up. We’ve got the situation where you’ve got prescriptive regulation in the US – where you have the ‘it’s legal, therefore it must be right’ attitude. We all know in our heart of hearts that just because something’s legal doesn’t mean it’s right.

We in the UK have a different interpretation. We tried principle-based regulation and that failed, but it didn’t fail completely. We’re now sliding back into the default position of prescription that is, in my mind, is a retreat into the wrong place.

Individuals need to have a far better idea about judgement, how they behave, the impact on their customer base and on the reputation of the company they’re working for.

Education, training and qualification is critical. Why is there a reluctance to allow professionalism to come into these markets? It’s extraordinary. I’ve spoken to Mark Carney, the Governor of the Bank of England, and he’s supportive of our view.

Professionalism reduces the need for regulation. What we’ve got at the moment is too much regulation. Regulation should step in only when markets can’t sort themselves out. Markets should self-repair. Every market participant, recognises that appropriate regulation is necessary, but they also need to be involved in the formation of that regulation.

When we had the self-regulatory organisations (SROs), they were responsible for the behaviour of their members. They didn’t fail completely, but an awful lot of what was good with an SRO is still good about an SRO. My suggestion is that regulators have to get more involved with the practitioner and the practitioner more involved with the regulator, so the regulations that come through aren’t so far behind the curve.

We’re already two years ahead of the regulator in most products. It takes them a long time to catch up. That’s not a healthy position to be in if people are going to take advantage of that position, because markets need to be clean. Clean markets are there because the people who participate in them want them to be clean, because that is how you keep the cost of equity and the cost of capital as low as possible.

**Nick Robbins:**

Corien, you’re the Chair of ABP, but you also have a background in the European Parliament. What are your thoughts on why this agenda is so important for ABP and your beneficiaries?

**Corien Wortmann-Kool, Chair, ABP Pension Funds:**

The issues of corporate governance and responsible investments are key to our investment portfolio. As a long-term investor, we have a lot of opportunities to invest in infrastructure and in real estate. Whether it’s about equities or other assets, we try to use our power or our influence as an investor to contribute to sustainable goals.

Of course, our primary goal is to ensure adequate pension benefits. We want to generate that revenue in a responsible and a sustainable way throughout our portfolio. ESG is now
one of our investment beliefs, but we are currently also reviewing our sustainable investment policies.

I’ve been in this role for five months, and previously I served for ten years in the European Parliament – most recently as Vice President of the EPP Group on Financial and Economic Affairs. I have been involved in many of these pieces of legislation that you are currently complaining about.

The first point I would like to make is that it’s not very inspiring to complain about legislation. I’m the first to acknowledge that improvements are needed in many parts. What we try to do, given the current regulatory and supervisory environment, is to look for what we can do because we are convinced that we can step up our ambition today.

An important goal is dealing with climate change. As a long-term investor, we can do a lot more in real estate around issues like energy efficiency, which are extremely important. Public opinion tries to force us to step out of fossil fuels. We are not going to do that because fossil fuels will be part of our energy supply for decades to come. We try to use our influence and our investment strategy to push the energy sector in stepping up their ambition, the speed of the transformation to a low carbon economy, and their efforts in that area.

In one year, we have doubled our high sustainability investments from €16 to 30 billion and lowered our CO₂ emissions by 10%. In three years’ time, we want to double our investments in renewable energy. There is a lot of potential out there and we are going to look for that actively.

As a long-term investor, a stable regulatory and policy environment is key. Subsidies on fossil fuels – and even subsidies on renewables – make for a very fragmented energy market in Europe and throughout the world. That’s bad for us because we want stable, long-term revenues on our investments. Reform of the European emission trading system and, even better, a worldwide CO₂ price is an important issue. We’ve seen five big European energy companies pleading for a worldwide energy price.

Nick Robbins:

I’d like to look across the Atlantic and welcome Evan Harvey, Director of Corporate Responsibility at Nasdaq.

It’s interesting that much of the innovation on sustainability in the exchange world has been coming from emerging economies – Bovespa and Johannesburg in particular. However, Nasdaq has been active too.

Evan Harvey, Director of Corporate Responsibility, Nasdaq:

The exchange industry has been both a leader and a laggard when it comes to this. Some exchanges have done tremendous things in terms of compelling better ESG data from listed companies, as well as building and sustaining capital products that reward green investment behaviour.

Then you have a number of exchanges, largely the larger equities-based, IPO-competitive exchanges, that have been absent on this issue for a long time. Nasdaq stepped into that void four or five years ago to try and form a coalition between exchanges to drive the
industry forward. We think that we have a unique amount of leverage in our position. We have this quasi-regulatory relationship with most of the public companies on the planet. When you're talking about our groups of exchanges that band together in something like the Trade Association for the World Federation of Exchanges, it's an overwhelming majority of global GDP. If we can drive some consensus, change and shared thinking around this topic at that level, the scale justifies itself.

Why is it so important for the policy, legal and regulatory frameworks governing capital markets to promote long-term capital sustainable value creation?

First, it's because voluntary measures, opt-in measures and benighted self-interest measures only go so far. You're only going to get so much compliance, no matter how good the business case is.

Policymakers and regulators are designed to look at long-term trends. If we left this entirely up to companies, we would get too mired in short-term drivers and short-term interests because that is the state that we have right now. There are a lot of legitimate issues that are driven through the short term and the quarterly cycle of earnings that companies have to go through. There are also a lot of illegitimate issues and a lot of issues that were just subterfuge and kabuki.

One of the main reasons why policy, legal and regulatory frameworks should be put in place and why those bodies should be in charge of it is because some imperatives are just beyond market control. I take issue with the Lord Mayor’s comment about markets being completely self-correcting. Sometimes they are and sometimes they aren’t. Traditional constraints are not always capable of dealing with global issues that cross borders and cross markets, like climate change. I’ve seen first-hand that the old ways don’t always work.

The Johannesburg Stock Exchange was a real leader in the space in 2010. Coming out of the King Code, it mandated not only better environmental reporting from its 450 or so companies, but integrated reporting, which is a pretty substantive request for companies to provide. It’s been a tremendous good but there’s also been a downside.

It instantly put better ESG data into the system. It instantly made that market one of the largest and most complete providers of ESG data for investors. It instantly put them at the top of a lot of lists in terms of market disclosure rates among exchanges. The downside is there are a lot of issues with the integrated reporting format that companies use. The regulation itself was a little bit vague. There was a ‘comply or explain’ aspect to it that a lot of companies took to mean ‘I will just explain very well why I don’t have to do this’. They had to issue subsequent regulation or guidance on why they should report on some metrics.

Exchanges are wrestling with this very question and hope to answer it very quickly. What process for getting information out of public companies works the best? Is it a listing rule that we can put into place tomorrow? Is it making the business case over and over again, proving the value to companies and showing them the way forward? Or is it some mix of the two? So far, it’s been a mix of the two, but we’re still trying to figure that out.

**Nick Robbins:**

Edward, you’ve been very busy over the last two years on various parts of the Church Commissioners’ responsible investment agenda, and its new climate change policy has just come out. It would be very interesting to hear about how the work and your investment beliefs are driving what you’re doing internally, but also what that means in terms of policy engagement.
Edward Mason, Head of Responsible Investment, Church Commissioners:

The Church Commissioners runs the Church of England’s endowment; it’s a £6.7 billion fund. I feel like the tiddler of the asset owners on the panel, but we like to think we get some of our influence from other sources as well.

In terms of how we integrate sustainability into what we do, the first is that we restrict our capital to certain areas that we want to be unsustainable: those are areas like indiscriminate weaponry, tobacco and most recently the highest carbon fossil fuels like oil sands and thermal coal.

Another key part of it is active ownership: how we vote our shares and how we engage with companies. We’ve integrated sustainability into that: for example, in voting, we require companies to reward long-term performance more than short-term performance in executive remuneration. We require them to have environmental and social, non-financial factors recognised in their remuneration schemes, as well as financial factors, or we will vote against.

On engagement, we’re piloting more forceful forms of stewardship and engagement. You’ve particularly seen that in the BP and Shell shareholder resolutions, of which we were co-filers. Robust engagement, particularly in the fossil fuel sector as Corien was saying, is absolutely vital to forward-looking sustainability.

We also promote research and growing intellectual capital on sustainability issues. We were partners in the Mercer study on climate change and asset allocation that was published yesterday. If you haven’t had a chance to look at that, or weren’t aware of it, I would encourage you to do that. It’s a very thoughtful and detailed piece of work on climate change and what it means for investors.

Finally, there is public policy. Public policy has become an increasingly important part of our approach to sustainability. That’s largely because of climate change becoming ever larger on our agenda. Climate change is the biggest market failure that there is, the failure of markets to take the externalities of carbon emissions into account. So, I very much agree with the Lord Mayor in terms of the role of regulation, that it is to ensure that markets work effectively, and markets are not working effectively on this issue because carbon isn’t priced. This is a classic area where we need public policy.

I agree with the Lord Mayor on the role of individuals, and I think as a church and as church investors, this is very much part of our philosophy and part of our engagement that people matter and how people behave matter – that’s at companies and investors as well.

The last observation I would make is that we need investors to step up to the table more on public policy. Everyone else is at the table: corporates are at the table in a big way, NGOs are at the table, politicians are reflecting their kind of immediate priorities for their parties and electorates. Investors need to be there because we have a real interest in the long-term sustainability of the economy.

Nick Robbins:

Alan, the City of London is a major voice in terms of financial policy. How do you make sure that it’s a credible voice and not seen to be looking after the self-interest of institutions?
Alan Yarrow:

The fundamental thing is that you need a belief that the markets have to be efficient and fair and clean. If you don’t start from that belief, you might as well not be participating.

We have a dichotomy all the time in the City. In fund management, the long term is made up of a number of connections of short-term issues. The fact is that there are still situations where people profess that they’re long-term investors, but they still report quarterly. The two are in direct conflict, especially if you’re constantly put up against a bunch of trustees saying, ‘Yes, but we’re investing long term, but, by the way, your performance last quarter was lousy’.

We’ve got to grow up and look at things objectively: look for long-term, sustainable issues and stick to a long-term sustainable reporting process. The reality is, there isn’t sufficient interest in the stewardship of companies by private investors. There has to be proper interest in the stewardship of companies by institutional investors, and that’s not just getting some agency to do all the voting for you. It’s about taking an interest in the issues that face that company.

Nick Robbins:

Evan, you tossed up a few different ways of getting consistent and comprehensive sustainability disclosure across exchanges. I’ve been working on this issue for 20 years, and I can sometimes feel a little bit fatigued that we haven’t made more progress. What do you think we can do, over the next six months to a year, to start getting a more comprehensive approach in the exchange world?

Evan Harvey:

I think the exchanges themselves are going to come out with guidance that’s going to help. We have to start working with the regulators too. There’s only so far this conversation will go unless the regulators get involved. Exchanges and companies working in their own self-interests are not going to get us all the way there.

Nick Robbins:

That balance between market principles, market standards and the regulatory frameworks is a very interesting theme. It’s odd to have exchanges saying the regulators could do more, but we’ll pick up on that a bit later.

One of the things that have come up quite a lot is not just corporate disclosure, but disclosure by institutional investors. Two weeks ago in Paris, the French Assemblée passed a law requiring institutional investors in France to report on their carbon footprint and for banks in France to think about climate change in terms of stress tests and so on.

Edward, do you think that we’re going to need to have some form of regulatory framework for institutional investors to ensure that they are being transparent on the full range of ESG issues?

Edward Mason:

I’m still trying to digest that move by the French Government, because it was quite unexpected.
We very much support carbon disclosure by companies and UK moves to make that compulsory. My hesitation is that it might lead to a ‘tick box’ approach where people are doing it because they have to. We’ve seen some quite interesting moves where people are doing it because they want to and because their beneficiaries are creating demand for it.

A couple of very interesting points have come up in this discussion: the point about pension funds and short-term thinking is very important. In the UK, pension funds are required to have triannual evaluations, to mark their assets to market and also measure their liabilities against current short-term bond yields. That is potentially quite unhelpful for pension funds.

Nick Robbins:

Corien, there is now a requirement in the Netherlands for pension funds to report annually on many of these aspects. Could you talk about that? Perhaps you could also pick up your point about European legislation and capital requirements?

Corien Wortmann-Kool:

We publish a quite extensive report on our responsible investment because we want to be very transparent not only on what we achieve, but also on the dilemmas we face. It’s an area we enter very easily – we get political pressure to do things or to get out of certain investment. But we want to be clear that we act according to objective guidelines because otherwise, we will be ‘playing ball’ due to public pressure.

At certain stages, we do step up. We publish an extensive list of all the companies we engage with. We don’t publish the issues that it’s about – or only very general information – but we say where we don’t see sufficient progress. For example, we went to the AGM of Shell to publicly speak out on the proposed drilling in the North Pole area. That got a lot of public and media attention. There you can step up: that’s not only about being big or small, but about acting together as institutional investors, and sometimes with NGOs.

Also, we publish our CO₂ footprint: listed companies should do that too, but national legislation is not the road to go because then we get a very splintered landscape. I prefer international guidelines because that would work better. Even European-level would not be sufficient for me on that issue.

On short-termism in the pension sector, and speaking for the Dutch pension funds, it’s actually the national legislation was doing that. It’s a real big problem for us, especially in this time of financial downturn with regard to interest rates. We don’t get a lot of support because we are then seen as a financial institution more than being a pension fund.

Nick Robbins:

Any questions from the audience?

Erik Breen, Chairman, ICGN:

As investors, we encourage companies to create long-term value and we ask them to use integrated reporting. Do investors need to apply the integrated reporting framework?

Peter Montagnon, Institute of Business Ethics:

There seemed to be two strands to this debate that are coming across in the discussion. One is the point about ESG, and the other is about the sustainability of the capital markets themselves. In order to do all this, we have to have capital markets that are configured in a
way that they can deliver long-term capital from savers to those who can use them productively.

We seem to have got to a stage where the regulation that’s followed the financial crisis has really inhibited the development of bank lending. If you talk to people in the Commission about capital markets union, they’re looking to the capital markets to replace the lending that was done by the banks. Then, they begin to worry about the systemic risk of the new lenders, the shadow bankers: that brings in the asset managers, and they begin to worry that asset managers are systemic.

Having killed off the banks, do you think that the authorities are now about to kill off asset managers because they’ve decided they’re systemic, and if so, what should we do about it? How can the asset management industry demonstrate that it plays a safe and useful role in the capital markets and contribute to the building of sustainable capital markets that can deliver everything else that we’ve been talking about?

Christianna Wood, Independent:

My question is for Evan. My observation in engaging exchanges throughout time is that they rarely want to raise the level of disclosure. What is going to be different this time, on this subject of sustainability? They’re all willing to say they want to be sustainable, but I wonder if they’re really willing to do anything. What’s going to happen to make exchanges raise the level of disclosure and walk the walk?

Alan Yarrow:

Peter, it’s a very good question and we don’t know what the answer is, ultimately. But the reality is that – we hope – the banks are no longer systemic. It’s like the soap in the bath – you don’t know where the soap is, but you know it’s there. Similarly, the risk is still there, it’s just not in the banking sector as we know it at the moment. Has it gone to the fund management business? I don’t know: it’s possibly gone to peer-to-peer lending, it might have gone to crowd funding: there are all sorts of other instruments which are coming in from the challenge of banks, to try and fill a vacuum. But there’s one thing that’s absolutely clear and that is that we’ve lost the shock absorbers in the financial system. In other words, liquidity has disappeared. Those shock absorbers have a direct impact on the cost of capital.

The more volatile the market, the bigger the premium affected if people are going to charge the use of capital. I think we’re beginning to see the lack of liquidity in the markets. We have got to look very hard as to how we can replace the distribution of risk and how we actually are living with the unintended consequences of trying to make our banks safer. We used to have a broking industry of some size, which knew exactly who the buyers and sellers were, and introduced liquidity by being intermediaries in the system. That broking layer has largely disappeared. People got lazy, they’d just go over to one of the investment banks to go and get their line of stock because the bankers had the inventory. They no longer have the inventory, either in bonds or in equity, and we haven’t replaced it. So the unintended consequence of making our banking system safer has meant the risk has gone somewhere and volatility’s going to go up.

The cost of equity’s going to go up, which means the whole concept of capital union is going to be more difficult to deliver. These are things we’d have to cope with every day: this is the evolving market, this is what’s exciting about being involved in financial systems – you have to adapt very quickly. I don’t know what the answer is, but I do think we need to think quite hard about how we improve liquidity of markets when it comes under pressure. When these interest rates start to go up, we’re going to see a very, very difficult market.
Nick Robbins:

My experience, certainly at if we’re talking about the world, is that it's seen to be a particularly European problem. Other parts of the world look at the European banking system as being a little bit less solid, perhaps. Corien, you’ve been on both sides. What do you think about this question of the systemic implications and the unintended consequences?

Corien Wortmann-Kool:

I was indeed involved in the capital requirements for bank legislation, but also on the banking union. I would argue against the suggestion that the capital requirement killed off banks. I think we are still in a period of adaptation. Capital requirements are important for the stability of the financial sector and in particular, the banking sector.

Many countries in Europe were or are too dependent on bank lending. More diversification is healthy for our financial system. There are other areas that we, as an investor, are closely linked to. They have to play their part as well. When you put everything into the basket of ‘shadow banking’, it might be as if everything takes place in the dark, but that’s not the case. We have a lot of regulation for financial markets, we even have our Alternative Investment Fund Managers Directive (AIFMD) for hedge funds and private equity. A lot has been regulated in order to announce transparency and to increase better supervision. If one thing is clear, it’s that we are just at the beginning of building up the banking union, but we definitely also need a capital market union.

Nick Robbins:

If I could just touch on this question of capital markets union with Corien and Alan. This is probably the biggest piece of financial reform around. What are the top priorities and opportunities that you see?

Corien Wortmann-Kool:

It’s about putting the right incentives to enhance long-term investments. It’s about, harmonising the sectorisations, because harmonisation can help to make this market work effectively again. That can also help banks because, through sectorisation, assets can be taken off the balance sheets of banks. I would argue in that direction for covered bond markets too. With the capital markets union and the energy union, legislation in that area is well connected and gives the right incentives to each other.

Alan Yarrow:

There’s no doubt that if you just look to see how countries came out of the last recession, it was those countries that had a mature alternative capital market, other than banking, that came out the fastest. There’s no doubt that Europe in general relies too much on banking. Therefore, we’ve got to find a way to get money into industry and into business. A capital markets union is, without doubt, a very important change in the approach. May it be through private equity or through private placement, whatever it is, we’ve got to get moving quickly because, effectively, Europe is starving of capital in certain places.

Young companies need capital. We also need to tackle the extraordinary ability of big companies to use small companies as a way of financing their working capital. The SME sector suffers from being used as the financiers of working capital for big companies and that is genuinely unacceptable.
Nick Robbins:

How many institutional investors have been engaging with listed companies on their treatment of SMEs in terms of working capital? Maybe that’d be a good area for long-term strategic engagement.

Evan, you said there was some guidance was going to be coming out from the World Federation of Exchanges about how we are going to ‘walk the talk’?

Evan Harvey:

I think that the scepticism about the exchanges’ willingness to do this is well founded. I don’t think that there’s much of a track record there apart from the notable examples of exchanges that I mentioned earlier – Brazil, South Africa, Singapore to some extent – coming up with their arbitrary rules.

There are some particular factors that drive rule creation in those markets. It’s a small market generally and there’s not a lot of IPO competition so there are some things that have happened in those markets where an arbitrary rule has been more palatable. But most exchanges are spectacularly unwilling to just drop more regulation on companies.

They’re trying to find this ideal mix between relevant and material information from companies and what’s a burden. We don’t want to bury companies, especially premarket companies and fresh companies, in a lot of regulation that doesn’t really have a lot of material import. There’s probably room here for a ‘grand bargain’ where we can trade the better long-term insight that we get through ESG and other factors for some of the short-term stuff that’s just part of the churn and doesn’t really have as much material value. Some people have been talking about a trade-off in this way: how can we make the total burden of compliance and reporting on companies equal, but add more on the ESG side and take some away from the financial side that is not as telling?

IOSCO could help lead. IOSCO could drive consensus among securities regulators like Nasdaq and other people have been trying to do in the exchange industry. First and foremost, what IOSCO could do is just publically address the issue more. It has been fairly mute on this through the years. It has a dozen different committees on a variety of different topics in our industry, and sustainability is not among them.

PRI and Ceres have sent a letter to IOSCO asking for a number of things related to ESG information in the markets – dialogue and engagement with different parties, a creation of a rule set or maybe a task force, some sort of official statement but primarily urging IOSCO to become part of the public conversation. As I mentioned earlier, the SEC has not really been part of it either, but we’re thinking that IOSCO probably offers the most opportunity to scale the effort.

Nick Robbins:

Obviously most exchanges now are listed companies themselves, and that business model has changed from being owned by participants to being owned by shareholders. How much encouragement are you getting in this area by your owners, as well as the market participants?

Evan Harvey:

Not much. The encouragement tends to come from institutional investors. It tends to come from individual shareholders and other market participants. There hasn’t been a huge driver
from our particular owners as a public company to get into this area. This is one of those areas where the boundary between being a public company listed on an exchange and also having this semi-regulatory role with thousands of other listed companies gets a little bit murky.

**Nick Robbins:**

On the question of integrated reporting, is that something that all investors should be doing?

**Edward Mason:**

Integrated reporting is very important for sustainability and hopefully it’s where we’re going with corporate reporting in particular. We’re some way off finding the ways of doing that. I'm not sure whether institutional investors will be at the vanguard of it in their own reporting. We produce a responsible investment review as part of our annual report: that's a new thing, so it’s something that we are growing. But many, many asset owners are very small and poorly resourced, particularly in the UK. I think it’s quite tricky for them to start doing really innovative things like integrated reporting. The future is for it to kind of come more into company reporting, for accountancy standards to be established on it, and then it will more naturally flow into the investment arena.

On Peter Montagnon’s points about asset managers and withdrawal of bank lending, I too agree that Europe is too dependent on bank lending and that institutional investors have a role to play in kind of directly providing capital in other ways. We very quickly went into private credit after the financial crisis. I think that’s a positive thing.

On the question of whether asset managers are systemic, I think it depends in what context you apply the word systemic. You can debate whether they’re systemic in financial risk. But I don’t think you can debate whether they are systemic in terms of sustainability. This is something Professor Kay very much picked out in his report. Many people felt that perhaps he didn’t put enough emphasis on asset owners and the role of asset owners in long-termism and sustainability, but he was spot on that the big asset managers are huge players and they’re big on shareholder registers. How they behave affects the sustainability of our economic system.

**Evan Harvey:**

It’s important to keep integrated reporting in context. Integrated reporting is done by a small minority of companies and an even smaller minority of investors. Integrated reporting is a very specific, sophisticated framework that requires you to balance ESG concerns and financial concerns in the same narrative. It is a difficult format to master.

We’re still at the point where we don’t have basic ESG data in the system; integrated reporting is two steps down the road because most public companies are not reporting on a lot of very basic ESG data. I know we don’t want to rely on a ‘tick the box’ kind of methodology, but we haven’t really ticked the box yet that will enable us to move onto this more sophisticated narrative of how ESG affects your business story.

**Corien Wortmann-Kool:**

It looks like a defensive approach to say ‘well, it's far away’. For us, developing our report on sustainable investment is a journey and it’s not perfect. I had a press conference on that last week: I got a lot of questions and some not-so-nice articles in newspapers because we also disclosed what we’re not doing well. But, it helps transparency and discussion, and it really helps credibility. So, I think we should be offensive on this.
Nick Robbins:

More questions from the floor, please.

Tracey Rembert, Senior Manager of Investor Engagement, Ceres:

What are the top two things for each of you that really need to be changed to get the markets thinking much more holistically long-term?

Peter Crow, Managing Director, Quarry Group:

Many of the commentators yesterday were speaking in terms of trust, whereas much of the commentary this morning has spoken more in terms of structural matters, such as reporting the sustainability agenda. I’m very keen to understand what the panel’s got to say around desirable behaviours in the boardroom to pursue this agenda.

Unidentified Male Speaker:

Andy Haldane at the Bank of England has a wonderful paper which says investors always over-discount the future in terms of cash flows – they value cash flows 16 years out as if they’re eight years out. Citicorp came out with a paper yesterday that said investors in the US much prefer share buybacks than investing for the future.

They didn’t link it, but I will: it makes perfect sense that if we over-discount the future, we over-value present share buybacks. It strikes me that that mental disconnect between the supposedly rational investor, able to appropriately discount the future, undercuts everything that people of the panel are trying to do. How do we more fundamentally value future cash flows and sustainability in a way that doesn’t over-value present short-termism?

Nick Robbins:

We have been talking about refinements to the system, better reporting, CMU and so on. But this question of time horizons is absolutely at the heart of everything that investors do when we’re looking forward. How do we actually get proper discount rates? I’d also like to extend the question of desirable behaviours from the corporate boards, but onto the boards of institutional investors as well.

Corien Wortmann-Kool:

A lot is about practising what you preach. What are we doing ourselves about culture, integrity and enhancing sustainability? Are we really doing whatever we can?

Taken as a whole, my priority would be the climate and energy policy and the changes needed there. We need this CO₂ price on a worldwide scale to enhance and step up our investments as long-term investors and get the right risk-return profile.

Edward Mason:

I absolutely agree that the key is carbon pricing. That would set a tone for pricing externalities and getting markets to work in a more sustainable way. It would also feed into things like integrated reporting because if it’s financially material, it’s got to be right there in the financial account. Listing standards are another potentially interesting area, but perhaps Evan might want to pick that up.
Behaviour in the boardroom is very much our territory and something that we work on a lot in our engagement. It is a real problem: there have been studies of whether boards would make investments that would pay off in the long term, but would involve them missing their quarterly earning targets. By and large, they don’t do it. One of the things that we encourage boards to do is to think in terms of business purpose, because that can anchor the company in a longer-term perspective.

Coming to the last question on the value of future cash flows, it’s about a cultural and behavioural shift. There is a cultural reason for investors behaving in a short-term way. It’s not logical: we know that, in terms of active asset management, high conviction asset management does better taking a long-term view. There are cultural problems there in terms of herding and fear of underperforming your peers in the short term.

Nick Robbins:

Evan, you’ve been quite honest about how some of the exchanges haven’t been leaping forward on this agenda. What are your thoughts on the future?

Evan Harvey:

On a macro level, carbon pricing solves a very particular problem. Listing standards, or listing guidance as we like to say, solves another kind of problem – not the future per se, but it gets us to a point in the future that is better than where we are right now.

Engagement with the board is absolutely essential. Boards that are checked in on this topic tend to represent higher-performing companies. Those companies have all kinds of lines, dotted or otherwise, so you can draw between their performance and financial performance. I think that boards that have one or two specialists in this area who care about this tend to bring it to the fore and make it part of the agenda, and boards that do not tend to isolate it.

We need to de-marginalise ESG. This has to become part of our standard workflow when we talk about company reporting and company performance management. We never get analyst questions about ESG per se, but that depends on the language that people use on the quarterly calls. The more CFOs are called to task for not performing on ESG issues, the more we’ll see a ripple effect throughout the company.

Alan Yarrow:

What I find fascinating about the conversations here is that big companies don’t need banks. They’ve either got access to capital markets already or they don’t need banks. Ninety-nine per cent of the companies in this country are SMEs – they’re not the big companies. The SMEs are the ones who can’t get the bank finance.

If we’re talking about sustainability of the economy and going forward, the SME is the area where the real sustainability is, because that is where most people are employed. That’s where behaviour of big companies is absolutely critical. Equally, these small companies desperately need cash and they can’t go to the banks. We have to get better at asking how big companies treat their suppliers.