Breakthrough Money

7 JULY 2017 | EVENT SUMMARY

Introduction

On 7 July 2017, we brought together a group of c.60 leading thinkers and innovators in sustainable finance for a day-long workshop at UBS in London. This was the second in a series of London 'Basecamps' convened as part of Project Breakthrough—a collaboration between Volans and the UN Global Compact. The first—held at the RSA in mid-June—was on the theme of 'Reimagining Carbon'.

The purpose of the 7 July event was to explore what it will take to create a global financial system that serves a sustainable future. All this in the context of rapid technological change and widespread market disruption.

This document is a distillation of key themes from the day.

Session 1 | Global Finance and the Global Goals

Mark Campanale, Carbon Tracker
Tessa Tennant, NDCi.global / Call to Action on Climate Finance
Nick Robins, UNEP Inquiry

- *"Markets are actually really bad at pricing scarcity."* - Mark Campanale

  In 2011, Carbon Tracker first published its work investigating the extent of unburnable carbon (or 'stranded assets') in the reserves of many companies. Today, other scarce resources, such as water and fish, also need to be taken into account. Markets are beginning to sense that there are ecological boundaries, but we're still a long way off those boundaries being fully reflected in asset valuations.

- *"We need to turn this trickle into a flood."* - Tessa Tennant

  The purpose of the financial system should be to serve the Global Goals holistically. Most sustainable investment today has limited exposure to emerging markets, unlisted companies, and infrastructure—this flow needs to go beyond a trickle. We also need to foster a culture that challenges what is accepted as normal—for example, the lack of integration of climate risk in sovereign bonds.

- *"Do robo-advisers dream of a sustainable future?"* - Nick Robins

  While there is huge potential for Fintech—and new technologies like Blockchain—to bridge current gaps, tackle corruption and provide more transparent information, they also pose risks to sustainable development. In a tech-driven world, code is law. If sustainability is not in the code, we won't get sustainable outcomes.

Session 2 | Disruptions ahead: How markets are changing

Paul Donovan, UBS
James Arbib & Henrik Olsen, Rethinking Capital

- *"We're borrowing the equivalent of 50% of our income on environmental credit every year."* - Paul Donovan

  Our current standard of living is based on 1.5 planets' worth of resources. The addition of another 1-2 billion people to the global population over the next few decades will only compound the situation. Unless we address the impending environmental credit crunch, we face the prospect of a 50% drop in living standards—the equivalent of a second Dark Ages.

- *"Technology has the capacity to change our lives dramatically."* - Paul Donovan

  We need a (resource) productivity revolution. Simply stated, we have to learn to do more with less. This requires investment in capital and innovation. Technology and the so-called 4th Industrial Revolution are important in this, but the dislocation caused by rapid change is triggering a dangerous backlash. In times of 'scapegoat economics', the private sector needs to provide not only capital, but also the intellectual environment in which innovation can succeed.

- *"We're linear thinkers… [that makes us] hopeless at thinking about the future."* - Jamie Arbib

  Failing to understand the dynamics of disruption results in ineffective forecasts. RethinkX's first report, which focuses on the transport sector, predicts a much faster adoption of autonomous electric vehicles than others have forecast—predominantly because of the drop in cost per mile (due to longer vehicle lifetime, lower insurance costs, higher utilisation, etc). This transition will impact the entire value chain of cars. Across sectors, technology-driven disruption will lead to a lot of value destruction—and there is no iron law that new value created will outweigh value destroyed so we may see a shrinkage of global GDP.

- *"The past is no guide to the future."* - Henrik Olsen

  Much of the financial services sector uses past performance as an indicator of future performance. In an era of disruptive change, this can be dangerously misleading. Passive investing (which accounts for 60% of the US market, up from 30% in 2007) is particularly at risk of badly affected by exponential change—"if everyone is travelling on the same road, looking at the rear-view mirror rather than the road ahead, it's difficult to turn off and change directions". We need new mechanisms to help investors move away from a herd mentality—and to create products aligned with the future not the past.

Session 3 | Unlocking the $12 trillion prize: The SDGs as market opportunity

Jeremy Oppenheim, SYSTEMIQ
Steve Waygood, Aviva
Andrew Parry, Hermes Investment Management
Valeria Piani, PRI

- *"[Delivering the SDGs] isn't about investing a lot more, it's about re-directing capital flows."* - Jeremy Oppenheim

  Rather than thinking about the SDGs as a cost, we should see them as an investment opportunity. Between 2015 and 2030, somewhere in the region of $90 trillion will be invested in infrastructure worldwide. Making that infrastructure sustainable will have big economic benefits. The Business and Sustainable Development Commission's Blended Finance Taskforce is seeking to bring together both private and public capital to invest in these opportunities.

- *"If we think that the SDGs are relevant, then we have to change the way we do responsible investment. It's not just about risk and return. We have to add a third dimension: impact."* - Valeria Piani

  There is a big distinction between ESG investing, which is focused on process, and SDG investing, which is focused on outcome. PRI now has 1,700 investors signed up, representing one-third of global capital under management. 50% of their members see the SDGs as relevant. True SDG investing will also mean a re-balancing of portfolios away from equities and towards other asset classes that can work across borders, with significant capital going into urban infrastructure, as well as issues such as land use.

- *"Help us build public, free benchmarks ranking companies on the SDGs."* - Steve Waygood

  Transparency was supposed to lead to accountability and improved performance. It has a bit, but not as much as it could. Why? Partly it's because we're flooded with data—it's difficult to distinguish the signal from the noise. And secondly it's because transparency analysis itself is privately held and therefore not always transparent. SDG benchmarks should be a public good. This is what Aviva's proposed World Benchmarking Alliance will seek to create.

Session 4 | Creating a vibrant economy: Transparency, trust and accountancy

Sacha Romanovitch, Grant Thornton

- *"For innovation to solve important problems, people need to trust it."* - Sacha Romanovitch

  Public trust in global institutions, both governments and business, is worryingly low. The current leadership paradigm is white, male and rich. Self-interest is seen as a good thing. But companies need to create a thriving environment, economy and society beyond their own four walls to regain trust. This means creating opportunities for meaningful employment, education and health. And it means changing compensation frameworks to reward long-term performance.

- *"We have a fundamental leadership mindset problem... Rather than experts or achievers, we need leaders who can think systemically."* - Sacha Romanovitch

  A new breed of corporate leader is required—one that considers how their actions fit into a wider system. Three tools can help: 1) stretching leaders' timespans of how far forwards and backwards they look; 2) helping leaders to cluster issues and understand root causes; and 3) helping leaders to see the world from others' perspectives. Grant Thornton's purpose—"shaping a vibrant economy"— has required its leadership to consider a wider sphere of influence. Rather than thinking just about the impact it can have as a single organisation, it now thinks about the positive impact it can have by working with and through its client base.

Session 5: Advance of the algorithms: Where AI meets sustainable investing

Omar Selim, Arabesque Asset Management
Marjella Lecourt-Alma, eRevalue

- *"We're only as good as the data we use."* - Omar Selim

  Over 90% of the world's data was created in the last 2 years. Companies like Arabesque Asset Management are already enabling investors and others to track corporate ESG performance through AI-enabled analysis. There's a tipping point coming. "ESG is to finance, what electricity is to the auto industry," says Omar. Within companies, other technology platforms like eRevalue's Datamaran are helping to enable a more data-driven approach to materiality analysis and sustainability management.

Session 6: Connecting capital to sustainable growth: New models, metrics and mindsets

Antoni Ballabriga, BBVA
Martin Rich, Future-Fit Foundation
Giles Sibbald, UBS & David Newman, Delio Wealth

- *"There's a huge amount of capital that is ready to go into sustainable investment opportunities."* - Giles Sibbald

  Collaboration and aggregation are critical to achieving impact at scale. Align17, a new digital platform, is striving to syndicate and channel investor demand towards the SDGs. It aims to match up supply and demand for sustainable investments, bringing together foundations, family offices, high net worth individuals and institutions like the World Bank and IFC.

- *"We need to know where we are actually heading. What does that place look like and how do we assess our progress?"* - Martin Rich

  The Future-Fit Business Benchmark aims to allow investors to assess whether companies are causing harm or contributing towards system value (e.g. restoring the environment and helping to make society fairer). To do this, Future-Fit is working with others, including Sustainalytics, to create a system value rating for companies, as well as developing new ESG templates that capture information on both negative and positive externalities created.

- *"Too often, the left hand doesn't know what the right hand is doing."* - Martin Rich

  There is a lack of communication both within companies and within investment firms. ESG analysts and financial analysts assessing the same equities don't talk to each other. Investor relations and sustainability teams often give out contradictory messages. And, notwithstanding the growth of integrated reporting, sustainability reporting remains too siloed in most companies. There is increasing interest in sustainability topics from investors, but we're starting from a very low base, so companies need to be more proactive in pushing sustainability issues up the agenda.

Roundtables: Pathways to a Breakthrough financial system

Achieving the Sustainable Development Goals requires a shift in ambitions from incremental to exponential change, from short-term to long-term outcomes, and from managing risks to pursuing new opportunities for value creation. How can finance be an accelerator of—rather than a brake on—progress towards the SDGs?

6 roundtables explored this question. What follows is a summary of the key themes, ideas and questions surfaced during the roundtable discussions.

- Redefine purpose.
  - We have to turn portfolio construction on its head: rather than ESG being a secondary lens that gets overlaid on financial value, we should start with positive impact.
  - From 2D investing to 3D investing: risk, return and impact.
  - For investors, we need to shift from a transactional to a relational focus. Who is the industry intended to serve? What do those people truly care about?

- Use the SDGs as a framework.
  - There is a need to consolidate and the SDGs potentially provide a common framework around which to rally investors and companies. The fact that 50% of PRI members see the SDGs as relevant is encouraging up to a point, but it's also concerning that, conversely, half of PRI signatories don't see the SDGs as relevant.
  - There's a danger that addressing the SDGs is a case of treating the symptoms rather than the cause. We need to keep capitalism's structural challenges in mind—e.g., the offshoring and/or automation of jobs, inequality etc.
  - Reporting on and measuring both positive and negative impacts in an integrated way is critical. The multi-capital approach, mapped against the SDGs, can be useful in this respect.

- Redefine success.
  - Companies need to look at success not merely in terms of results, but in terms of how things are done.
  - We need to get much better at distinguishing between "true profit" and "fake profit".
  - Incentivising companies to focus on value creation, whilst internalising externalities is key.

- Break into the mainstream.
  - Education and financial literacy are critical if we're to successfully mainstream sustainable investing. We need to empower asset owners with knowledge about the choices they can make and the implications of those choices.
  - We need to learn to collaborate with those who may not be like-minded.
  - We need to simplify the language and lower the barriers to entry for engaging in sustainable investing.

- A new, simpler language.
  - The current framings used in the financial industry such as "Socially Responsible Investment" (SRI), or "Environmental, Social and Governance" (ESG) investing can sometimes be misleading. Most SRI and ESG investing is focused on minimising risks and negative externalities, rather than on innovation and value creation in line with the SDGs. We need a new framing of investments focused on the latter. We are already beginning to see a confluence between mainstream ESG investing and impact investing.
  - Sustainability reports rarely actually get read by asset managers—and the language is inaccessible for the majority of asset owners. A traffic light system, based on a single measure of sustainability, might be more useful in its place.

- Use technology to accelerate progress.
  - Can we digitalise all the data present onto a single platform—an app that can help the finance industry navigate sustainable investing? Can technology help to break down the complexity behind sustainability into something that people can understand?
  - At the same time, we need to rigorously test new technologies—and figure out if and how they can be gamed.

- Pay more attention to SMEs.
  - Small and medium enterprises (SMEs) account for about 90% of business, and more than 50% of employment worldwide. SMEs are also the growth engine in developing countries. How can sustainable investing (and lending) be used to help encourage SMEs to address the SDGs?
  - Integrating sustainability terms into rental contracts and mortgages in return for other benefits to customers is one promising example of what can be done.