



Forum for the Future

Financial Systems and SRI

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Financial Systems for Sustainability and Responsibility

- Much of the focus in SRI has been on investors' impact on individual companies
- But long-term investors and their fund managers have an interest in the impact of the financial system on:
 - Environmental Protection
 - Social Development
 - 'Macro' issues such as economic stability and growth
- Financial Regulators and Central Banks also have a key role to play and a responsibility for financial stability
 - Investors should engage with them (on macro issues) as well as the companies they are invested in.



How should Financial Systems encourage sustainability and responsibility?

- By providing the oil that lubricates the economic system
 - By debt and equity prices providing a powerful signal to companies to be sustainable and responsible
 - By allowing equity owners to encourage corporate responsibility through their corporate governance activities
 - By providing capital for the companies and technologies of the future
- This was the focus of the ‘Financing the Future: the London Principles of Sustainable Finance’ project
- Helping to improve this process is the ambition of the MoU between the Corporation of London and UNEP



Debt and equity price signals

- SRI has part in a cost of capital signal for better corporate sustainability and responsibility
 - Government and civil society action required to give value to an environment or social service
 - An emissions market and accounting standards are required to make that value transparent
 - Sustainability rating analysts are required to understand how that value drives a company's competitive position
 - SRI-type stock selection and actively managed funds are required to turn that understanding into an equity price premium or discount, or change the interest rate spread



Active investor engagement

- SRI has a part in more engagement in actively encouraging better corporate governance
 - Corporate governance covers a broadening range of assets
 - Corporate governance covers a broadening range of stakeholders
 - Company law needs to be clear whether equity owners are in a joint venture with management
 - Analysts are required to show the materiality of sustainability and responsibility issues to long-term enterprise value
 - Long-term investors in Anglo-Saxon markets are developing new models of ‘relational’ investing to ensure that strategies and management structures are in place to deliver ‘long-term’ shareholder value



Capital for businesses of the future

- SRI has a part in the supply of new capital for the businesses and technologies of the future
 - Secondary equity markets affect use of existing assets, which is the main role of SRI today
 - Transformation is only achieved ultimately by replacing the capital stock
 - Capital markets not used for bulk of business investment
 - SRI investors should consider alternative asset classes
 - Venture capital
 - Project finance
 - Micro-credit and mini-enterprise lending
 - Property
 - If they want to have an influence on the sustainable economies of the future



Financial systems do not always provide the oil to lubricate the economic system

- Corporate governance failures in the US destroyed investor trust and has paralysed capital markets
- Bubble-generated debt has paralysed the banking system in Japan and led to decade (?) of lost growth
- 'Crony capitalism' in developing Asia has led to banking and then currency crisis with an, albeit short-lived, period of lost growth
- Globalisation (capital account liberalisation) in developing Asia fuelled the financial bubble and contributed to instability
- World Bank/IMF 'stabilisation' programmes in developing Asia have revealed the importance of institutional and other capital assets for economic success
- SRI does not have all the answers to these policy areas but it can make a contribution, and arguably has a responsibility to do so