

# Financial system change

Transforming capitalism to make  
it fit for a sustainable future

# Financial system change

Transforming capitalism to make  
it fit for a sustainable future\*

**Beth Knight**

Head of Corporate Sustainability for EMEIA  
Financial Services

\* This paper was originally published as a submission to the Robin Cosgrove Prize in Ethics in Finance 2015.  
The paper represents the opinions of the author and not necessarily EY's point of view.

# Contents

Introduction	1
Rebooting capitalism	3
Traditional change approaches aren't working	5
A question of value and values	8
Bold and innovative strategies are needed	11
Conclusion	14

# 01 Introduction

---

Our modern system of capitalism is no longer fit for purpose. Faced with a growing series of economic, social and environmental challenges the time has come to reboot the way capitalism is conducted and to recalibrate the way we value resources, people and the services they provide.

One hundred and fifty years after 19th century thinkers coined the term capitalism, this free market system of private investment and ownership in the pursuit of economic growth has more than proven its worth. It has made nations great, turned fledging companies into corporate powerhouses and delivered social development and an unprecedented standard of living to millions of people all over the world.

Yet these achievements have come at a high cost for the planet we inhabit and at a rate that threatens the physical wellbeing of many more millions of its inhabitants. At the same time, despite facilitating the growth of a global middle class, capitalism has exacerbated the divide between very rich and very poor – a phenomenon that is only increasing. Today, industries and economies are being shaken up by technological change, the world's population is consuming more natural resources and they are rushing to settle in cities at a faster rate than ever before.

Increasingly, as United Nations (UN) Secretary General Ban Ki-moon has described it, our economic mindset and models look like “a global suicide pact,”<sup>1</sup> adding: “We mined our way to growth. We burned our way to prosperity. We believe in consumption without consequences.”

Traditional capitalism proved itself incredibly successful at delivering growth in an age of abundant land, natural resources and biodiversity. That age is over.

---

**We need to shift the debate from traditional change approaches, which risk leaving problematic system dynamics untouched, to bold and innovative strategies.**

---

Such strategies would significantly shift our capitalist model towards a more resilient, equitable and sustainable economic order.

In short, we need to create nothing less than a new, sustainable form of capitalism that accurately values opportunities and risks in a global economy that is being reshaped by a changing climate, finite natural resources, dwindling biodiversity and an increasingly urbanized and connected population.

---

<sup>1</sup> United Nations Secretary General Press Release (2011). Twentieth-Century Model “A Global Suicide Pact,” Secretary-General Tells World Economic Forum Session on Redefining Sustainable Development. Retrieved from <http://www.un.org/press/en/2011/sgsm13372.doc.htm>

---

What will be the driver of this bold, innovative form of capitalism? The answer lies with our financial system. Yes, the same financial system that is seen by many as the cause of inequality, unsustainable growth and a myopic focus on short-term profit while ignoring long-term stewardship of society and planet.

The financial system is a fundamental component of capitalism. By managing large pools of capital and assets, the industry has the ability to shift economies onto a more sustainable footing. Some financial institutions already are working to improve their transparency, simplify their products and increasingly engage with their stakeholders. When investing and advising on capital expenditure, some are starting to review their investment to ensure that environmental and social risks are managed properly. For example, Citigroup holds annual events for investors to discuss equity research and financing challenges related to climate change and water. JPMorgan Chase and BNY Mellon each hold meetings with investors on relevant sustainability issues including climate change, consumer lending and business ethics. Regulation and industry standards are slowly gaining pace to accelerate this change. Yet this is just a start.

As a global society, we need the financial system to reassess how it judges and rewards business success; it needs to revalue companies and entire industries based on a world of finite resources and it needs to replace its own much-maligned culture with a new value system based on transparency, integrity and trust.

Here is how financial system change will deliver capitalism fit for this century and beyond.

# 02 Rebooting capitalism

In the early days of sustainability advocates liked to frame their thinking in terms of the “triple bottom line” of people, planet, profit. There was a sense that the pursuit of profit could be mitigated, offset even, if you proved a good steward of the planet and a good corporate citizen.

---

**Today, forward-looking corporate leaders realize that environmental and social concerns can't be separated from the economics of business – an uncertain, disruptive future means profits will depend on reducing environmental risk, identifying more sustainable ways of running operations and supply chains while developing stronger relationships and trust with society as a whole.**

---

This shift in business strategy is easy to understand when you consider the challenges companies face in a capitalist framework that no longer fits the trajectory of a changing world. Symptoms of systemic breakdown are increasingly apparent and increasingly linked. To ensure that we are meeting current needs – but not at the expense of future generations – we must achieve a fine balance between economic, societal and environmental factors. In its current form, our existing capitalist model is not getting that balance right.

Consider how the economic landscape is changing. Global economic power is shifting to rapid-growth economies and it's estimated that by 2030, such markets will comprise 63% of global GDP and amount to \$223 trillion (a 38% rise from today).<sup>2</sup> The world's center of economic gravity is tipping towards the east and south. Growing economies and populations in China, India, Sub-Saharan Africa, the Middle East and North Africa are driving socioeconomic trends including declining dependency levels, rising demographics and increasing income levels.<sup>3</sup> Such markets will gain an additional 220 million middle class consumers by 2030 – seeking levels of affluence that cannot be sustained without major adjustments to our existing capitalist model.<sup>4</sup>

The majority of that burgeoning middle class is headed to cities. The UN estimates that 54% of the world's population currently lives in cities, and by 2050 this proportion will increase to 66%.<sup>5</sup> Such rapid urbanization has significant implications for economic growth – spending power is shifting to urban areas and consumer spending on nonessential products will outpace growth in spending on essential items,<sup>6</sup> putting added pressure on supply chains. At the same time infrastructure investment and government policy are struggling to keep pace with the challenges that cities pose, including poverty, a disaffected young population where unemployment is high and an aging population that expects and needs a standard of health care not catered to in the past.

---

<sup>2</sup> EY (2014). *EY Megatrends Report*. Retrieved from [http://www.ey.com/Publication/vwLUAssets/ey-megatrends-report-2015/\\$FILE/ey-megatrends-report-2015.pdf](http://www.ey.com/Publication/vwLUAssets/ey-megatrends-report-2015/$FILE/ey-megatrends-report-2015.pdf)

<sup>3</sup> Calverley, J., et. al. (2013). *The super-cycle lives: emerging markets growth is key*. Retrieved from [www.sc.com/en/news-and-media/news/global/2013-11-06-super-cycle-EM-growth-is-key.html](http://www.sc.com/en/news-and-media/news/global/2013-11-06-super-cycle-EM-growth-is-key.html)

<sup>4</sup> Oxford Economics (2014). *Future Trends and Market Opportunities in the World's Largest 750 Cities*. Retrieved from <http://www.oxfordeconomics.com/Media/Default/landing-pages/cities/oe-cities-summary.pdf>

<sup>5</sup> United Nations, Department of Economic and Social Affairs (2012). *World Population Prospects: The 2012 Revision*. Retrieved from <http://esa.un.org/wpp/>

<sup>6</sup> Oxford Economics (2014). *Future Trends and Market Opportunities in the World's Largest 750 Cities*. Retrieved from <http://www.oxfordeconomics.com/Media/Default/landing-pages/cities/oe-cities-summary.pdf>

---

The rise of urbanization will exacerbate the impact climate change has on global society. A 2013 study projected that flooding would cost the world's 136 largest coastal cities US\$52 billion per year by 2050.<sup>7</sup> The cost of adapting to climate change for developing countries will be US\$70 to US\$100 billion per year through 2050.<sup>8</sup>

The fast growing, increasingly urban population also puts more pressure on the world's energy supplies (currently dominated by fossil fuels) and natural resource infrastructure – notably access to fresh water, which is likely to be the biggest concern in the

short term. In drought-stricken California legislators are looking to cut water usage state-wide by 25%<sup>9</sup> – adding massive costs to one of the world's largest agricultural communities while also challenging the lifestyle expectations of a state that has grown rich from the technology and entertainment industries. Away from parched California, the struggle to access fresh water has been cited as a factor in sparking the Syrian civil war<sup>10</sup> and in regional conflicts in Darfur.<sup>11</sup> These so-called resource wars will only continue as the century progresses and will pose serious challenges not just in terms of geopolitics but also to global trade and economic growth.

---

<sup>7</sup> Hallegatte, S., et.al. (2013). *Future flood losses in major coastal cities*. Retrieved from <http://www.nature.com/nclimate/journal/v3/n9/full/nclimate1979.html>

<sup>8</sup> World Bank (2011). *Economics of Adaptation to Climate Change*. Retrieved from <http://www.worldbank.org/en/news/feature/2011/06/06/economics-adaptation-climate-change>

<sup>9</sup> Fitzsimmons, E. G. (2015). *In California, Cities Braced to Cut Water by 10 to 35%*. Retrieved from <http://www.nytimes.com/2015/04/09/us/in-california-cities-braced-to-cut-water-by-10-to-35.html>

<sup>10</sup> Hammer, J. (2013). *Is a Lack of Water to Blame for the Conflict of Syria?* Retrieved from <http://www.smithsonianmag.com/innovation/is-a-lack-of-water-to-blame-for-the-conflict-in-syria-72513729/?no-ist>

<sup>11</sup> Tatlock, C. W. (2006). *Water Stress in Sub-Saharan Africa*. Retrieved from <http://www.cfr.org/world/water-stress-sub-saharan-africa/p11240>

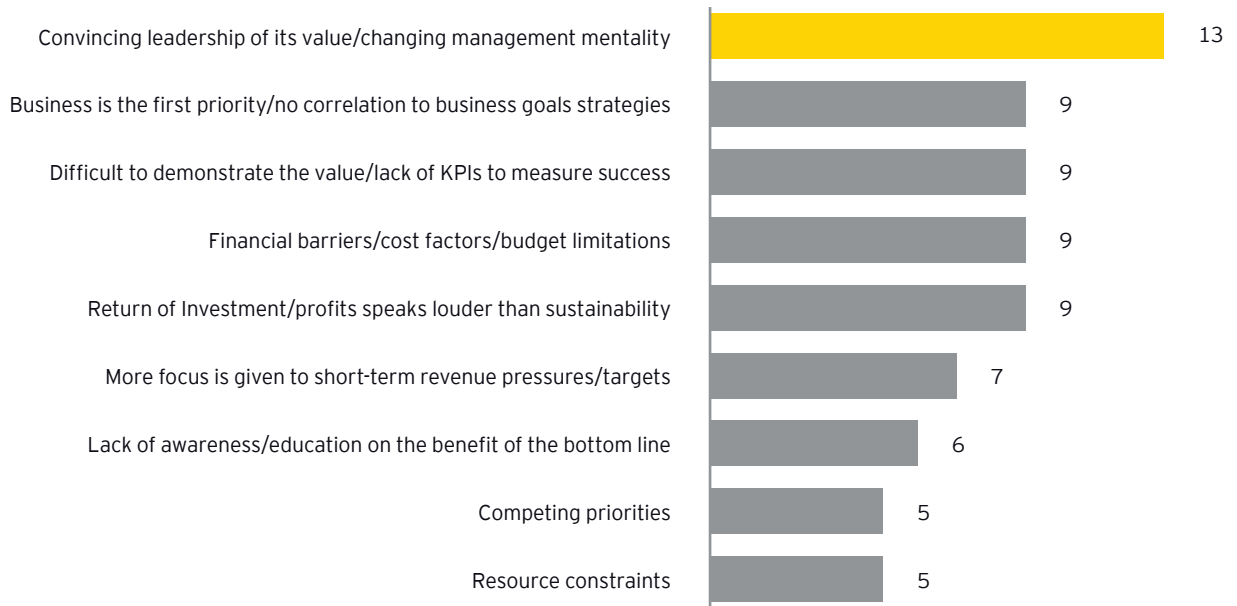
# 03 Traditional change approaches aren't working

Integrating sustainability considerations within the current model of capitalism is a difficult and disruptive process. As a result, most traditional (or incremental) change approaches are failing to tackle the systemic nature of our challenges.

Take the transition to a lower-carbon economy – acknowledged by most business leaders outside of the oil, gas and coal industries as a key element of tackling climate change and creating a sustainable global economy. Leaders are using policy instruments such as carbon taxes, emissions trading programs, deforestation disincentives and factoring carbon costs into decision-making processes. However, the World Bank estimates that US\$6 trillion will need to be invested globally in infrastructure, every year, up to 2030 to deliver a truly low-carbon economy.<sup>12</sup> In this context those current policy instruments are mere tinkering.

Convincing leadership of the value of integrating sustainability remains a major task as shown in figure 1.<sup>13</sup> There are exceptions as the sustainability leadership shown by consumer goods and technology companies like Unilever, SAB Miller, Kingfisher, Intel and Google (ones that often find themselves on the frontline of the sustainability debate) demonstrate. But all too often political leaders, investors and chief executive officers (CEOs) are taking incremental steps (often two forward and one backward) as they underestimate the interlinked nature and scale of the relevant risks to business. This is often connected with challenges such as the difficulty in demonstrating the value of integrating sustainability – especially where there are financial constraints and where profit is prioritized over social and environmental concerns.

**Figure 1: Barriers to integrating sustainability, 2013 (% of total mentions) based on the 2013 BSR-Globescan State of Sustainable Business Survey.<sup>14</sup>**



<sup>12</sup> World Bank (2011). *Economics of Adaptation to Climate Change*. Retrieved from <http://www.worldbank.org/en/news/feature/2011/06/06/economics-adaptation-climate-change>  
<sup>13</sup> BSR and Globescan (2013). *State of Sustainable Business Survey 2013*. Retrieved from <http://www.bsr.org/en/our-insights/report-view/bsr-globescan-state-of-sustainable-business-survey-2013>  
<sup>14</sup> BSR and Globescan (2013). *State of Sustainable Business Survey 2013*. Retrieved from <http://www.bsr.org/en/our-insights/report-view/bsr-globescan-state-of-sustainable-business-survey-2013>

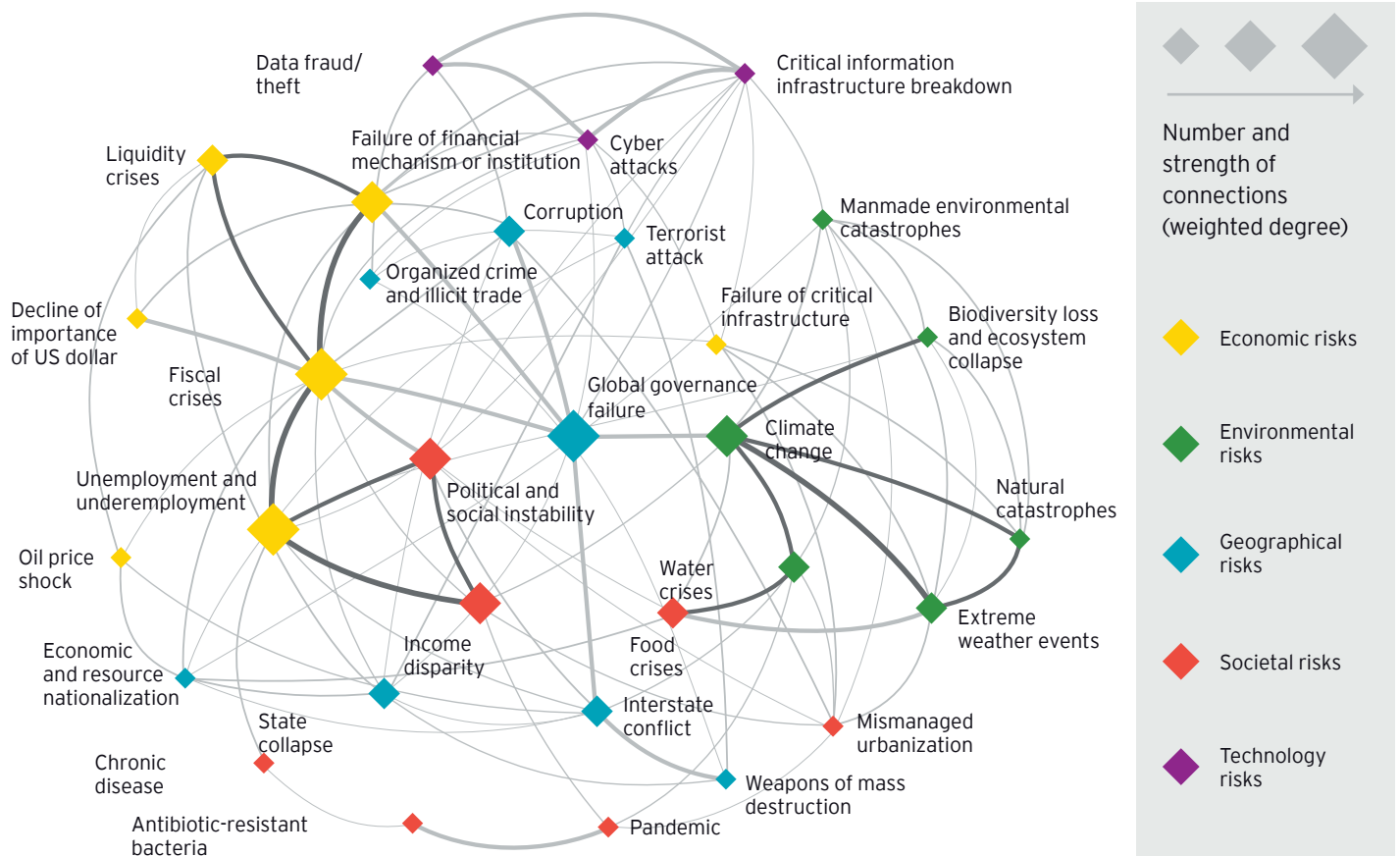


There are some examples of innovative solutions that seek to address the systemic nature of such challenges. The work of the Banking Environment Initiative (BEI) and Consumer Goods Forum (CGF)'s "Soft Commodities" Compact is a unique, client-led initiative that aims to mobilize the banking industry as a whole to help transform soft commodity supply chains and help clients achieve zero net deforestation by 2020. Most, however, are experimental and isolated from mainstream methods. Emerging initiatives often stall because they fail to provide short-term returns in the form of jobs, revenues and taxes. They are also subject to fierce competition by incumbent multinationals and their business models.

This is exacerbated by typically weak and unreliable government support for innovation in the financial system – unless there is clear competitive and political gain to be sought.

To drive change at the pace and scale needed requires disruption to the fundamental application of capitalism. The problem is that we are seeing a deep-rooted shift in the nature and complexity of the challenges we face. The World Economic Forum has developed an important tool, the "Global Risks Interconnection Map," to understand the interrelated nature of these challenges (see figure 2).<sup>15</sup>

**Figure 2: The Global Risks Interconnections Map 2014, World Economic Forum**



<sup>15</sup> World Economic Forum (2014). Global Risks 2014 Report. Retrieved from <http://www.weforum.org/reports/global-risks-2014-report>

---

By understanding global risks and the capitalist system within which we operate, it's evident that we need to take a more transformational outlook. Worthy approaches such as corporate responsibility, socially responsible investing and sustainability reporting are simply providing a short-term and makeshift fix to a capitalist model that is not adapting quickly enough to the global challenges we face. There are many projects designed to boost efficiency, effectiveness and return on investment, yet the system change imperative is largely ignored.

What do we mean by systems change? In the context of capitalism, it involves moving beyond the narrow lens of financial value to incorporate the wider influences of

environmental and social impact in our understanding. Peter Senge, systems scientist at MIT Sloan School of Management, defined systems thinking as the capstone for true organizational learning<sup>16</sup> – the ability to affect change by leveraging the linkages and interactions between the elements that compose the entirety of the system.

If we assume that system change is inevitable, our challenge becomes shifting the pace of change to enable bold and innovative strategies that seek to pioneer a more sustainable capitalist model.

That's why the financial services sector must take the lead.

---

<sup>16</sup> Senge, P. (1990). *The Fifth Discipline*. Doubleday.

# 04 A question of value and values

The financial services sector sits at the core of modern economies. It is critical to ensuring that businesses function and people maintain their livelihoods.

Capital markets play an important role in economic development – in simple terms, they facilitate the reallocation of capital across the economic value chain. Properly functioning markets should ensure that valuable projects (businesses) will be financed and facilitated, while negative value projects will be rejected. This assumes that financial institutions are incorporating all relevant factors into their investment, lending and insurance decision-making.

We know at present that they are not. The financial system, and capitalism by extension, is governed by a blinkered focus on short-term financial return and a failure to understand the bigger picture of where economic value lies in the 21st century economy.

One business leader who has railed against this short-termism is Unilever CEO Paul Polman. He articulated his views in a McKinsey article, writing:

“We have aligned management incentives for the long term and invested heavily in R&D to build our pipeline of innovations. In addition, we have moved away from quarterly profit reporting; since we don’t operate on a 90-day cycle for advertising, marketing, or investment, why do so for reporting? ... the share price may have fallen on the day we announced an end to guidance but is now 35 percent higher.”<sup>17</sup>

Polman’s vision of long-term capitalism is what the financial system needs to embrace and move away from the pursuit of short-term profits to long-term value. And how this concept of long-term value applies to two connected, but very different, areas of the economy – divestment/diversification from fossil fuels and accounting for natural capital – will have major implications.

If we are to have even a 50% chance of limiting the rise of global temperatures by two degrees Celsius we can burn just a third of current fossil fuel reserves between now and 2050, according to the IEA’s 2012 World Energy Outlook. Within parts of the financial system, the prospect that global oil and mining companies will be forced to abandon their “stranded assets” is very real indeed. In 2013, HSBC analysts warned that oil and gas majors could lose up to 60% of their market value if current global carbon reduction targets came into effect.<sup>18</sup> And in both the US and the UK there is a growing movement calling on institutional investors to divest from fossil fuel companies – driven in part by ideological motivations admittedly but also by a concern that oil, gas and coal are a bad long-term bet.

While the financial system starts to question the long term value of fossil fuels, it is also starting to get excited about “natural capital” – the concept of placing economic value on natural resources and biodiversity – and how that new economic weighting radically changes the business calculations of what products and investments actually are profitable.

<sup>17</sup> Polman, P. (2011). *The remedies for capitalism*. Retrieved from [http://www.mckinsey.com/features/capitalism/paul\\_polman](http://www.mckinsey.com/features/capitalism/paul_polman)

<sup>18</sup> Nichols, W. (2013). *HSBC: BP, Shell, Statoil at risk from “unburnable” reserves*. Retrieved from <http://www.greenbiz.com/news/2013/01/30/bp-shell-statoli-risk-unburnable-reserves>

Global human activity resulted in an estimated US\$6.6 trillion environmental costs (11% of global GDP) in 2008 according to the UN Principles of Responsible Investment.<sup>19</sup> In 2008, the world's 3,000 largest publicly listed companies were responsible for US\$2.15 trillion cost of environmental damage. And over 50% of company earnings could be at risk from environmental costs in an equity portfolio weighted according to the MSCI All Country World Index.<sup>20</sup>

These are the figures that convince environmentalists that business will soon value natural resources. But unless these costs are a line item on a company's balance sheet most investors and analysts won't understand their importance (for example, it's notable that environmental risks are missing from Basel III banking reform).<sup>21</sup>

---

**Even then, looking at natural capital only in terms of the cost of environmental damage misses the greater point of what they are worth in a world where natural resources and biodiversity are becoming increasingly important for business sustainability and profitability.**

---

Take HSBC, which was the first private bank to adopt the decision-making framework of the World Commission on Dams to reduce the risk that water scarcity poses to its business.<sup>22</sup>

Some sustainability leaders have serious concerns about putting a market price on natural resources. However, as companies take government regulation, costs of sourcing and availability of natural resources into their future planning, natural capital is going to become an important consideration for executives and investors. Acting now to minimize natural capital impacts is likely to cost companies far less than if they are forced to take action later on.

Assigning the correct long-term economic value to fossil fuels and natural capital will have enormous implications for both the financial system and capitalism as a whole. Indeed, if the financial services sector can show bold leadership in this re-evaluation of the value of natural resources, then it will have taken a major step to becoming sustainable and "fit for purpose."

But if the financial system is going to lead this transformation to an economy based on long-term value rather than short-term profit, then it first has to put its own house in order and address its own business values.

The short-term myopia of the financial services sector has done far more damage than skew the sensibilities of CEOs – it has created a working culture that is costing financial services companies billions each year in fines and penalties.<sup>23</sup>

---

<sup>19</sup> PRI and UNEP Finance Initiative (2010). *Putting a Price on Global Environmental Damage*. Retrieved from <http://www.unpri.org/press/pricing-environmental-damage-28-trillion-by-2050-2>

<sup>20</sup> PRI and UNEP Finance Initiative (2010). *Universal Ownership – Why environmental externalities matter to institutional investors*. Retrieved from [http://www.unepfi.org/fileadmin/documents/universal\\_ownership\\_full.pdf](http://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf)

<sup>21</sup> UNEP Finance Initiative, (2013). *Analyses whether and how Basel III addresses systemic environmental risks*. Retrieved from <http://www.unepfi.org/fileadmin/documents/StabilitySustainability.pdf><sup>22</sup> HSBC (2005). *Freshwater Infrastructure Sector Guideline*. Retrieved from <https://www.hsbc.com/-/media/hsbc-com/citizenship/sustainability/pdf/freshwater-infrastructure-guideline.pdf>

<sup>23</sup> Titcomb, J. (2014). *The banking industry's bill for bad behavior: \$300bn*. Retrieved from <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11228773/The-banking-industrys-bill-for-bad-behavior-300bn.html>

---

The excesses and scandals of the past decade are both shocking and also predictable in a culture where the pursuit of short-term profit trumps all other considerations. The subprime mortgage debacle that brought Lehmann Brothers to their knees, the widespread mis-selling of payment protection insurance (PPI) by UK retail banks, the manipulation of LIBOR rates or the facilitation of tax evasion and money laundering by some financial institutions are just the most egregious examples of this “get rich quick” culture.

As Paul Abberley, CEO of Aviva Investors, put it in 2011: “If you are investing in a company with a long-term time horizon, it very much matters to know about sustainability issues, but if you are taking a time horizon of an average holding of six weeks, you might take the view that there may be a time bomb ticking but it is unlikely to go off in my holding period.”

Some financial services companies have begun to demonstrate their commitment to sustainability by expanding investments in clean technology, adopting policies to address environmental and social risks, and

engaging in more proactive and robust stakeholder engagement and disclosure. Yet much of this progress is limited and led by a minority – and while public commitments to sustainability are welcome, the scale of commitments is still relatively small.<sup>24</sup> Change has been further prohibited by challenging capital constraints and the need to generate sustainable profits, coupled with the elevating cost of compliance as new regulation continues to emerge.<sup>25</sup> The sector has a long way to go.

---

**Ultimately, changing corporate culture in the financial services sector might seem a tall order but, when the business potential and rewards of realizing long-term value become more compelling than the foolhardy pursuit of short-term profit, it becomes clear there’s no better sector to embrace the opportunity and make gains.**

---

---

<sup>24</sup> Eccles, R. G., Serafeim, G. (2013). *Sustainability in Financial Services Is Not About Being Green*. Retrieved from <https://hbr.org/2013/05/sustainability-in-financial-services-is-not-about-being-green>

<sup>25</sup> PWC (2015). *CBI/PWC Financial Service Survey – March 2015*. Retrieved from <http://www.pwc.co.uk/financial-services/publications/cbi-pwc-survey.jhtml>

# 05 Bold and innovative strategies are needed

We require innovators, entrepreneurs and intrapreneurs, investors and policy-makers to work together to build a new system for “sustainable capitalism” that is fit for purpose (i.e., for a world that will be populated by nine billion people in 2050).<sup>26</sup> Progress will only be achieved through initiatives that dare to address key leverage points, set ambitious targets and drive them through to change the face of capitalism. The ultimate actors in pioneering this change will be the global C-suite, those leaders with incumbent power and influence to implement transformational strategies that positively influence the status quo.

---

**The challenge is great but the financial services sector – the linchpin in shaping the entire global economy – is best placed to lead this transformation from myopic profit to a wider sense of value.**

---

The financial services sector already demonstrates its understanding of long term value through responsible investment guidelines like The Climate Principles, The Equator Principles and the UNEP Finance Initiative, as well as sustainability ratings like the FTSE4Good and Dow Jones Sustainability Index. In recent years new sustainability financing models have developed in the form of the Business and Biodiversity Offsets Program, the Environment Bank Ltd, Global Impact Investing Network and the Global Alliance for Banking on Values.

But to make this business philosophy mainstream, the sector needs its own leaders to articulate what many already know – the current obsession with short-term performance and rewards isn’t sustainable.

The seeds of change are already apparent. Just look at how the global insurance industry has reacted to finding itself on the sharp end of climate change. In 2012, some 30 leading insurance companies joined a UN-backed process to promote a set of Principles for Sustainable Insurance. Together they were worth over US\$5 trillion in assets and represented over 10% of world premium volume.<sup>27</sup>

Transformation is also taking place within middle-management as a generation of Millennial executives – armed with ideas and values attuned to assessing the opportunities of long-term capitalism – move up the ranks.<sup>28</sup>

It’s clear that the talent exists within the financial system to shape a capitalism that is fit for our future. To make that happen those leaders will need to collaborate and implement comprehensive system change. Here are the six key principles they will need to embrace.

---

<sup>26</sup>United Nations, Department of Economic and Social Affairs (2012). *World Population Prospects: The 2012 Revision*. Retrieved from <http://esa.un.org/wpp>

<sup>27</sup>Business Green (2014). *Industry unites around Principles for Sustainable Insurance*. Retrieved from <http://www.businessgreen.com/bg/news/2185489/industry-unites-principles-sustainable-insurance>

<sup>28</sup>The Next Generation Vision (2015). *A positive future for financial services*. Retrieved from <http://www.nextgenerationvision.co.uk/assets/Uploads/Next-Generation-Vision-brochure.pdf>

---

## **Bold and innovative strategies are needed**

Responsible finance and leadership start at home. To help shape this new sustainable capitalism, the financial system must embrace a corporate culture that rewards responsible behavior and performance. That will involve agreeing and adhering to international treaties on issues like tax evasion and money laundering. Financial institutions in developed markets must assert their leadership through syndications or arrangements with markets that have yet to join the sustainable finance movement. This will be increasingly important over time as developing countries that have no experience yet in sustainable finance become increasingly major players. Most critically, this shift will be dependent on institutionalized formal oversight of environmental and social issues. It will necessitate educating employees that along with the power that comes with shaping a global financial system also comes responsibility both to society and the planet.

## **Reframe government regulation and policy, where it's not "fit for purpose"**

Too often financial system regulations and policies are reactions to short-term behavior rather than forward-looking frameworks for sustainable development. A capitalist and financial system based on realizing long-term value will need regulations and policies that correct externalities, such as climate change and social inequalities, via a suitable market mechanism (e.g., through taxes or subsidies).

These policies also will need to restrict the power and influence of "too big to fail" financial institutions and multinationals – in a world where 51 of the top 100 economies are corporations.<sup>29</sup>

## **Ensure long-term incentives are in place and embedded in corporate values**

The financial system trained and incentivized a generation of smart traders, managers and investors to think in terms of short-term gain and the advances made through technology and digital connectivity have supercharged this mentality at the expense of what is sustainable for the long term. Now is the time to rethink growth in sustainable terms. Some companies are starting to reward their employees for building trust, adopting long-term decision-making and meeting sustainability targets as part of their approach to Profit and Loss (P&L). Incentivizing sustainable investing will be crucial to change short-term thinking in the financial services culture.

---

<sup>29</sup>Unesco (2010). *Corporate Power Facts and Stats*. Retrieved from [http://www.unesco.org/education/tlsf/mods/theme\\_c/popups/mod18t04s01.html](http://www.unesco.org/education/tlsf/mods/theme_c/popups/mod18t04s01.html)

---

## **Champion innovation in investment products and services**

Moving beyond a culture of short-term profit will be viewed as nothing but empty rhetoric unless the financial services sector can create products that make sustainable investing and management attractive. Luckily, financial institutions have had no trouble attracting some of the brightest talent – it was these minds that created so many of the complicated derivative vehicles that drove profits pre and post the 2008 financial crash.<sup>30</sup> So the question isn't whether innovation can be used to create sustainable financial products, but how creative can the financial services sector be in turning sustainability ideas into sustainable business. That will involve new vehicles for green investing, natural capital management and improving pension fund management to secure the futures of retirees and protect people from excessive speculation and gaming the system. It will also mean exploring new avenues for alternative and inclusive finance<sup>31</sup> – making crowdfunding and peer-to-peer lending acceptable and responsible.

## **Integrate environmental and social materiality alongside economic performance**

The financial services sector needs a more rounded and integrated understanding of what factors will make companies successful in the new capitalist age. This will entail understanding the value of natural capital in a world where natural resources become

more precious. It will also include nurturing talent in an era of global mobility, and being responsible corporate citizens in a connected society where reputations and share price can be harmed in an instant. The companies people trust are the ones that will distinguish between market value and fundamental value – accounting for things such as job creation, poverty alleviation, education, health care, agriculture, public transport, infrastructure, water, low-carbon energy, affordable housing, low-carbon mobility, food and waste.

## **Improve reporting transparency and forward-looking risk assessment**

To gain trust the financial services sector has to embrace transparency both in the way it reports its own actions, and in the way it assesses future investments and operations. In addition to evolving data disclosure and reporting, sustainability risks must be disclosed in financial filings and the industry must embrace third-party nonfinancial auditing while making integrated reporting mandatory (similarly to the practice adopted in South Africa). Voluntary principles and standards, such as the Equator Principles and UN Principles for Responsible Investment, are meaningless unless the C-suite of financial institutions hold themselves to account for their commitments and performance against sustainability goals.

---

<sup>30</sup>Sikka, P. (2012). *Bankers must be made to bear the cost of their reckless risk-taking*. Retrieved from <http://www.theguardian.com/commentisfree/2012/nov/04/bankers-bear-cost-risk-taking>

<sup>31</sup>Wardrop, R., Zhang, B., Rau, R. & Gray, M. (2015). *Moving Mainstream – The European Alternative Finance Benchmarking Report*. Retrieved from [http://www.jbs.cam.ac.uk/fileadmin/user\\_upload/research/centres/alternative-finance/downloads/2015-uk-alternative-finance-benchmarking-report.pdf](http://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2015-uk-alternative-finance-benchmarking-report.pdf)



# 06 Conclusion

---

We've seen instances in our history where change is not linear or predictable – revolutions occur and unintended consequences ensue. This is largely fuelled by a state of denial (there is no problem, there may be a problem, but we are not to blame, it's not our role to fix this), followed by compliance (the regulators have told us to act, our competitors are doing this so we should look to keep pace), to the point where a few brave innovators will look to lead change (to be the change they seek to see in the world). The emerging focus on systemic issues within our financial system, and ultimately our current capitalist model, means that the change agenda must be transformational and led by the global C-suite.

The recent economic downturn has reinforced a natural inclination to incremental change in the form of corporate responsibility, social

innovation and sustainability reporting. It's not about a roadmap for change, or iterative steps along a journey – bold and innovative action must be taken to ensure our future and the future of generations to come. We need to take the best of what is being developed by incubators and enable big companies to work with entrepreneurs, sector specialists and other business leaders to activate timely and tangible innovation. This could take the form of new products and services, business models and incentives – or bold steps to address the leverage points highlighted in the previous section. Paradoxically, our best hope for transformational change at scale lies in the C-suite of incumbent businesses.

# Contact information



**Beth Knight**  
Head of Corporate Sustainability  
for EMEA Financial Services

T: + 44 20 7951 7121  
E: [bknight@uk.ey.com](mailto:bknight@uk.ey.com)

EY | Assurance | Tax | Transactions | Advisory

## About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [ey.com](http://ey.com).

© 2015 EYGM Limited.  
All Rights Reserved.

EYG No. CQ0255

11220\_11235.indd (UK) 07/15. Artwork by Creative Services  
Group Design.

ED None



In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

[ey.com](http://ey.com)