Event Summary: "Brexit: An opportunity to create a more sustainable financial system and Capital Markets Union?"

The UK's decision to leave the European Union presents opportunities and challenges for responsible investors. In November 2016, we ran an event for civil society leaders which explored the responsible investment issues around Brexit. This is a report of that event.

ShareAction exists to make investment a force for good. Our vision is an investment system that truly serves savers, supports communities and protects our environment for the long term.

This vision cannot be achieved without an international outlook, nor without collaboration with our neighbours across Europe. Many in European civil society recognise the growing power of capital markets to shape our world, and see the value in co-ordinating, collaborating and supporting each other as champions of responsible investment. It is clear that the future of the financial services industry in the UK and Europe will be a key topic in the Brexit negotiations. It is less clear what this means for responsible investment, particularly as the European Union (EU) is moving ahead with its ambitious Capital Markets Union (CMU)[1] programme to create a single market for capital, make the finance system more sustainable and work better for citizens whose trust in this sector is so low.

Our event on 11 November 2016, "Brexit: An opportunity to create a more sustainable financial system and Capital Market Union?" explored the outlook for responsible investment in the aftermath of the UK's referendum decision to leave the EU. We hope that the event helped to further understanding of both the risks and opportunities for the sustainable finance agenda raised by Brexit, and encouraged the responsible investment community to engage fully in the important debates to come. This paper summarises the discussions that took place at the event, and reflects the views expressed by those who participated.

We would like to thank everyone who attended the event and took part in the discussion. In particular, thanks to our speakers:

- Anneliese Dodds MEP (Labour), Economic and Monetary Affairs Committee
- Camilla de Ste Croix, Senior Policy Officer, ShareAction
- Cecilia Thorn, Head of International Relations, FRC
- Daniel Brooksbank, Editor, Responsible Investor
- Dr Ian Williams, freelance consultant specialising in financial services and responsible investment
- Ingrid Holmes, Director, E3G
- Jon Hoare, Director of Policy, ShareAction
- Mick McAteer, Founder and Director, The Financial Inclusion Centre

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- Molly Scott-Cato MEP (Green), Economic and Monetary Affairs Committee
- Nick Robins, Co-Director, United Nations Environment Programme (UNEP) Inquiry
- Paul Watchman, Director of Sustainable Finance of the CCP Research Foundation[2]
- Ron Batten, Chair of the Responsible Investment Working Group, EFAMA (the European Fund and Asset Management Association)
- Sue Rust, Senior Reporter, Investment & Pensions Europe
- Dr Waltraud Schelkle, Associate Professor of Political Economy, European Institute, LSE
- Will Pomroy, Manager, Hermes Investment Management

What has the EU ever done for responsible investment?

A key topic of discussion during the event was the current status of responsible investment within the EU. For those concerned with protecting sustainable finance in the Brexit context, it is important to recognise and defend the progress that has been made within the EU. However, it is equally important to recognise the challenges that responsible investment has faced, and to identify opportunities for improvement as the UK negotiates its future relationship.

Progress

The discussion recognised the progress made on responsible investment within the EU. Anneliese Dodds argued that while the majority of the UK's financial sector wanted to remain in the EU, the financial actors that argued to leave tended to be those that stand to benefit from volatility and have been negatively impacted by the EU's prudential regulation. She saw these same actors now lobbying heavily for deregulation.

The various positive developments in EU policy on responsible investment were also discussed. Perhaps most notably, the recently revised activities and supervision of the Institutions for Occupational Retirement Provision (IORP) Directive now includes requirements for occupational pension funds to consider and explain how they manage environmental, social and governance (ESG) risks.[3] The IORPs requirements are the strongest yet seen on responsible investment in an EU text, and this was viewed as a major breakthrough. Mick McAteer also raised the EU's track record of measures on consumer rights and protections, including the right to a basic bank account. It was pointed out that the UK opposed this initiative, which makes it especially relevant in the context of Brexit. Waltraud Schelkle also pointed to the importance of EU policy in allowing the regulation of banks for structural reasons.

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The High Level Expert Group on sustainable finance recently announced by the EU Commission was also discussed.[4] Ian Williams expressed some scepticism as to why this group was being set up, given the wealth of information already available to EU policy makers on the state of the market. Ron Batten emphasised the need for the group to be action-focused, and to show leadership by putting things into action rather than just formulating policy proposals.

Challenges

The discussion also recognised that the EU is far from perfect when it comes to responsible investment. On the whole, it seems that financial services are over-complex, and failing to adequately serve the real economy. Mick McAteer argued that the foundation of a sustainable financial system is one where capital is transferred from where it is to where it is needed in the most economically productive and socially useful way. Judged against this benchmark, EU reform initiatives like the CMU are a long way from adequately improving the system. Rather than being a vehicle for meaningful reform, there is a danger that the CMU may simply reflect the prevailing assumption that Waltraud Schelkle identified as “more integration is better integration”.

It was also argued that the power of financial lobbyists has skewed EU authorities' understanding of investment, frustrating opportunities for progressive change. Yet to truly understand this dynamic and its significance in the context of Brexit, Molly Scott-Cato emphasised the importance of recognising the nature of policymaking in the EU. Most policy is created by the European Commission and then amended and approved by the European Parliament and European Council which represents member states. Understanding financial regulation in the EU therefore requires looking to member states, including the UK, as opposed to analysing the EU as an entirely separate entity.

Responsible investment in the UK

The discussion also explored the state of sustainable finance in the UK, which is equally important to understand in order to assess the likely impacts and avenues for action on responsible investment under Brexit.

Progress

It was encouraging to hear Cecilia Thorn from the UK's Financial Reporting Council (FRC) present on the steps the regulator has been taking in the wake of the Brexit vote. She emphasised the importance of the UK remaining a magnet for global capital and maintaining its wealth of talented professionals with the capacity to innovate. She highlighted that the Corporate Governance Code, the Stewardship Code, and accounting standards which are set and monitored by the FRC, are all significant contributors to the UK's status as an attractive place for investment activity. However, she also recognised the need to strengthen the regulatory environment to address past failures, combat a race to the bottom, and address the erosion of trust in business in the UK, which has been accelerated by the increase in inequality that has accompanied wealth creation. Also recognised was the importance of changing corporate and financial culture if regulatory changes are to realise their intended impacts.

The discussion also recognised the significant thought leadership the UK has shown on sustainable finance. For example, Ingrid Holmes pointed out that the UK played an important role in pushing for and shaping the EU's Non-Financial Reporting Directive.[5] She also pointed to the existence of good advisory services, and the establishment of a Green Investment Bank. The UK has also taken the lead in introducing a corporate governance code and a stewardship code, which are now being replicated in Europe and Japan.

Challenges

However, Nick Robins made the point that while the UK does act as a thought leader on sustainable finance, it often fails to institutionalise the necessary reforms. For example, France is ahead of the UK on the implementation of responsible investment initiatives, despite the fact that much of the thought behind such initiatives originates in the UK. In terms of climate risk, it was also pointed out that while the UK has been a leader in some areas such as the Climate Change Act,[6] it has also frequently opposed progressive climate legislation in the EU courts.

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London is clearly a hub for finance, but it seems to be lagging behind when it comes to sustainable finance in particular. Ron Batten pointed out that while London represents a 40% market share for European financial services, it has a much lower share of sustainable finance. In this area London is competing with other financial centres across Europe, all with roughly similar amounts of sustainable financial assets under management.

London's financial sector is clearly extremely effective when it comes to providing services to international clients, such as helping other countries to raise capital through bond issuances. However, Nick Robins pointed out that it is lagging behind on servicing the productive economy in the UK. In this respect, Brexit could be an opportunity to re-orientate the UK's financial sector towards better serving, and investing in, the UK's economy.

It was also pointed out that while London is the first point of call for financial advice on bond issuance, it is actually relatively weak when it comes to the issuance of green bonds. The danger associated with the relative underperformance of the market for sustainable finance in comparison to the prominence of finance in general in London was summed up well by Mick McAteer. He warned that "there is a big ship called capitalist finance, and a tiny ship called green finance". Post-Brexit, the UK may begin to attract more mainstream capital, tipping the balance further against sustainable finance which "risks being swamped".

Brexit: implications of anger towards the financial sector

The discussion also explored the interpretation by many of the Brexit vote as an expression of popular anger at the status quo. Some of this seems to have roots in the 2008 financial crash. Despite increased public anger towards the financial sector since then, there has been a distinct lack of institutional reform. Thus, a financial sector bailed out by public funds appears to continue with business as usual, while the rest of the population faces the impacts of the crash. The sense of injustice generated by this situation can be seen to have fuelled the fire of anti-establishment sentiment that arguably contributed to the result of the referendum.

Nevertheless, much of the public debate around Brexit has been focused on the need to protect the UK's financial sector. The extent to which the City should be awarded a privileged position in the trade-offs that will occur in Brexit negotiations is therefore an important question for those concerned with reforming the system and promoting sustainable finance.

Interesting discussions were had on the need to determine the true value of the UK's financial sector: is it a stunning cash cow, or a dangerous time bomb? Anneliese Dodds and Molly Scott-Cato both highlighted the irony that as Members of the European Parliament who have until now argued for stronger regulation of the financial sector and highlighted its shortcomings, they are now in the strange position of defending it. The dangers to the British economy of losing passporting rights, the right to clear euro-denominated trades and access to the single market were emphasised. Parts of the population that are angry at the financial sector would be happy to see it and its so-called 'fat cats' suffer under Brexit. However, it was argued that letting the sector 'fall off a cliff' and then trying to reassemble it would not be the best way to create a more sustainable, socially useful finance sector. Moreover, the financial sector provides a significant number of jobs, beyond just the high-earners in the City. Protecting these jobs is therefore an important consideration as the future of the City is forged against a Brexit backdrop.

Yet, it was also suggested that the value of the City has been overstated. Waltraud Schelkle pointed out that while the annual tax revenue from financial services is £30 billion, the bailout of the Royal Bank of Scotland (RBS) alone cost the taxpayer £113 billion. Nevertheless, Mick McAteer emphasised that until the government is persuaded that the City's value is inflated, the power of financial lobbyists to direct the political debate around Brexit, and policymaking more broadly, will persist.

Solutions: what can be done to protect and advance responsible investment?

During the group discussion, some participants expressed fears over the potential impact of the growing anti-establishment sentiment behind both Brexit and Donald Trump's presidential victory across the Atlantic. This was seen as a direct challenge to the continued growth and success of responsible investment. Moreover, concerns about deregulatory lobbying taking place around Brexit, and its potential to trigger a race to the bottom, came up frequently. Once again, the result of the US presidential election was identified as accentuating this risk.

Mick McAteer pointed to the potential for deregulation in America – such as through the repeal of the Dodd-Frank act, previously hinted at by Donald Trump – to have a dangerous influence on bolstering downward pressures on financial regulation in the UK.

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Nevertheless, Camilla de Ste Croix emphasised the importance of identifying the opportunities associated with Brexit, and fighting to positively influence the process. Civil society's involvement will be vital to defend and promote sustainable finance; apathy is not an option. The first step may be to demand more information from the government, and clear procedures whereby progressive voices can influence the discussion. There is a lot of uncertainty surrounding the Brexit process, and the UK Government is committed to a "no running commentary" position. Nevertheless, civil society will look for, and demand, access to the process both during and after the negotiations.

Rather than racing to the bottom, the potential for London to join cities like Dublin, Luxembourg, Singapore, Hong Kong and Shanghai in a race to the top to become the responsible investment capital of the world was discussed. In an environment in which pension funds are struggling due to low interest rates, there is a strong case to be made for the sustainable returns offered by responsible investment, particularly through stewardship of investee companies. Ron Batten and Will Pomroy pointed to the wealth of evidence showing that responsible investment does not negatively impact financial performance. Ingrid Holmes went a step further, arguing that responsible investment is no longer a "nice to have", but a "must have" risk management strategy.

Additionally, there was general agreement on the need to make finance work for the real economy. Molly Scott-Cato argued that the UK should rethink its prejudice against public banking: RBS should be nationalised properly, rather than sold off at a loss to the taxpayer, and used to support the middle strand of business, following examples set in Germany. Nick Robins highlighted the need to develop meaningful connections between the finance sector and the population at large; ShareAction's campaign to rally institutional investors behind calls for companies to pay a Living Wage was cited as a good example of how this can work in practice.

Lastly, Jon Hoare pointed out that whatever the outcome of Brexit negotiations, the EU will still influence the UK's financial system and vice versa. EU initiatives like the CMU therefore remain highly relevant to the future of sustainable finance in the UK. If the UK remains in the single market, it will have to implement new EU legislation and even if the UK leaves the single market it seems likely that regulatory equivalence will be maintained.[7] Those fighting for responsible investment in the UK and EU must therefore continue to work together and learn from one another, maintaining the strong relationships and networks that have been forged so far.

Conclusions

The UK's vote to leave the EU is a landmark political event that will impact all sectors of society and the economy. As the UK negotiates its future relationship with the EU, strong engagement is required from civil society to defend existing progress on responsible investment.

The referendum result clearly raises fears and challenges. Yet as Jon Hoare emphasised, Brexit means change, and change means opportunity. Avenues for the advancement of sustainable finance during this political sea-change must be identified and acted upon.

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Many commentators and participants in our event believe that the swell of anti-establishment feeling, and the sense that globalisation has not delivered economic benefits to a large proportion of voters, are what propelled many to vote for Britain to leave the EU, and for Donald Trump to be the next US president. While these responses may at first seem at odds with the responsible investment agenda, they are in fact what make it all the more salient. The financial system must be made to work for ordinary people: to provide investment in left behind communities, and to serve the real economy. Responsible investment is no longer just a topic for the finance sector. It is an issue of vital importance for the entire economy, and everyone in it.

References

1. For more information see: European Commission (2016). *Capital Markets Union*, European Commission. Available online at: http://ec.europa.eu/finance/capital-markets-union/index_en.htm [accessed 19 December 2016].
2. Paul Watchman was unable to attend the event due to unforeseen circumstances, but a paper detailing his position is forthcoming.
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7. For more detail on this, see Williams, I., (October 2016), *Brexit: an opportunity to create a more sustainable financial system?*, ShareAction. Available online at: https://shareaction.org/wp-content/uploads/2016/11/CMU-Brexit-Background-Paper-2016.pdf [accessed 19 December 2016].

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About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes Responsible Investment practices by pension providers and fund managers. ShareAction believes that Responsible Investment helps to safeguard investments as well as securing environmental and social benefits.

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