Tomorrow's Finance

How to make finance socially useful

Tomorrow's Finance lecture, 5 December 2012

by Matthew Bishop

Tomorrow's Company in partnership with MAM Funds plc

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Matthew Bishop is the U.S. Business Editor and New York Bureau Chief of *The Economist*. Mr Bishop was previously the magazine's London-based Business Editor.

He is the author of several books, including most recently an e-book, "In Gold We Trust? The Future of Money in an Age of Uncertainty", with Michael Green. "The Road from Ruin" (also with Green), about how to improve capitalism following the crash of 2008 and subsequent economic downturn, was published in 2010. It was described as "provocative and refreshing" by the *New York Times*. According to Professor Robert Shiller of Yale, "The Road from Ruin" will be *"remembered as a serious, highly readable book of the broadest intellectual scope. Its insights will help all of us reshape the future and enable both citizen and policy maker alike to separate real reform from the grandstanding bluster so prevalent today."*

"Philanthrocapitalism: How Giving Can Save the World", his previous book (also with Green), on the new movement that brings together the business and social sectors to solve some of the world's most pressing problems, has been described as "terrific" by the *New York Times* columnist Nicholas Kristof, and as *"the definitive guide to a new generation of philanthropists who understand innovation and risk-taking, and who will play a crucial part in solving the biggest problems facing the world"* by New York's Mayor and leading philanthropist Michael Bloomberg. According to former U.S. President Bill Clinton, *"This is an important book. Our interdependent world is too unequal, unstable, and, because of climate change, unsustainable. We have to transform it into one of shared responsibilities, shared opportunities, and a shared sense of community. Bishop and Green show us how to do it."* Mr Bishop is also the author of "Essential Economics", the official *Economist* guide to economics.

Mr Bishop is the author of several of *The Economist's* special report supplements, including most recently 'The Great Mismatch', about the future of jobs; 'A Bigger World', which examines the opportunities and challenges of the rise of emerging economies and firms; 'The Business of Giving', which looks at the industrial revolution taking place in philanthropy; 'Kings of Capitalism', which anticipated and analysed the boom in private equity; and 'Capitalism and its Troubles', an examination of the impact of problems such as the collapse of Enron. He is a member of the World Economic Forum's Global Agenda Council on the Role of Business. He is on Twitter as @mattbish.

A few months after the fall of Lehman Brothers brought the global financial system to its knees, I was invited to take part in a conference at Columbia University's Center for Capitalism and Society on the topic of "Emerging from the Financial Crisis". Gathered there in the fake renaissance splendour of Columbia's Casa Italiana were many of the finest economists, investors, bankers and financial policymakers of our time. George Soros, Joseph Ackermann, then the head of Deutsche Bank, Christine Lagarde, France's finance minister before her promotion to head the IMF, Nobel prize winning economists Joe Stiglitz, Ned Phelps and Bob Mundell, as well as my old boss, back at London Business School, Britain's very own John Kay.

Yet the speech that I remember most clearly was by Paul Volcker, the 81-year old former chairman of the Federal Reserve. (We now know that Volcker was speaking just after Barack Obama had decided not to appoint him as his first Treasury Secretary – in my view, a missed opportunity of historic proportions.) Everyone looks up to Volcker, and not just because he is six foot seven. Having seen off inflation when he was chairman of the Fed, in the years before the crash he was an often lone voice of wisdom and integrity, especially when he warned that deregulation was going too far, or pointed out that in the financial markets irresponsibility was everywhere.

In his speech Volcker told us that this was a crisis unlike any other, and that there could be no going back to how things were before. *"Relatively unbridled financial capitalism operating on a global basis has broken down,"* he said. He was incredibly rude about the modern finance theory that had dominated academia for decades, and had provided the intellectual backing for all sorts of financial innovations on Wall Street and the City. (The innovation in the previous few decades that had really made a difference to the average person, he said, wasn't some fancy derivative or collateralised debt obligation, but the good old ATM machine).

He then told us how his *"heart sunk"* the day when he asked his grandson what he wanted to be when he grew up, and got the answer, *"a financial engineer"*.

That wasn't the end of the story. Volcker had been rude in public about the role financial engineers had played in the crash by coming up with fancy ways of obscuring the deteriorating quality of credit in the economy. His daughter saw these comments and told her son, by now in his dream financial engineering job at a bank. He sent an email back: *"Grandpa, don't blame it on us! We were just following the orders of those guys up above, getting the big salaries."* To which Volcker replied, *"I will not accept the Nuremberg defence."* Ouch.

Now consider the comments that Adair Turner made three years ago from this podium, which provoked so much controversy. *"Some financial activities which proliferated over the last ten years were 'socially useless'"*, he said, *"some parts of the system were swollen beyond their optimal size."* Compared to Volcker's, Turner's conclusions seem mild, even feeble.

From Volcker to the Occupy movement, the financial collapse of 2008 has certainly given rise to a great deal of righteous anger. That said, Fred the Shred should probably consider himself lucky that Parliament has not taken up a proposal by one of its even angrier members in the 18th century. After the bursting of the South Sea Bubble, the MP proposed that directors of the South Sea Company should be *"sewed into sacks, with a monkey and a snake, and drowned."* No need then for a massive pension.

If anger is one common response to a financial crisis, so is denial. Rather than engage in a serious debate about what went wrong with the financial system and how to fix it, the sort of debate Volcker called for, too many of the leaders of the City and Wall Street have said *"crisis is over – let's get back to business as usual."* In January 2011, Bob Diamond of Barclays, who at least had turned down his bonus two years in a row, famously told Parliament that *"there was a period of remorse and apology for banks – I think that period needs to be over."* 18 months later, he had to fall on his sword when the LIBOR fixing scandal came to light. Cue more expressions of remorse and apology from Diamond's successors.

I can think of no more potent symbol of the current leadership crisis in finance. The mere passage of time and a frankly half-hearted apology from some in the City certainly doesn't justify ending a process of financial reform that, so far, has barely scratched the surface of what needs to be done. It is also a warning to those in the City who are still in denial – that if they fail to change they may be the next to have to eat humble pie in front of the politicians.

Let's be clear. Many of the reforms that are still needed to make finance socially useful were obvious even before the crash.

I was a member of the Tomorrow's Company inquiry into investment in the twenty-first century, chaired by Sir Richard Sykes. We published a report called 'Restoring Trust' which concluded that *"there has been a significant and continuing erosion of trust, not just in the financial services industry but also in big companies as stewards of people's savings and pensions."* This was in 2004.

Surprise, surprise, the Restoring Trust inquiry was, alas, largely ignored both by my colleagues in the media and the leaders of finance that we had hoped to influence.

Launching the report, Sir Richard said that *"what is needed is a change in the culture of the financial system that genuinely puts the customer first and takes a longer-term view, so that the whole chain creates value for the end-customer and continues to create wealth for all of us in the UK. This requires an act of collective leadership that puts common interests ahead of the traditional fiercely competitive instincts of the City."*

Imagine if we had been listened to back in 2004. Maybe it needed a crisis on the epic scale of the one we've just been through to shake people out of their complacency and denial. But is anyone listening in 2012?

In the months after the crash, my co-author Michael Green and I drew on two decades of financial reporting for *The Economist* by me and economic policymaking by him to try to make sense of what went wrong and figure out what was needed to put capitalism on a more sustainable and unambiguously socially useful footing. The result of this soul searching and reflection was our book, "The Road From Ruin".

To cut a long story short, we became convinced that the crash had been caused as much by toxic ideas as by toxic assets. The most toxic of these ideas was the 'efficient market hypothesis', or at least the lobotomised version of it that spread like a virus throughout the financial system.

One of my favourite interviews as a journalist was in the spring of 2000. With my then colleague Richard Cookson, I was led through the bowels of the Federal Reserve to an audience with Alan Greenspan, the then chairman. At the time, this was like I sometimes imagine it would be to come face to face with God. He sat in a huge leather armchair, with an enormous pair of horn-rimmed spectacles, peering at us as we perched uncomfortably on a chaise longue while Richard explained at length why he thought the American banking system was riddled with bad debt and doomed to collapse. *"Very interesting"*, Greenspan responded after a lengthy silence, *"but that bears no relation to the American banking system I know." The Economist* one, Greenspan nil.

Today, I often wonder why someone as intelligent as Greenspan was taken in so easily, and placed so much faith in the rationality of the market. There was just that one moment of doubt, back in 1996 when he wondered aloud about the possibility of share prices being moved by *"irrational exuberance"*, then the great mind slammed shut. But his was hardly alone in that. The simplistic version of the efficient market hypothesis that took hold provided intellectual cover for a short-termist mentality to spread like a cancer to every part of the financial system, and then to the rest of the economy. It should surprise no one that this cancer of short termism spread fastest in those parts of the financial system where staff are involved in managing other people's money, not their own.

At its most basic, this faith in the infallibility of financial markets led to an increase in a company's share price being taken as an unambiguous sign that the company is headed in the right direction. Executive bonuses became linked to these short-term increases in the share price. Pension funds competed against each other to be better at spotting where these short-term increases in share prices would occur, asking only – "is our portfolio sufficiently diversified?" Absent from their thinking, with a few honourable exceptions, were principles of responsibility and stewardship that should underpin the concept of fiduciary duty to those whose savings they invest.

In this world of short-termist finance, it is no surprise that companies have tended to focus on maximising short-term profits and all too often have promoted into leadership positions those best able to deliver bigger short-term profits – people who I suspect are often unusually accomplished at not thinking about the long-term consequences of their actions. In finance, as Volcker explained at that dinner, this short termism manifested itself in a culture known as IBGYBG – 'I'll be gone, you'll be gone'. In its weakest form IBGYBG led to grandsons pleading the Nuremburg defence; and, in its worst form, to people colluding in doing deals they knew to be bad, pocketing their commissions, then getting a new job before the chickens came home to roost.

For investment firms and regulators, as Lord Turner admitted in his speech here, these toxic ideas led to a belief that any financial innovation should be welcomed as long as it provided liquidity to the market. Nobody asked where that liquidity came from (excessive short-term trading, perhaps?), or whether the liquidity would be there in the tough market conditions when it was most needed. In 2008, many markets that had seemed to be oases of liquidity turned out to have been mirages.

Instead of the efficient market hypothesis we need economic ideas that reflect how people actually behave. We need economic theories with an appreciation that markets and institutions can often behave imperfectly, not least because they face or create incentives that reward people for doing so.

These new ideas will certainly lead us to want new measures of the performance of companies and, indeed, of national economies. A short-term increase in the share price can often be a very poor guide to a company's long-term performance, for example. I'm glad to see a growing recognition by remuneration experts that incentives for chief executives based on the performance of the firm's shares should not be bankable until some years after the boss has left that post, giving time for the true performance to become clear. And of course, financial performance, short or long-term, can be a poor guide to a company's social usefulness. So the sooner companies start doing the sort of integrated reporting of their financial, social and environmental performance proposed by the International Integrated Reporting Council (and the Global Reporting Initiative), the better.

Likewise, short-term increases in GDP can often be a poor indicator of a nation's economic health. We celebrated the strong economic growth in the first few years of this century, when perhaps we should have viewed it as a warning that we were growing unsustainably.

Lord Turner argued here that the finance sector had grown to too large a share of Britain's GDP. I don't know if he is right. As I will argue later, perhaps a truly socially useful finance industry would be an even bigger part of our economy than today's sometimes socially useless one. But it is clearly the case that rather than merely rejoicing at the rising share of finance in GDP it should have prompted some serious questions, such as, why is this growth happening? Can it continue in the long term? Does it reflect rising wealth or something less positive, perhaps a dangerous increase in the amount of debt in the economy? Instead, we all cheered the growing contribution of finance to our GDP much as the directors of Barings bank once cheered the ever growing value of Nick Leeson's derivatives portfolio, with similar consequences.

We also need to place much less emphasis on short-term financial value and much more on enduring ethical values. Finance needs to rediscover a professional ethic, one that, as the Restoring Trust report proposed, actually puts the interests of customers first. This is not an unrealistic demand. I know I write a lot about the case for philanthropy, but I do not expect financiers to ever become selfless altruists.

There are alternatives to IBGYBG and the short-termist 'greed is good' of Gordon Gekko. Remember not so long ago, when Goldman Sachs was still a widely respected private partnership rather than a giant vampire squid? Back then, before its customers became 'muppets', the investment bank used to describe its philosophy as 'long-term greedy'. As a starting point, that is not a bad slogan for the sort of enlightened self-interested behaviour that would move finance in a more socially useful direction.

In "The Road From Ruin", Michael Green and I worried that any attempts at fixing the financial system would focus too much on banks at the expense of far more important changes needed elsewhere. Alas, so far that is how it has played out, in the United States – with that confused 2100 page Frankenstein's monster, the Dodd-Frank Act – on the continent, and here in Britain.

In part, we worried that most of the reforms proposed for banks were nothing like as straightforward and costless as their supporters claimed. We can all agree that going into September 2008, most of the world's big banks had too little capital to survive the coming crisis. Yet it does not follow that if regulators increase bank capital requirements they will prevent future disaster – unless, of course, banks themselves believe they need more capital, in which case there should be no need for the regulator to impose it on them.

The most famous capital requirements are known as the Basel rules. When we write about them at *The Economist*, we like to use headlines such as 'Basel brush' (boom, boom) and 'Basel faulty'. There have been several attempts to set rules that work. Currently, we are on Basel III. And like 'Police Academy' sequels, they don't really get any better. The story of Basel and other attempts to increase capital adequacy is one of well-paid financial engineers finding clever ways to exploit loopholes in rules set by less well-paid regulators. This appearance of compliance creates a false sense of security as levels of risk in the banking system soar. On the other hand, as we are already seeing, higher capital requirements reduce the supply of credit to the economy, especially to small businesses and poorer people, whose protests tend to ensure that tougher capital rules are rarely fully enforced.

Likewise, history shows that so-called 'structural' reforms that try to reduce society's exposure to financial losses by separating risk-taking from utility retail banking tend to be undermined, sooner or later. In some cases, banks find loopholes in the rules. Sometimes a big new 'shadow' banking sector emerges that is not subject to the regulations, and which eventually grows so big that, in a crisis, government cannot afford to let it experience the full downside consequences of its bad risk-taking. That is why it is unwise to rely much on structural fixes such as the Volcker rule, which separates investment and retailing banking, or the Vickers Commission plan to 'ring fence' retail bank assets inside a combined retail and investment bank.

And, yes, we can all agree that no bank should be 'too big to fail' – and I like, at least in theory, the idea of the 'living will' for a bank that makes the process of failing more straightforward – but how big is too big, exactly? How long is a piece of string? My hunch is that whatever the political process, lobbied by the City, whatever amount of assets is judged, small enough to fail will not be small enough.

But the bigger problem in focusing on the banks is that their bad behaviour is mostly merely a symptom of deeper social uselessness elsewhere in the financial system – much as a heart attack is less about the structural flaws of a heart than the bad diet, lack of exercise, excessive stress and so forth of the person whose heart it is.

In "The Road From Ruin", we argue that the members of the financial system in greatest need of reform are the institutional investors, such as pension funds, which manage our savings, especially long-term retirement plans. They are the organ grinders to banking's monkeys. And they are currently playing some lousy music. Indeed, to continue the metaphor, this begs the question of why we, the public, are not doing a better job of calling the tune, and what we can do about it.

The obsession of many institutional investors with short-term profit growth is one of those terrible tunes. By now there is extensive empirical evidence that the bosses of public companies are heavily influenced in their decision making by a belief that the market will punish them for any actions that depress short-term profitability, even if it raises expected long-term profits. In banking and investment banking, this pressure to keep growing even as high-yielding investments became ever harder to find led to ever more reckless borrowing in the hope of boosting profits.

As an illustration of what might happen if public companies were encouraged to take a longer-term view, look no further than the private equity firm of Kohlberg Kravis Roberts. Nowadays, private equity firms are relatively long-term investors. However, you will remember KKR back in the 1980s when they were known as the Barbarians at the Gate. You may not have heard of their more recent activities, such as a flourishing partnership with the Environmental Defence Fund, which gets full access to all the companies in the KKR portfolio and is invited to propose ways in which to make them more sustainable – and to publicly criticise KKR if these ideas aren't taken up. Over the long term, KKR reckons this Green Portfolio Program will add significantly to its profits. At the end of last year, it reported cost savings since starting in 2008 of $365m, and said it had avoided 810,000 metric tons of greenhouse gas emissions, 2.2 million tons of waste and 300 million litres of water.

My own experience was not so positive in the early 1990s, when as a local councillor I chaired a local authority pension fund committee. I succeeded in persuading my fellow councillors to adopt a responsible investment policy requiring our outside fund managers to take account of environmental and social impacts when making their investment decisions. But when I tried to switch to fund managers who specialised in this sort of investing, I fell foul of our pension fund consultants. The reports they wrote on the pros and cons no doubt met the legal definition of fair and balanced, but their tone was so remorselessly negative that they scared us into doing nothing. Today, the innate conservatism of pension fund consultants – if that is the right word for it – remains a serious obstacle to progress.

Another way that institutional investors failed to invest our money properly was by neglecting to play the ownership role required of shareholders. They did far too little to ensure that banks were prudently governed, by electing suitably qualified directors and by demanding that those boards performed their duties well. I am with Lord Paul Myners in thinking that supine institutional investors who are unwilling to behave like owners have left boards and executives unscrutinised, creating what are in effect 'ownerless corporations'. Clearly this governance failure extends far beyond the banking sector, though it clearly contributed to the problems there. Why else did the board of Lehman Brothers include a retired admiral, a theatre producer and an octogenarian actress who appeared in Caddyshack 2?

We need new rules to empower shareholders further. The 'shareholder spring' this year seemed finally to justify the introduction of 'say on pay' votes a decade ago – though I can't help feeling that the excited headlines were more a reflection of how disengaged shareholders had been in the past than a sign that they are now fully engaged as owners.

How to increase long termism in the investment system is the focus of the recent review conducted for the government by John Kay, who long ago gave me my first real job after university. I'm glad to say I like almost all of what John has to say in his final report, from his sceptical comments about the *"exaggerated faith"* placed in the efficient market hypothesis to the pragmatic mixture of legal, regulatory and voluntary industry responses he proposes. I'm sure my fellow members of the Restoring Trust inquiry will applaud John's emphasis on the need for our investment institutions to rebuild trust and develop a culture of stewardship.

In only one respect do I wish that the Kay Report had taken a stronger line – the need for clearer law on what constitutes the fiduciary responsibility of anyone investing other people's money. It seems to me that we need new or improved laws that clearly extend fiduciary responsibilities to everyone involved in managing investments for others, and which broaden the definition of a loyal, prudent fiduciary to be more than someone simply trying to maximise financial returns. The campaigning group FairPensions has been calling for this kind of change, whereas the Kay Review is ambivalent. Any new rules should push investors to play their proper role as owners as well as to manage environmental risks and take into account wider factors such as the quality of life that will be enjoyed by the ultimate beneficiaries of the investment strategy.

On the subject of the FairPensions group, I wonder if we are seeing the long overdue first stirrings of a new movement reconnecting savers with how their money is invested.

Catherine Howarth, the chief executive of FairPensions, argues that the public whose money is being invested should *"be at the table, asking how the industry that invests on our behalf is going about its business, and pushing for greater transparency about what is being done with our money."*

I have often wondered why pension funds make so little effort to engage with their future pensioners over how they invest their money. Why doesn't every pension fund follow the example of Warren Buffett, who rents a sports stadium to welcome thousands of shareholders in his investment company to spend a day grilling him on his strategy and decisions? Why isn't this sort of 'Woodstock for capitalists' the norm for investment organisations?

Surely the time has come for all of us to hold our investments to the same ethical standards that many of us now apply to the products we consume. Just as ethical consumerism has over time driven significant change in how companies produce, so this responsible investment movement could drive change in how our investment institutions invest on our behalf. This could be a genuinely new 'citizen capitalism'. Built on long term, engaged ownership by the public, this 'popular capitalism 2.0' would be the exact opposite of the 'sell off the family silver cheap' version of popular capitalism pushed in the 1980s by Mrs Thatcher.

One potential obstacle is that the public does not yet really know what is involved in being a 'citizen capitalist'. Does it mean moving your money out of a big bank into a small local one, or writing to your pension fund company and asking if it has signed up to the UN Principles for Responsible Investment, and if so, what is it doing to comply with them? Maybe. But leadership is needed to help figure this out. Perhaps Tomorrow's Company will take up the challenge.

Already there are some encouraging signs that this movement's time has come. Top of the list is the fact that Sir Richard Branson is about to throw his massive charisma behind making capitalism better. In the new year he will launch something called the 'B Team', a team of a dozen business leaders who have run their firms in an enlightened, long-term oriented way. By the way, yes, there are some companies – let's call them tomorrow's companies – that are run in positive, long-term ways. There have even been sessions at the World Economic Forum in Davos where bosses of big firms like Nestlé and Unilever declared their commitment to creating 'shared value' that simultaneously benefits shareholders and society.

Each of Branson's B Team leaders will take on one specific reform, and with the others work to build a popular campaign to get the reform implemented. Top of the list will probably be proper accounting for environmental impact, an end to quarterly reporting of financial results and the phasing-out of fossil-fuel subsidies. If anyone can make this dull but vitally important stuff popular, I reckon it is Branson.

It would be remiss of me not to mention the contribution of my own industry to short termism. Last year, the Committee of Concerned Journalists commissioned my co-author, Michael Green, to research the performance of the news media in the run up to the crash, during it and after. This involved extensive interviews with journalists, financiers, politicians and other experts on both sides of the Atlantic. The overwhelming conclusion of Michael's report, which I highly recommend reading, was that, although all the key facts tended to get published in one place or another, the overall emphasis of the reporting was pro-cyclical. The media was cheerleading in bull markets and adding to the panic when things went wrong. Frankly, I'm not sure what can be done about this, but we should at least acknowledge the problem and take a serious look at possible remedies.

It is my belief that it is by no means inevitable that shifting the financial system to a long-term orientation will reduce innovation or put talented financial engineers such as Volcker's grandson out of work. My hope would be that instead, the ingenuity of financial innovators would be directed more towards socially useful ends.

I don't fully share Volcker's view that the most worthwhile financial innovation in the past few decades was the ATM, important though it was. Financial engineering often has been misused, either deliberately or negligently. Yet the innovation of high yield 'junk' bonds has given many promising companies shunned by the banking system access to much needed growth capital, for example. Even sub-prime mortgages helped many poorer people buy their home, until those in charge of that market lost their discipline and lent to people who would be hard pressed to afford the repayments on a home not really worth what they paid for it.

Securitisation also has helped extend access to basic financial services to millions of families in the developing world, not just through microcredit but also in micro-insurance and micro-savings accounts.

Ending the exclusion of millions of people from the mainstream financial system is one of the biggest challenges innovators have to solve if finance is ever to be truly socially useful. The African-American social entrepreneur John Bryant says that financial exclusion is the biggest civil rights issue of the 21st century. He has proposed a set of 'silver rights' including access to financial literacy education and a bank account for every person.

One of the main causes of financial exclusion is the high cost of providing financial services to poor people. I expect the coming era of big data, combined with ubiquitous mobile phone based digital payments systems, to allow a dramatic reduction in these costs. This has the potential to be a cornucopia of socially useful finance.

Richard Thaler, the behavioural economist who is the inspiration for the world renowned ‘nudge unit’ in 10 Downing Street, says that government can help this along by passing ‘smart disclosure’ laws to give people rights to their personal financial data in a useful digital form, instead of the current useless paper format. Thaler points out that many people make bad financial decisions because they find finance too complex and intimidating. With smart disclosure, whole industries may emerge to analyse that data and help people make better decisions about, say, which credit card or mortgage to have. That would be another example of socially useful finance.

Another important American economist, Bob Shiller, the man who told Alan Greenspan about ‘irrational exuberance’, has long argued that we should create all sorts of new socially useful financial instruments. One example he has proposed is a security tied to the income of a particular profession, allowing people to hedge the lifetime earnings risk they take when opting to enter one profession over another. Another idea is for governments to limit the impact of the economic cycle on public finances by creating debt securities whose payments automatically vary in step with the rate of growth or decline of GDP. I’ve come to share Shiller’s belief that the best way to extend the good life to more people is not to shrink the finance sector nor *“restrain financial innovation, but instead to release it”*.

I could not end without mentioning my favourite topic, philanthrocapitalism, and the effort now underway, led by wealthy philanthrocapitalists, to create a new financial asset class called ‘impact investments’. These are investments that are designed simultaneously to do good for society and the environment and generate a good financial return. One of the impact investment ideas getting a lot of buzz around the world is a British financial innovation, the ‘social impact bond’. This is a way to get for-profit capital to scale up a non-profit with an idea that can reduce government spending over the long term. If the non-profit succeeds, investors get paid a good profit by the government out of the savings. On the other hand, if things go wrong, the private sector takes the hit, not government.

A social investment bond may sound simple enough, but actually it is a complex financial derivative that requires plenty of expert financial engineering. J.P. Morgan has forecast that by 2020 the ‘impact investment’ asset class could be worth between $400 billion and $1 trillion. In my view, with the City’s talent for innovation, Britain has the potential to be a world leader in what could soon be a lucrative social finance industry.

In closing, it has been assumed widely, including here by Lord Turner, that a more socially useful finance industry would generate a smaller share of Britain’s GDP and attract fewer of the country’s most talented workers. Well, maybe it would. But I think there is a huge opportunity if Britain is willing to make the difficult changes that are needed. Why shouldn’t a City of London reinvented to be the global capital of socially useful finance be a more valuable part of our economy and a more attractive place to work? After all, there is a big world out there, getting richer by the day, teeming with people looking for someone they can trust to do the right thing with their money.

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supported by:

LONG FINANCE

Centre for Tomorrow's Company
Charity registration number 1055908.
Registered office: Samuel House
6 St Alban's Street, London SW1Y 4SQ.

ISBN 978-0-9572949-3-6

£10 Institutions/Organisations
£5 Individuals/Members/Reduced
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Designed and produced by studio401