Coalition for Inclusive Capitalism

Leading the Charge for Inclusive Capitalism
Speech by Tracy Blackwell, CEO, Pension Insurance Corporation
9 March 2018

Introduction

Before I start I would just like to say thank you to Lady Lynn Forester de Rothschild and to Professor Colin Mayer for this opportunity to present my thoughts on this vital topic, in such distinguished company.

I am Tracy Blackwell, CEO of Pension Insurance Corporation.

I'm fully aware that not everyone here will have heard of the insurance company which I head, so forgive me for the brief introduction to PIC.

The purpose of PIC is to pay the pensions of our 150,000 policyholders.

To do so we have a portfolio of about £26 billion of assets backing those pensions. This portfolio has been accumulated, since 2008, by consolidating more than 150 UK defined benefit pension schemes. We provide guaranteed pensions, in bulk, to the members of those schemes. These transactions, which average £100 million in size, are agreed with the trustees and sponsoring companies of those schemes.

We're proud of our company's purpose and believe that the business model benefits individuals and the economy in a number of ways:

- We remove risk – pension risk - from companies which have perhaps proved over recent years that they aren't best placed to deal with it. This leaves them free to focus on the day job, and invest in jobs and increase productivity

- Our policyholders' benefits are then better secured within the insurance regulatory framework than in a DB scheme – they are far more likely to receive their full promised benefits with us than under the existing pension trust structure
- Finally, we recycle the assets backing the pensions into the real economy, investing in things like schools, social housing, student accommodation and vital infrastructure, such as Thames Tideway (London's "super sewer").

It's interesting to note that this process of recycling capital through the economy does address some of the issues that have been noted around intergenerational equity – securing DB pensions but investing for future generations.

==

But what does PIC have to do with Purpose? And why am I stood here today?

I think PIC has succeeded in a very closed industry, with many vested interests, primarily because we are focused on our purpose of looking after our pensioners.

Our focus on purpose means that our pensioners can rely on a secure income. 98% of our policyholders are satisfied or better with the service they receive.

The Trustees of pension schemes we insure feel they are working with an organisation they can trust and work with. We are proud that we can ask any one of the 150 pension funds that we have done a transaction with to give us a reference. Our employees feel motivated. 93% would recommend PIC as a good place to work. And 95% understand our values. And therefore, shareholder returns follow – importantly over the long term, not just the short-term.

Our shareholders are also, very long term in nature. Therefore they don't look to short term earnings gains at the expense of the long term stability and security of the business. Our long-term purpose (and I am very pointedly not using the word strategy) is very clear from the top of the organisation on down. We are successful precisely because we look after our pensioners. To borrow a phrase from a previous employer – if we look after our customers for 125 years, our customers will look after us.

So, this success got us thinking about the finance industry in general, and about its purpose – and that led us to start a series of papers on the Purpose of Finance, which is I suspect why Colin asked me to be here today.

What has been interesting about all of this to me is the sheer number of people who are thinking about the same things right now. I think this programme is an excellent example of this, but there are many others. But pointedly, with a few exceptions, most of the agitation for change is coming from small and medium sized businesses. Who believe in their purpose and are long term in their thinking.

So why is purpose so important?

Everywhere you look society seems to be under attack. People seem less and less enamoured of our democracy. For example, it's been widely reported that only about 30% of millennials (those born roughly in the 1980s) think it's essential to live in a democracy[1]. And the numbers are getting worse.

[1] https://www.forbes.com/sites/neilhowe/2017/10/31/are-millennials-giving-up-on-democracy/#34a8c3022be1

For some, this isn't very surprising. There seems to have been a relentless attack on the institutions of our democracy over recent years: Westminster, the police, charities, the media, the Church(es), big business, the City – the list goes on.

I would say that, where there is genuine wrongdoing, people should be of course held to account.

But the nature of these attacks seem to create their own momentum, leading to the conclusion that not only are groups of others engaged in some malpractice, but that they are all in it for themselves, and not only that, but these groups are disadvantaging others.

A headline in the Times this week speaks to this theme: "Workers dragged beneath poverty line by low wages."[2] The article highlights research by the Institute for Fiscal Studies which went on: "The main reason why more working households are in poverty now was because "earnings growth has been so low since the early 2000s and non-existent since the recession"."

With a declining stake in society through falling real wages for a large percentage of the population, the perception that companies, and especially financial companies, are run for the short-term gain of their senior employees and their shareholders inevitably leads to questions of how the wider system is set up. As Liam Byrne MP, Chair of the All-Party Parliamentary Group on Inclusive Growth, writes in our forthcoming publication on the Purpose of Asset Management, "recent elections in Europe and America show, in a democracy economic anger is not abstract. It shows up on election day in the votes for extreme parties and positions, which can be bad for business."

[2] https://www.thetimes.co.uk/article/workers-dragged-beneath-poverty-line-by-low-wages-xss9k5xj9

It is also true to say that business and finance do not operate in a vacuum. They are mere reflections of society, and the culture that we observe in these areas is also widespread in other parts of society.

However, that does not mean that business and finance are incapable of leading change. In fact, I believe it is crucial that they do so and that entrepreneurs and business leaders discover and focus on the purpose of what they are doing.

==

Having a purpose goes far beyond merely providing the right products for customers, important though that is.

To my mind, the purpose of any organisation dictates the fundamental principles on which that business is based. It is the guiding light for decisions and actions that are taken to achieve business goals.

Business plays a vital role in society, creating millions of jobs, providing needed goods and services and, via the taxes generated from corporation tax and income tax, directly supports public services such as the NHS, from which we all benefit.

So there is a shared space between business and society, and this symbiotic relationship works best when it is based on long-term thinking. This to me in what inclusive capitalism is all about: finding an effective long-term balance between the needs of all stakeholders, which has in some cases, broken down.

This issue is not about capability. We all know that the UK finance sector can outperform, as can pharmaceuticals, manufacturing and so on. That we have globally significant corporations in the UK is undeniable. Having a long-term business model is about more than short-term remuneration, next quarters sales figures and endless M&A.

For me, it is about character. And a focus on purpose.

==

Which brings me to the S word. Strategy.

I get asked all the time about "what is PIC's strategy?". Strategy should be about purpose. It should be about what you do as a business and how are you going to do it better.

However, I think the word strategy has become a codeword for financial ownership and structure.

In PIC's case, it is a codeword for "when are you going to IPO?" or "who are you going to merge with?". Strategy appears to have become about short-term objectives that prioritise shareholders.

Whereas purpose is different – purpose is about what is in the long-term interests of all stakeholders.

So if "Strategy" is today about short-term ownership, corporate structure and M&A, and "Purpose" is about long-term beneficial ownership of, and therefore investment in, a business, there is a clear link in my mind to the wider issues of low productivity growth weighing down the economy and the lack of growth in real wages weighing down society.

Many of you will have heard of the productivity puzzle, but how does this connect to Purpose?

The Office for National Statistics gives a good definition of the puzzle: "Economies are subject to cyclical fluctuations – booms and busts. It is not unusual for productivity to fall during downturns, as happened in 2008-09. What is unusual is the flat-lining of productivity since 2010. This is unprecedented in the post-war era and has come to be referred to as the "productivity puzzle"."[3]

And to put this in its historical context, according to Andy Haldane, Chief Economist at the Bank of England, speaking in 2017: "For the past decade, average productivity growth has been negative. This is unusual, if not unique, historically. You would have to go right back to the 18th century to see a similarly lengthy period of stagnant productivity."[4]

There is much evidence pointing to low productivity growth leading to low real wages. Bank Underground, the blog of the Bank of England states that: "The MPC, and others, have…argued that low productivity growth has been a major cause – if not *the* major cause – of weak wage growth."[5]

The Centre for Social Justice agree, in a recent report on productivity they state that "a decline in capital investment has reduced productivity growth…[but]

[3] https://visual.ons.gov.uk/productivity-puzzle/
[4] https://www.bankofengland.co.uk/-/media/boe/files/speech/2017/productivity-puzzles.pdf?la=en&hash=708C7CFD5E8417000655BA4AA0E0E873D98A18DE
[5] https://bankunderground.co.uk/2017/03/30/does-productivity-drive-wages-evidence-from-sectoral-data/

without increasing our output capacity, we are unlikely to see great improvements in wages or our quality of life."[6]

Cited in the FT, Philip Rush, an economist at Nomura, believes an ongoing misallocation of resources in the economy, together with a long-term shift to less productive jobs and sectors, will hold productivity back.[7]

For me this is a line worth pursuing as we tackle the idea of Purpose.

Let's call it the **Purpose-Productivity Puzzle.**

In my view, if businesses were to focus on "Purpose", rather than financial engineering, this should naturally lead to increased investment in the business today, to generate higher returns tomorrow. By extension, if we believe the economists, an increase in capital investment will lead to higher real wages across society.

Thus a focus on purpose will benefit a wide array of stakeholders, spreading the rewards of wealth within society more generally, helping alleviate poverty and also giving people a stake in the system.

Or to put it another way: if you give too much back to shareholders in dividends, you have less to invest in the long-term future of the company. And part of the reason for this short-termist perspective are capital market pressures, given that "corporate structure is especially relevant to investment in research

[6] https://www.centreforsocialjustice.org.uk/core/wp-content/uploads/2017/09/CSJJ5710_Productivity_report_WEB-170918.pdf
[7] https://www.ft.com/content/cc1ee450-1ff2-11e5-aa5a-398b2169cf79

and development."[8] So the corporate advisers, the investment bankers and the asset managers, along with asset owners all play a part in this problem.

So one might argue that really, at the heart of the Purpose-Productivity puzzle, is the question of "The Purpose of Finance."

==

The "Purpose of Finance" is a topic that we have been discussing for the past couple of years, progressing to the launch of our paper on this last year and a pipeline of new reports coming out on areas such as asset management (later this month – watch out for it!) and stock exchanges.

It is interesting that Purpose seems to be cropping up more and more, including recently in a speech by Sam Woods, CEO, of the Prudential Regulation Authority, entitled "Looking out for the policyholder".[9]

I think that this is partly driven by the less than spectacular results of focusing on culture in financial services. It is very difficult to change an institution's culture for the better – something I think everyone is finding 10 years after the crisis – without first focussing on the purpose of the organisation. Culture is the "how", purpose is the "why."

Few have sought a wider perspective and thought about the essential functions the finance industry should provide. Our work with David Pitt Watson and Dr Hari Mann suggests that the finance industry fulfils four specific purposes:

[8] Colin Mayer, "Firm Commitment"
[9] https://www.bankofengland.co.uk/speech/2018/sam-woods-association-of-british-annual-conference

Safekeeping of assets, Facilitating payments, Risk mitigation and intermediation.

But as we have continued to think about and discuss the topic, it has become increasingly apparent that because our financial industry is at the heart of our economy, a focus on purpose has an impact far beyond moderating undesirable behaviours in the City.

Focussing on the Purpose of Finance might help resolve the Purpose-Productivity-Puzzle.

Yet scandals in the City over the past 30 years, and the regulatory response to it, have both contributed to a situation where we are only at the beginning of a focus on purpose across finance.

==

As I said earlier, the purpose of any organisation dictates the fundamental principles on which that business is based. It is the guiding light for decisions and actions that are taken to achieve business goals. By its very nature, it is long-term.

So a simple way to think about “Purpose” might be deferred gratification, that is the ability to withstand temptation now in the expectation of something better later.

A 2013 study from the University of Chicago and the Chinese University of Hong Kong built on the ideas made famous by Walter Mischel in his marshmallow experiment.

The study developed the idea "that delay adds value in certain situations…because if waiting for something makes someone feel it is worth more, then that person is willing to display even more patience. As wait time grows, so too does the perception of value. The result? The very act of delaying gratification enables us to wait for a larger reward."[10]

But where many financial institutions are today, one might say that impulse control is both lacking, and the need for it is being eroded as we become more and more reliant on increased regulation to moderate behaviour.

I think this is wrong.

This regulatory arms race only benefits recruitment consultants, lawyers and compliance people. Don't get me wrong, in its place regulation is a vital part of consumer and systemic protection. But regulation can be overdone. It replaces a values driven approach with a legal framework.

In my view this creates perverse incentives where management teams play to the letter of the law, rather than the spirit, leading to a kind of regulatory whack-a-mole.

I understand the aims, but I question the outcomes.

For example, in 1990 there were 3,000 pages of regulation covering pensions. Today, there are 160,000, a 5000% per cent increase![11] Whilst this mass of regulation has been brought forward with the best of intentions, it's very

[10] https://econlife.com/2013/10/behavioral-economics-and-delayed-gratification/
[11] https://www.pinsentmasons.com/PDF/PAGETURNER/PENSIONSANDCHOCOLATE/files/assets/common/downloads/Pensions-and-chocolate-brochure.pdf

difficult to argue that our current pensions system is fundamentally any better than the system of 30 years ago – it's certainly not 5,000 time better!

At one level, increased costs to a business due to more regulation is simply passed on to the customer. In turn, this can make products unaffordable, pushing risks into other, less highly-regulated parts of the financial system. These unforeseen problems may contribute to future financial crises.

==

Where we are today is far from the ideal, unless of course you are a fan of complexity.

As Andy Haldane, Chief Economist at the Bank of England, has pointed out, "Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex. Applying complex decision rules in a complex environment may be a recipe not just for a cock-up but catastrophe. Because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity, not complexity.[12]"

This imbalance between risk and uncertainty is a key issue. Regulators should regulate to prevent systemic issues – individual companies should be allowed to rise and fall and investors should be encouraged to take responsibility for their investments. But underpinning this, and indeed allowing this type of system to evolve from where we are today, requires a behavioural change not just from people within the finance industry but also asset owners.

[12] "Simplify bank regulation, Haldane says", Daily Telegraph, 31 August 2012

Financial executives could do worse than starting with the question: "What are we going to do to delight the customer?". And Asset Owners could do worse than asking "what is in the long-term interests of my beneficiaries?".

Public companies will argue that they are focused on short termism because their shareholders are focused on the short term. Asset managers argue that they are only doing what their clients have asked them to do. And asset owners have the same short term quarterly governance as everyone else. But this focus on short termism at all levels means that few are willing to take risk anymore, and specifically invest in companies for the long-term. And only by taking risk and focussing on purpose will productivity improve.

A focus on purpose should be seen as an opportunity to help build an efficient, balanced financial industry that serves society much better, and where un-purposeful activities naturally fall by the wayside.

But we have to lead the charge. We have to at least regain the social contract between finance and society. However, we can do better. We could look to build a social covenant between finance and society.

To quote Rabbi Lord Jonathan Sacks, "Social contract creates a state; social covenant creates a society… Social contract is about laws and their enforcement. Social covenant is about the values we share. Social contract is about the use of potentially coercive force. Social covenant is about moral commitment, the values we share and the ideals that inspire us to work together for the sake of the common good."[13]

[13] Rabbi Lord Jonathan Sacks, "The home we build together", P.110

And if we do manage to turn that black box, understood only by experts, into something more transparent, the benefits for the economy, not least in terms of productivity growth, could be huge.

The financial services industry and capital markets have a vital role to play in helping us overcome some of the very big problems that society faces: issues around long-term savings and an ageing society; the costs of social care; intergenerational equity; the housing crisis; and improving the standard of the country's infrastructure. But it is only through a focus on purpose within the industry can finance play its full role in society and deliver the benefits of Inclusive Capitalism.

So I think we are standing at a crossroads where we have the power to not only change the narrative, but to actually also change society. There is certainly willing – as we can see from the numbers of people in this room. But it is going to take some really new approaches and ideas to change this fixation on the short term at the expense of the long term, especially in capital markets.

Which is why I am so excited about today's programme. I hope that we all come out of today with some practical ideas to change the culture of short termism to a focus on purpose.