Finding the Longitude, from Maskelyne and Harrison to Perera and Clements-Hunt: A Social Review of UNEP FI's *Financial Stability and Systemic Risk: Lenses and Clocks*

Financial Stability and Systemic Risk: Lenses and Clocks by Paul Clements-Hunt; a joint paper presented by the United Nations Environment Programme Finance Initiative (UNEP FI), the International Institute for Sustainable Development (IISD), and The Blended Capital Group (TBCG); Geneva: Switzerland, 2012, 67 pp. Available from http://www.iisd.org/publications/pub.aspx?pno=1375

Reviewed by Leland Lehrman

If the reader will oblige, I'd like to take advantage of the fact that this is a book review rather than a scholarly article to provide a "social review" of UNEP FI's latest contribution to the evolution of investment in civilization. Just so there is no confusion arising from my occasional mild critiques, readers will not be surprised that I consider UNEP FI to be the single most important division of the UN, as well as perhaps the most progressive governance institution in the world. This conclusion derives in part from the revision to fiduciary obligation made by UNEP FI in its Fiduciary 2 paper in 2009. Fid 2, in the tradition of the Magna Carta, established for the legal record the opinion of many estimable global lawyers that the fiduciary obligation extends to nonfinancial metrics and standards such as quality of life and ecological health. With the addition of the manifold updates to investment perspective afforded by *Lenses and Clocks*, UNEP FI now stands as the leading organization affecting the evolution of investment in a world where investment, rather than law or religion, provides the primary modus operandi for civilization's design or lack thereof.

I won't pretend to agree that such a state of affairs is a good thing. The evolution of the largely one-dimensional investment world has flattened and homogenized society in many ways to its detriment. Many alternatives to compliance token finance (numerical taxable currency) exist, from indigenous, self-reliant trading circles to time banks to social credit systems. But from a tactical point of view, UNEP FI is providing a framework for effective global intervention in a capital market rife with dysfunction and abusive behavior.

Before we look at the details of the document, I have a few more thoughts on the implicit communication in it, First of all, on the cover, you will find a picture of Big Ben, the famous clock in the Tower of London. In an age of networked atomic clocks, Big Ben seems quaint; but if you were to journey back in time to London's heyday, you would find that Big Ben, along with the Naval Observatory in Greenwich, provided the central timing control function for the largest geographic empire the world has ever known. Just recently, I stumbled upon the history of "finding the longitude," the process by which it became possible to keep accurate time across time zones for navigational purposes and thus reduce casualties at sea from navigational error. A fascinating story, it boils down to a journey from Nevil Maskelyne's lunar navigation tables to John Harrison's marine chronometers capable of keeping time without a pendulum. Why do I cite these facts? Because the paper's subtextual communications reveal one of the central problems of environmental finance: nature does not operate on a centrally controlled basis.

I am not arguing that the authors suggest turning the clock back to the age of empires as a solution to the environmental, social, and financial crises we face today. But I am suggesting that the continuing reliance on mechanical metrics and control systems overlooks one of the fundamental attributes of cultures that experience a high quality of life: natural integration and love for nature, rather than control over it, no matter the stated purpose.

With that said, let's take a look at the basic arguments of the paper and contrast them with global corporate business as usual. The central thesis of the paper explaining its title is contained in the opening thought from Clements-Hunt:

> *For a more stable and resilient financial system, all public and private actors involved in the investment and financial intermediation chains will benefit from the use of wider and better quality "lenses" that give greater depth, breadth and granularity to our vision and understanding of a wider range of risks. Also, those same market actors should employ "clocks" that heighten their appreciation of the temporal nature of risk by neither over-emphasizing those short-term and apparently more easily quantifiable risks nor under-emphasizing the slow, creeping risks that destroy value over the long term.*

Although it bears the bureaucratic weight of noncontroversial language in its tone, this statement is characteristic of UNEP FI's remarks: philosophically sound and welcoming to the ears of civil society, if politically bland. For the politically charged remarks, Clements-Hunt relies upon his friend the Right Honourable Gordon Brown, Scottish statesman and former British prime minister. The close relationship between the two friends was

highlighted similarly at last year's UNEP FI Global Roundtable in Washington, DC, where Clements-Hunt presided, and Brown provided the politically charged keynote address.

Brown doesn't disappoint in this paper, dredging up another iconic figure of history:

> *History tells us that communities, companies and markets only flourish in the long term when they are underpinned by shared values that promote stability. Through the centuries it has become clear that values build value and morals make markets. Seventeen years before* The Wealth of Nations*, the great Scottish philosopher, Adam Smith, gave us* The Theory of Moral Sentiments*. The moral compass Smith provided for the markets in the 18th century will enable us to steer a better course in the global markets of today.*

From the stage in DC last year, Brown did a remarkable job illuminating Adam Smith's life. A fellow Scot, Brown went to great lengths to paint a picture of Smith's seaside village and the importance of global trade to its success. None of this was particularly surprising, but Brown's real effort was to persuade the audience that Smith's *The Theory of Moral Sentiments* was the guiding light for *The Wealth of Nations*, and that the "free markets" of the world, based as they are upon Smith's "Invisible Hand," must not and cannot be divorced from moral sentiment. It is this Dickensian view of the social philosophers, from Adam Smith and John Maynard Keynes to Gordon Brown, that again provides hope for a world drowned by the high frequency, militaristic techno-economics of America and the G20. Indeed, the words of Clements-Hunt, Brown, and their colleagues remind us of the great quote by Edmund Burke: "The age of chivalry is gone. That of sophisters, economists and calculators has succeeded; and the glory of [that world] is extinguished forever."

Why do I spend so much time on the subliminal effect of this paper? Because the first casualty of modern economics is moral spirit. Lenses, clocks, mechanics, technology, economics; these tools of humankind have become masters, and before we determine how to measure our progress, we need to determine exactly where we wish to go, and what we desire to accomplish. Neither lens nor clock can tell us which way lies our heart's content, nor that of our loved ones in family, village, or nature. And so, although the paper does not explicitly discuss these subjects, the time tunnel presence of Big Ben, Brown's morals and values discussion, and a few other hints and cues here and there let the readers know that they are in the company of friends.

I hope this review will inspire readers to take a glance at the formal, systemic recommendations of the paper, many of which are very good. However, I will not provide an exhaustive inventory. The report lists six primary areas of engagement, with a focus on overcoming "short-termism" and a singular emphasis on financial performance inherent in all of them.

Here I name the six areas explored and provide a brief citation from each section (boldface emphasis within quotations is mine):

Dark Pools and the Shadow Side: Stability and Over-the-Counter Markets. "The clearest link between trading activities, OTC markets and derivatives with sustainable development is the systemic risk that **instability in capital markets poses potentially for balanced long-term economic, social and environmental development**."

Ownership That Counts: Institutional Investors and Accountability. "Since publication of the Freshfields Report in October 2005, there has been a development of 'soft law' across various jurisdictions that highlights a clear and developing trend whereby a consideration of broader risk issues by investors, including environmental, social and governance (ESG) considerations, is **not just permissible but in many cases is obligated**. In the case of institutional investors and the subprime collapse that led to the financial crisis, many questions surrounding the governance of banks in which they invested, including policies and practices regarding the fundamentals of risk management at the institutional and systemic levels, **appear to have gone unasked at worst and raised but not pressed at best**."

Listing for Stability: Stock Exchanges and Listing Requirements. "In November 2009, the UN Secretary-General, Ban Ki-moon, addressing an event exploring sustainable stock exchanges in New York, told the event: 'Stock exchanges and other financial bodies have a key role to play. Many of you have taken important steps to advance this agenda. **I welcome your efforts to incorporate ESG issues into new stock exchange indices, listing rules and regulatory frameworks**.' Subsequently, and in the run up to the United Nations Rio+20 Summit to be convened in Rio de Janeiro, Brazil, in June 2012, a broad global coalition of investor and civil society groups are backing the idea of a protocol to promote more effective corporate sustainability reporting to enhance information and data flowing into markets concerning ESG issues."

Banking Risk for the Long Term: Systemic Risk and the Basel Committee. "The banking supervisory community might argue that there is ample scope to consider sustainability risk issues within the existing BCBS [Basel Committee on Banking Supervision] parameters and that such risk is actually already factored into the Committee's well structured deliberations. Equally, the sustainability community might contend that rapid acceleration in public policy, legislative and regulatory **efforts to quantify sustainability risk and see them embedded in the markets normal assessment, pricing and accounting standards** means that they deserve a specific focus within both the structural (macro prudential) and operational (micro prudential) considerations of BCBS."

Rating Right: The Role of Rating Agencies with the Financial System. "When questioned on the potential conflicts of interest inherent in the 'issuer pays' business model of the CRAs [Credit Rating Agencies], the raters have traditionally contended that the importance of their brand independence and the accuracy of their ratings act as an efficient internal regulator. **Questions raised around CRA performance in the run up to and during the financial crisis have placed this argument under pressure**."

Insuring the Future: Stability and Solvency II. This section is more robust than the previous five, and includes a discussion of Solvency I and II, as well as the Sustainable Insurance Initiative. Perhaps it is best summarized with this editorial: "The insurance industry has long been in the vanguard of understanding and managing risk and has served as an important early warning system for society by amplifying risk signals. Through loss prevention and mitigation, by sharing risks over many shoulders, and as major investors, the insurance industry has protected society, catalyzed financing and investment, shaped markets and underpinned economic development. The global risk landscape is rapidly changing and global ESG factors require new risk management and financing approaches. **Given their multiple roles as risk managers, risk carriers and institutional investors, insurance companies have immense capacity to understand and manage ESG factors**."

The paper's final four recommendations are also worth listing:

> *Proposition 1: Build a deeper understanding of how policy-makers, market regulators and international financing institutions can support the growth and mainstreaming of responsible investment and inclusive finance approaches. Examine, identify, assess and replicate how innovative approaches can be scaled and accelerated to have a direct impact on meeting basic needs and supporting sustainability. . . .*

Proposition 2: Establish a monitoring body, which ensures that our global financial architecture is managed on sustainable fiduciary principles. The initiative will identify where there are flaws in the architecture, and advocate solutions. . . .

Proposition 3: Investigate why long-term pension investment has not resulted in a financial system that more obviously serves the interests of savers and supports global sustainability. . . .

Proposition 4: Build on the work of the Integrated Reporting Committee and others to promote transparency in the operations of financial and commercial organizations. This should include ensuring the principles upon which reports are based are sound and sustainable, and that those who provide such information are independent and that it is properly reported.