Value over Money

Synthesis of transition conversations in, with and about the financial sector

October 2023

drift for transition

RSM Erasmus
ERASMUS UNIVERSITY

Foreword

This document contains a synthesis of five conversations about transition in the financial sector. This 'transition arena' was facilitated by DRIFT, the Erasmus University transition institute, and the Sustainable Finance LAB. In this transition arena about twenty people from various corners of the financial system considered what role the financial system has to play in the current ecological and social crisis. How is the sector responsible and what role can it play a role in the transitions required? Does this imply a transition for the financial system too?

This document, compiled by Drift and SFL, shares some of the ideas and actions arising from, shared and discussed in this transition arena. This document does not so much present the consensus, but rather the thoughts, reflections and insights which can serve as a basis for further discussion and steps to take in the social transitions we face, and the role the financial system can play in these changes.

The participants were clearly highly motivated during the process. The perceived urgency created a common desire to convert the momentum for transition into actions and to show clear leadership. It became clear that participants still have very different opinions, particularly about exactly how fundamental the changes should be. The participants do not necessarily agree with the contents of this document and are therefore not mentioned as authors. However, they voice their thoughts in anonymous quotes to focus on the exchange of views and not on the individuals themselves.

We can look back on an inspiring process and would like to thank all participants for their time, intellect and motivation. This document would not exist without their commitment and willingness to discuss the issues together. We hope this provides a basis to continue tackling the major challenges with transformative energy,

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Contents

Foreword **2**

Participants and observers **3**

1. Introduction: The need for change **5**

Context: Social transitions exert pressure 5

Scope 7

Method 7

2. The downside : Four core problems **8**

Core problem 1: One-sided focus on growth and return on investment 9

Core problem 2: Backward-looking risk 11

Core problem 3: Wealth inequality 13

Core problem 4: Compartmentalisation and specialisation 15

3. Future direction: Three principles **16**

Principle 1: Social, long-term value creation 17

Principle 2: A broad understanding of risk 19

Principle 3: Transformative collaboration 20

4. A disruptive change process **23**

Black swans & grey rhinos 26

5. A desired transition **28**

The x-curve shows the transition dynamics for build-up and breakdown (Loorbach, Frantzeskaki & Avelino Avelino, 2017; Hebinck et al., 2022; Loorbach, D. 2010). Transition management for sustainable development: a prescriptive, complexity-based governance framework. (Governance, 23(1), 161-183.)

1. Introduction: The need for change

Context: Social transitions exert pressure

Agriculture, healthcare, construction, energy, mobility and water management are all nearing their ecological and social (systemic) limits. In the Netherlands, a small country partially below sea level, these boundaries are becoming increasingly tangible. A larger, systemic shift to an economy within ecological limits is unavoidable. The need for this shift is becoming less controversial, social pressure continues to increase and with this, the instability of existing systems is growing. Yet the transition, or systemic change, is faltering because in practice, it is hard to let go of the established structures, interests and routines.

In transition research, we call this phase **destabilisation** (see figure above): established regimes come under increasing pressure, erode from within due to emerging doubts and internal tensions, lose their legitimacy and face increasing competition from alternative views, solutions and opinions. Ultimately and sooner or later, this leads to a relatively short period of about ten years, in which large-scale institutional changes take place. During these complex processes it is quite common for the established parties to lose their control. After all, the processes of creating and dismantling are very erratic, making the outcomes difficult to predict.

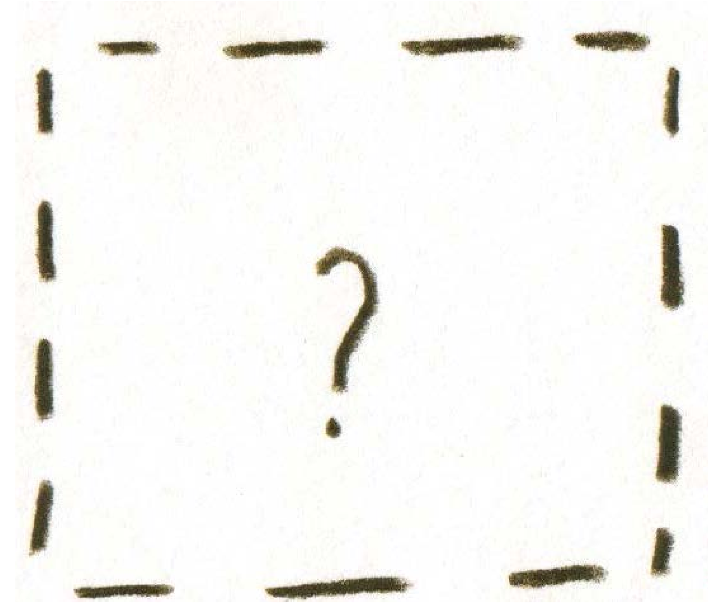
> ***"It is interesting to note that part of the sector indicates it would like to invest, but not in the uneconomic top. Almost automatically, people look to others, especially the government, to initiate these kinds of projects. It seems as if they wait patiently until an attractive proposal is presented on a platter. One would hope for more entrepreneurship here." – participant***

“ Politics and the broader world of policy making are struggling: ideally, this problem should be formulated as holistically and internationally as possible, with a view to the long term. But in practice, the issue is thornier than meets the eye, resulting in sub-optimal decisions based on short-term thinking. These do not solve the problem and are often just ‘kicking the can down the road’. Meanwhile, the damage and the challenges are increasing by the day.” – participant

Neither is the financial system immune to these dynamics. This too is under increasing pressure and we must ask ourselves: is this system also contributing to inequality and ecological damage? But can the financial sector also play a significant role in sustainability transitions? Sigrid Kaag, the Dutch Minister of finance, called this system a ‘flywheel for sustainability’[1]. The sector itself sees it that way too, as illustrated by its 2019 voluntary climate commitment. However, four years later, there are still too few specific steps being taken to achieve the climate goals set. Consequently, the Dutch government plans to increase obligations and pressure to force the sector to act more quickly[2].

This raises the question of whether the sector, as it is currently organised, is capable of financing societal transitions towards equitable sustainability. In other words: is the financial sector capable of transforming itself and the real economy concurrently towards a sustainable and equitable future? There are factors in the financial sector itself that seem to be obstructing the transition, such as the focus, culture and models that are only concerned with returns. And if the sector were actually to transition, how can we ensure it goes in the right direction, without causing panic, paralysis and large-scale disruption?

“ First and foremost, the financial sector is dependent on good impactful ideas from businesses for the impact it can make itself. It is important to recognise this. After all, this means the facilitating role is determined by changes in the real economy, and not the other way around. And this may also place greater focus on what the changes in the financial sector should actually be.” – participant



Scope

We're talking about the **Dutch financial system**: the way people think about financial transactions, how these are managed and how the system actually works in daily practice. So, it is about how parties work together to shape the rules and institutional frameworks, but also about how they define the prevailing values, opinions and routines in the financial system. This also involves the regulators, pension funds, insurers, institutional investors, banks and other parties. Each of these parties has its own interests, positions and targets. They also operate within the same scope and cooperate based on their shared logic and role in society. The systemic perspective forces parties to zoom out and look at the whole, where no one is actually in control, but each party has its own responsibility for maintaining the status quo – or not.

Our focus is on the Dutch context, bearing in mind that the European and international environments have considerable influence and that any desired changes also depend on this wider context. Despite this interdependence, we can still try to develop a new vision and strategy and so contribute to accelerating transitions, at home and abroad: after all, it has to start somewhere. Thanks to the 2019 climate commitment, the sector has indeed led the way worldwide and the climate transition plans have subsequently found their way into various European legislation and initiatives (for instance: the CSRD, CRR/CRD, SFDR and the SBTi[3]). Sustainability is already being pushed hard in a number of areas. This is due to demand from customers, who pose increasingly specific and more advanced sustainability questions, and the organisations own strategy, in some cases, pressured by (expected) legislation and regulations.

Method

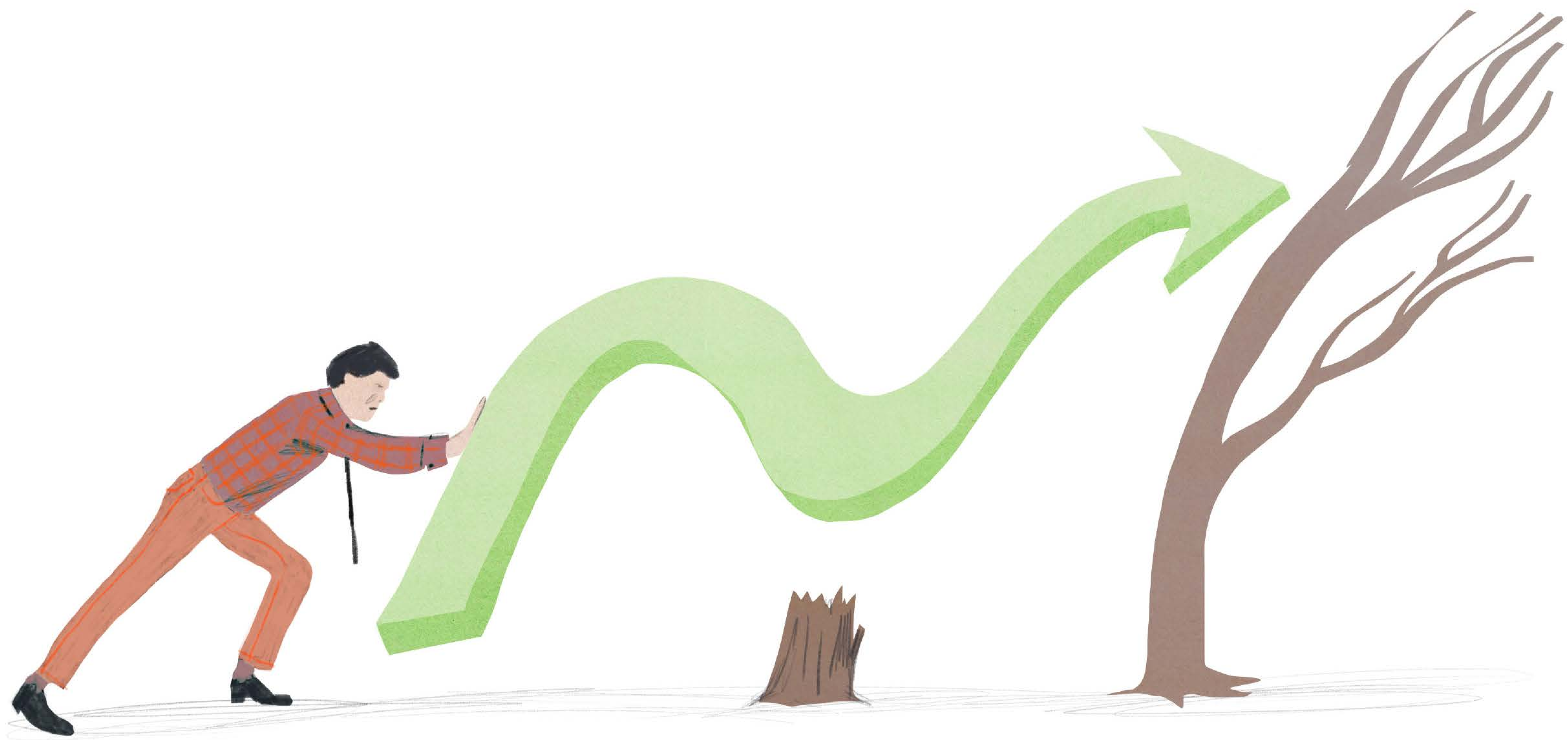
A transition arena is a method developed for scientific research in which a temporary innovation network is set up to bring about fundamental change in a specific system4. For this financial arena, some 25 change agents met in a personal capacity during five sessions. The factor linking these participants is their strong intrinsic motivation to make the sector sustainable. They not only brought together the wide-ranging institutional logic from the sector (from pension funds, insurers and the regulator, to banks and asset managers), but also knowledge and expertise in working on (radical) alternatives.

2. The downside: Four core problems

Even though much is already happening regarding sustainability, it is clear that phasing out unsustainable financing and replacing it with its sustainable counterpart, which can accelerate the transitions, has not (yet) been sufficiently developed. Even though our financial system operates efficiently and should have sufficient capacity to facilitate sustainable transitions, haste is required to define the radical changes needed and for the financial sector to build momentum for sustainable change.

The reason for this seems obvious: the 'how'. The sector is willing, but is looking for ways to make sustainability tangible. And in particular, for ways to determine when an investment is truly sustainable, and then to use existing processes and analyses on this. Although the 'how' is a legitimate issue for the sector and society to explore, the response to tackling the problem in our customary manner is potentially another dilemma in itself.

In the following pages, we identify four core properties of the current financial system that are maintained or even strengthened by a commitment to more sustainable investments or investments that are less harmful: 1) focus on growth and return on investment as key condition for a positive business case; 2) analysis of backward-looking risk; 3) maintaining wealth inequality; and 4) compartmentalisation and specialisation in organisations.



Core problem 1: One-sided focus on growth and return on investment

This much is clear from the transition perspective: continued economic growth based on the existing energy- and resource-intensive model is impossible, because we are already exceeding the planet's limits. Many parties believe that growth is an autonomous ('natural') phenomenon that we can only facilitate. If it were to falter, even temporarily, this would be bad by default. At the same time, no one can deny that in economic transitions with innovation and change, parts of the economy will disappear. A purely quantitative approach to progress in terms of economic growth is far too one-sided, because this does not take the planetary boundaries and social consequences into account. Ultimately, it is about long-term sustainable value creation.

In the past few decades, financing unsustainable economic sectors has achieved considerable economic returns without internalising the costs to society. Many of the social and ecological crises are directly related to the enormous scale on which raw materials, energy and public space are used for the needs of consumers and businesses, but also, and perhaps especially, are used for increasing capital and wealth. The sector therefore contributes to the undesirable destruction by financing the old economy and by solely focusing on financial return. At the same time, it also finances new and innovative models offering solutions and existing activities

> ***"Often, we still lack green products and services, so people aren't yet ready to say goodbye to the old grey way of doing business. We can de-grey today, immediately, but it often takes more time to go green. So a company will temporarily experience lower growth or even contract, which prevents many companies from starting the process of de-greying. But you can't go green without taking steps to de-grey. And so, the pain of temporary, grey contraction is a requirement to sharpen the incentives to go green with our products and services" – participant***

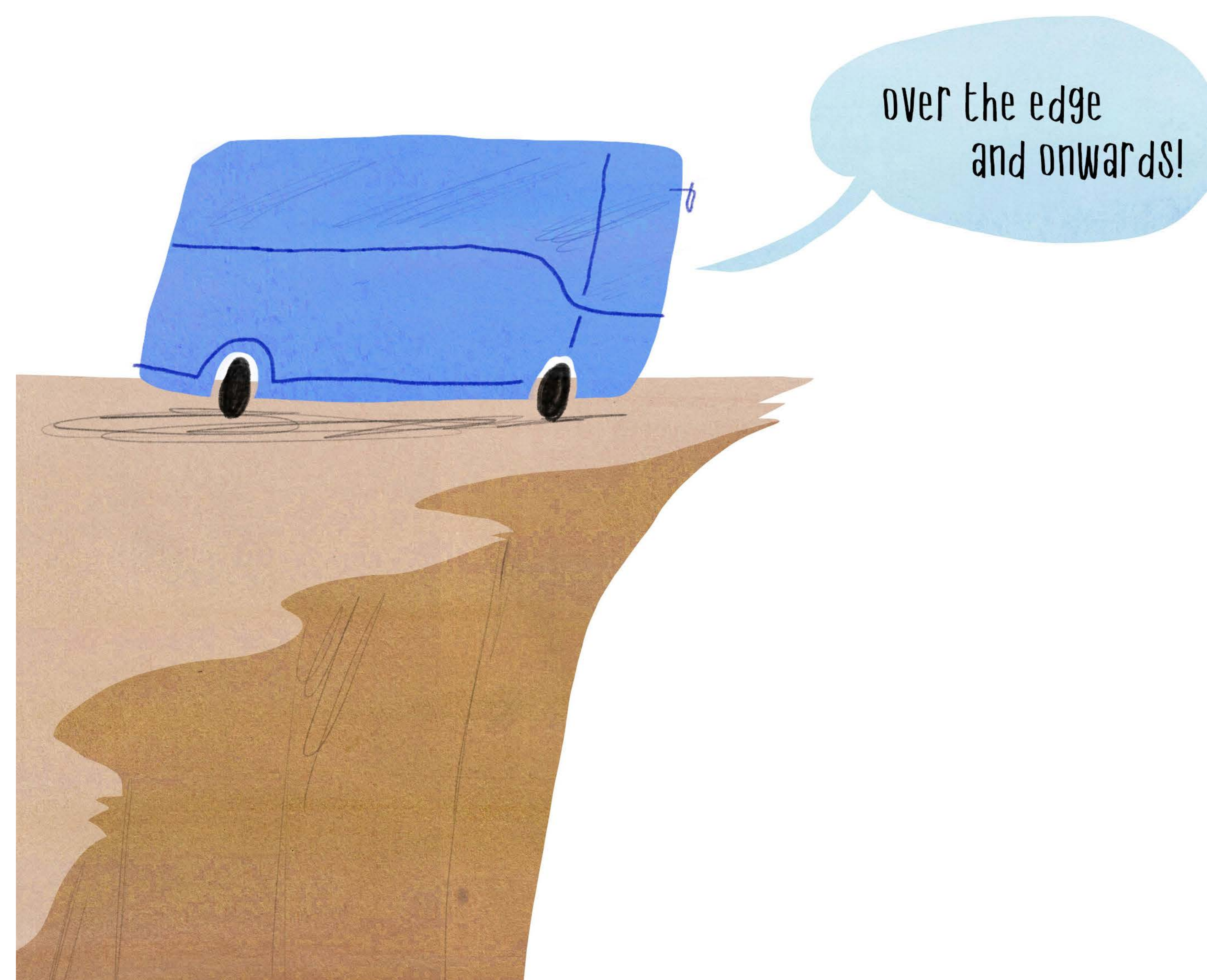
> ***"We will achieve a great deal if we can stop thinking in expected returns" – participant***

that are sustainable, or at least appear to be. In other words, the sector is a source of both value destruction and value extraction, and a source of value creation. Ideally, we should arrive at a model that discourages/punishes the former and rewards the latter.

Expectations are responsible for much of the pressure to realise (maximum) return on investment. Sometimes explicitly (from shareholders), sometimes implicitly (from regulators), but typically because professionals in the financial system put that pressure on themselves as well. This seems necessary to be competitive, but in general, managing for returns and issuing return on investment forecasts is not essential, and for the medium and longer term can be a somewhat fictitious exercise.

Pressure on economic growth is partly the outcome of competition and responding to the wishes of shareholders and society, but it is also closely linked to the monetary system itself. After all, return on investment implies that more financial value is created, and this has to come from somewhere. Because this can mainly be done by taking on debt (banks 'creating money'), higher returns increase debt, which in turn creates the necessity to make an even greater return on investment. The enormous ecological and social debt has arisen because the return requirements and return expectations in the financial system often considerably exceed the returns that nature provides.

> ***“Risk management mainly focuses on the risks that the financial system creates within itself (volatility of instruments, relative risk compared to benchmarks, collateral liquidity, currency risk, and the like). Managing the risks related to the underlying foundations in society (risks of externalities, transition risks, and the like) is of secondary importance. These risks are attracting more attention, even from the regulators. But we don't yet have integrated thinking. These risks, such as climate risk, are assessed in addition to existing risk management. But this won't bring about a fundamental change in the thinking.” – participant***



Core problem 2: Backward-looking risk

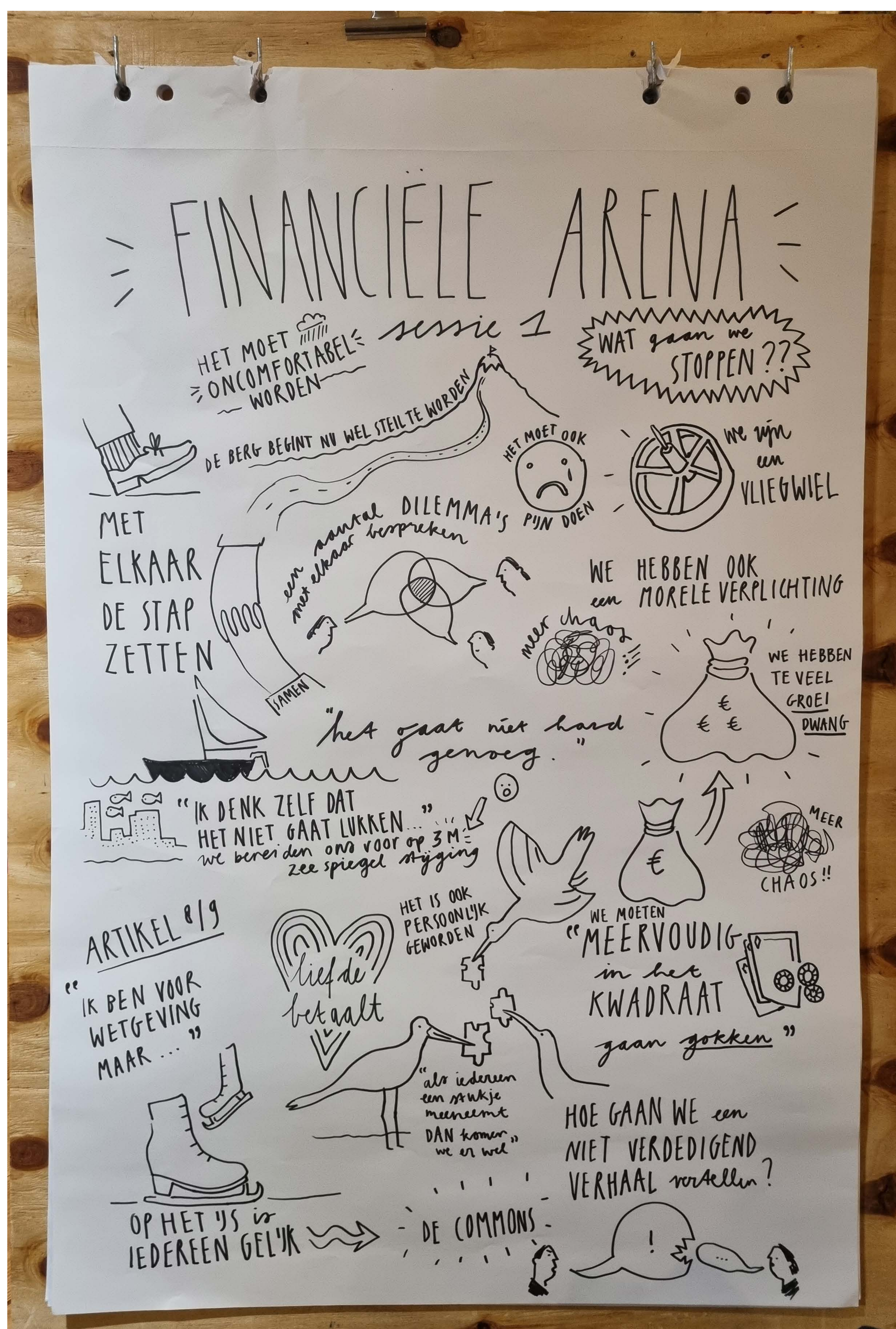
Focusing on and reducing risk provides security and stability in the financial sector. However, the current system thinks mainly in terms of known risks which are based on events in the past and which can be expressed in terms of quantitative risk and return. Legislation forces institutions to spread their risks, based on historical data. The assumption is that the past is a good predictor of the future, with data based on historical trends such as scope for almost unlimited economic growth, and for a long time, this was true. Focusing on the short term traditionally means lower risk for the company and the investor.

In principle, sustainability risks are long-term risks, but increasingly, they manifest themselves in the short term and so put the stability of the entire system under pressure. The only consequence institutional and private investors notice is, at best, general (via taxes) and is not an incentive to look at risk in a different manner. Furthermore, sustainability risks are thus far borne by society while profits remain private. It is the government's task to make that link more direct and more effective, and not to mitigate these risks through taxes.

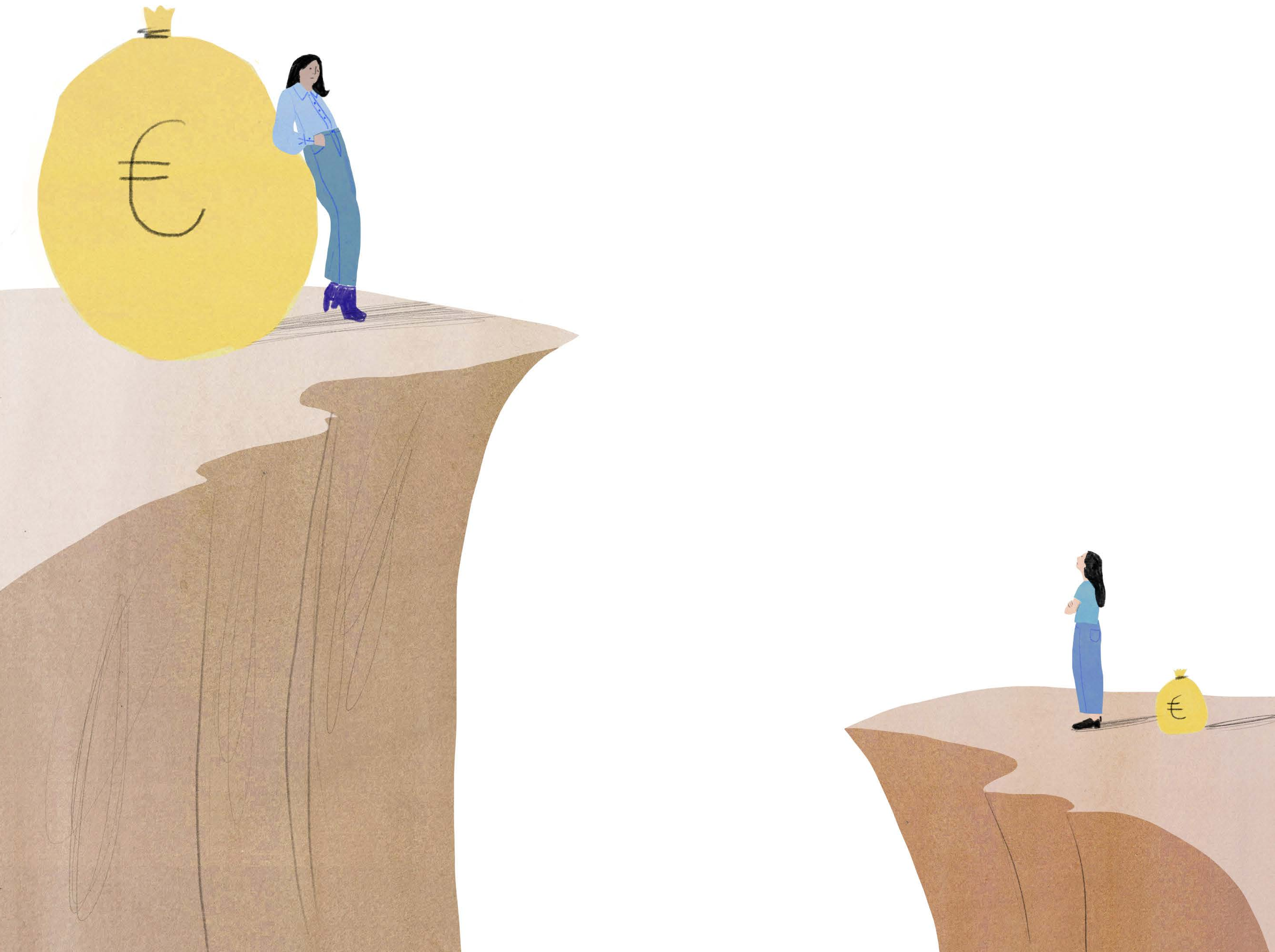
“It’s about having a broader vision on risk. So not only backward-looking risks, statistical and quantitative risks, and legal risks – and having a policy for these. But also forward-looking risks – with estimates, scenarios and longer horizons. We need dashboards that have more than just financial indicators, they should include social and ecological indicators too. Data shouldn’t be the goal but the starting point of the discussion – what risks are we prepared to take, which risks are invisible but still present and how can we quantify these? And last but not least, we must look at resilience – what bumps will we encounter and can we handle them? How will we deal with them? And so on. This needs debate, research and education.” – participant

Dominant thinking and accompanying models regarding risk and return keep the current system in place and hinder any organised efforts for transition. Parties estimate ecological and social systemic risk's (too) low, just as the potential benefits of the desired transition. Additionally, in this context, short-term competition (a lower return on investment than the competitor) is detrimental to one's own competitive position. Moreover, regulators do not allow investors to take too much risk and switching to new markets is so complex and uncertain that the situation currently resembles a 'waiting game' – whoever moves first will lose.

When we do look ahead, the future appears primarily uncertain and we seem not to know, or want to express, our vision of what the Netherlands will look like in 2050 and beyond. Because the transition is uncertain and systems have to be reconfigured, we seek assurance and stability. However, there is no blueprint for the future. But there is a dot on the horizon: one that indicates a common direction and offers the assurance we need to swing the changes coming our way in a desired direction. And to which legislation can be adapted, including putting a value on externalities. This is never going to work without creating a level playing field.



Visual notes from the first meeting



Core problem 3: Wealth inequality

Social unrest due to financial and economic inequality is a direct threat to social stability. To a certain extent, social inequality is also directly linked to how the financial system works: wealth creates wealth, if you have it to start with; but if you do not, you get left behind. People with less wealth generally pay higher interest on their mortgage, for example, because the risk for the lender is greater. In addition, there are riskier investments that give a better return, but these are only available to wealthy individuals because they can deploy venture capital.

“In the sustainability transition, inequality can hinder the facilitating role the financial sector must play. As long as it continues to think exclusively in terms of financial value, it will, by definition, only accelerate inequality: the cost of serving wealthy customers is lower, because the risk is lower. Customers with less cash are riskier and are therefore charged more for the same products.” – participant

The transitions currently taking place are creating instability in society, potentially intensifying the various forms of inequality. This is already visible, for example, in increasing energy poverty: low-income households have high energy bills and few options to improve their home's energy label (themselves). How can the financial system ensure that these groups are not disproportionately affected by the structures of the current regime? How can we ensure that the solidarity factor is sufficiently anchored in the financial system (no exclusions, cost transparency, basic products, and so on)?

This inequality in transitions, which only increases the call for fairness, comes on top of the extreme wealth that has been a point of contention for some time now. The mechanism in the financial system already highlighted, in which money generates money, also means that those who already have considerable wealth and who strive to maximise their returns and wealth growth, are becoming wealthier even faster. At the same time, as we noted with the problem of growth, this is always accompanied by increasing pressure on society and our natural resources to make that growth possible.

Core problem 4: Compartmentalisation and specialisation

Many organisations, including financial institutions, are very compartmentalised and highly specialised. This matches a mechanical view of the world in which the world and all its components function as machines. They may be complicated, but they are predictable and can therefore be optimised. Optimisation within subsystems (a department within an organisation, the financial sector within the economy, the economy within society) often leads to unintended and unforeseen feedback effects within the larger system.

The financial system itself is also segmented, and because of risk management, transparency and control, all sorts of walls have been erected between the various institutions. The emphasis was on regulating and facilitating financial institutions as effectively as possible, to create as much long-term return on investment and stability as possible on the public side. And on the private side, making the maximum possible contribution to economic growth with as few excesses and breaches as possible. In this public-private logic, the financial system has cut itself off from the real world and everything focuses on the optimal management of the system itself, regardless of the relationship with or impact on the real world.

This decoupling also has an impact at a cultural and personal level. Many employees are educated, trained and accustomed to thinking and analysing in mainly financial terms, furthermore they are rewarded for achieving financial targets. Within the financial system, this creates its own language and way of thinking, and professionals can agree on paper, according to the agreed methods and standards. But other knowledge and skills are required, along with other factors, forms of value and impact, in addition to the financial aspects.
For example, organisations are often not fully aware of their ecological and social impact, negative and positive, which increases the likelihood that these will be incorrectly estimated. Helping customers understand what social and ecological factors mean for the risks and impact of investments requires a different approach to relationship management and other communication skills. An upgrade to a more holistic strategy in which other qualities, such as trust and social embeddedness, become a normal component in the education and training and are overall better appreciated.

3. Future direction: Three principles

We see a world that is becoming more unstable, in which pressure for change is increasing, and in which more solutions and willingness to act are emerging: the signs of transition. However, a transition is uncontrollable and it happens in fits and starts, tipping the social order out of balance. One way or another, we have to move away from a financial and economic system that causes social and ecological damage. Either it results in increasingly severe ecological and social crises, or the financial-economic system adapts in such a way that it helps to restore ecological and social stability. The negative social (wealth inequality, social disruption) and ecological (climate change, loss of biodiversity) impacts therefore become levers for the transitions in and of the financial system.

But if, by definition, this transition is uncontrollable we have to stumble forward; if we have to anticipate future shocks and surprises, but also want to think proactively about the transition we would like, in which direction should we go? Which principles of a sustainable and equitable future will form the basis of sustainability in the financial sector? Based on the discussions about the financial transition, we have identified at least three elements that serve as a starting point for this question: how can money finance the desired economy? For this, we have identified three guiding principles.

Principle 1: Social, long-term value creation

The starting point should be the social and ecological value we want to create in the long term. For this, we must take a firm stance on what is not sustainable and equitable, and at least be able to assess the long-term direction and how any investments can potentially contribute to this value. For example, a food system that restores biodiversity and provides affordable and healthy food for all participants in the chain, taking geopolitical risks into account by also keeping the chain short. Or a sustainable energy system that is accessible to all, without emissions and requiring minimal fossil fuel, and where energy is generated as close as possible to where it is consumed. Or for example, a mobility system with only a few private vehicles, which takes up hardly any public space, and which consumes almost no energy. Then it is worth financing everything that contributes or can contribute to the desired social impact.

It is therefore about value creation in a qualitative sense in which hard planetary boundaries and social consequences are taken into account. This requires a commitment to organising our basic needs such that as many people as possible have access in the most affordable way – and doing all this with minimum use of energy, raw materials and public space. This will have to be managed in such a way that production and consumption contribute to ecological recovery, restoring social relationships and creating greater equality. In other words: a commitment to putting social and ecological value before financial return on investment.

This therefore means a fundamental revaluation of how risk and return are currently understood, defined and put into practice. Social impact is then no longer a 'nice to have' alongside

> ***"We acknowledge that the financial sector is still the major financier of the old, climate- and environmentally unfriendly economy. On reaching this future perspective, we must turn this around so the financial sector becomes the engine/catalyst of the sustainable economy." – participant***

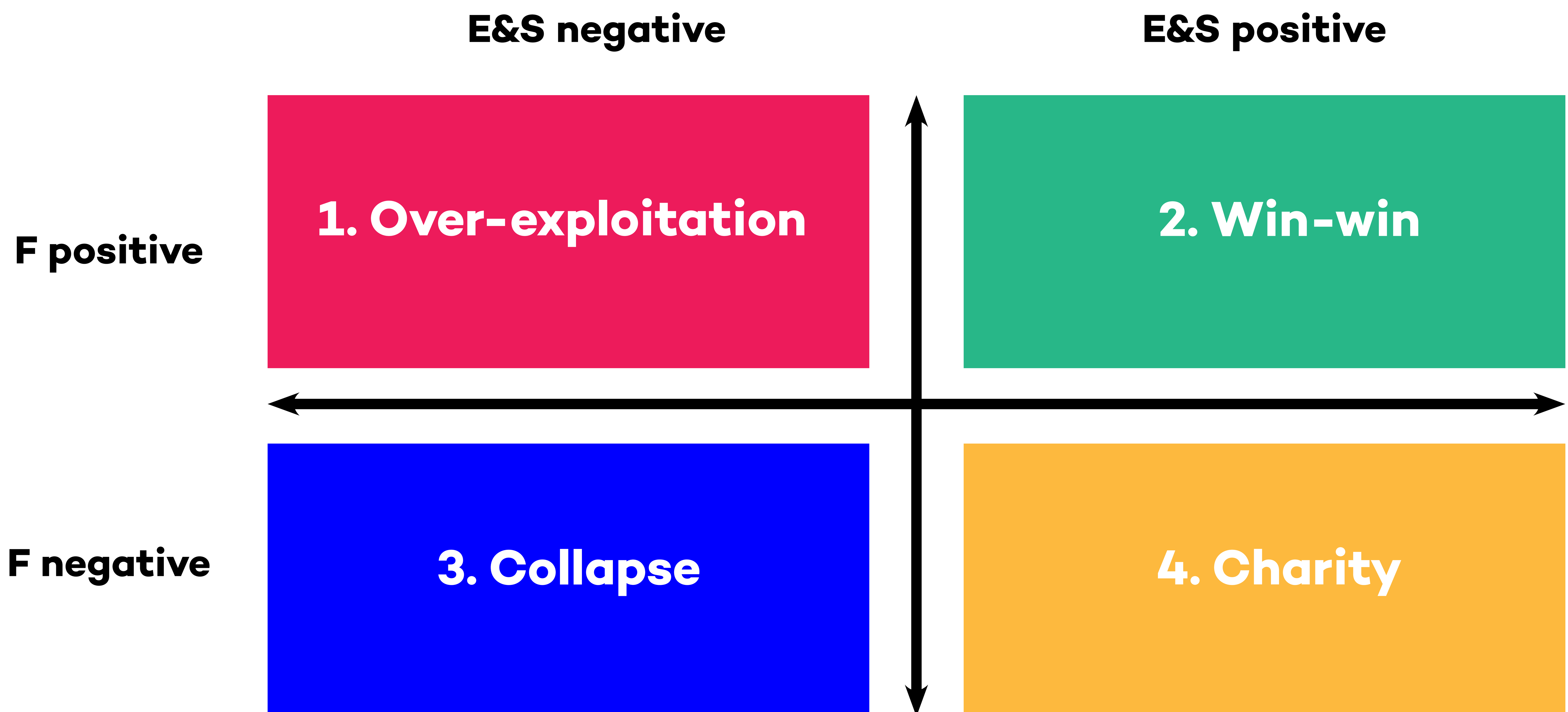


Figure 3: Value window with Financial (F), Ecological (E) and Social (S) values. Based on: Schoenmaker, D., & Schramade, W. (2023). Corporate Finance for Long-Term Value, Springer.

financial return, but an essential condition for achieving financial return – and an indispensable component of a broader form of return on investment. This is about broad value, combining social and ecological impact with financial return on investment. The remaining question is, of course, in what time frame will we see impact, who will determine this impact and how can we make all this practical?

Naturally, a certain amount of financial return (or limiting financial losses) is a prerequisite to making an impact: after all, people have limited resources and the choice to use these as best they can. For many people in the sector the next question is: what do you maximise? Do you go for maximum impact, with a minimum required financial return as restriction (bottom right in quadrant 2 of the value window in Figure 3)? Or, the other way round, do you go for maximum financial return with the minimum required impact as restriction (top left in quadrant 2)? Or do you try to maximise the sum of both with minimum requirements for both (furthest upper right as possible in quadrant 2)? This also requires a new set of theoretical foundations, in which social and ecological values are not added to existing values, but are part of the basis. In essence, the only socially acceptable strategy is to opt for the win-win quadrant, where 'win-win' stands for an overall, holistic approach.

> ***"In an ideal world, the financial sector should also make choices between (future-focused) activities which either promote or hinder the transition. This is actually happening incrementally, for example concerning fossil investments. But then acknowledging unhelpful activities, such as fast fashion, food that destroys biodiversity and so on, is a bridge too far for many." – participant***

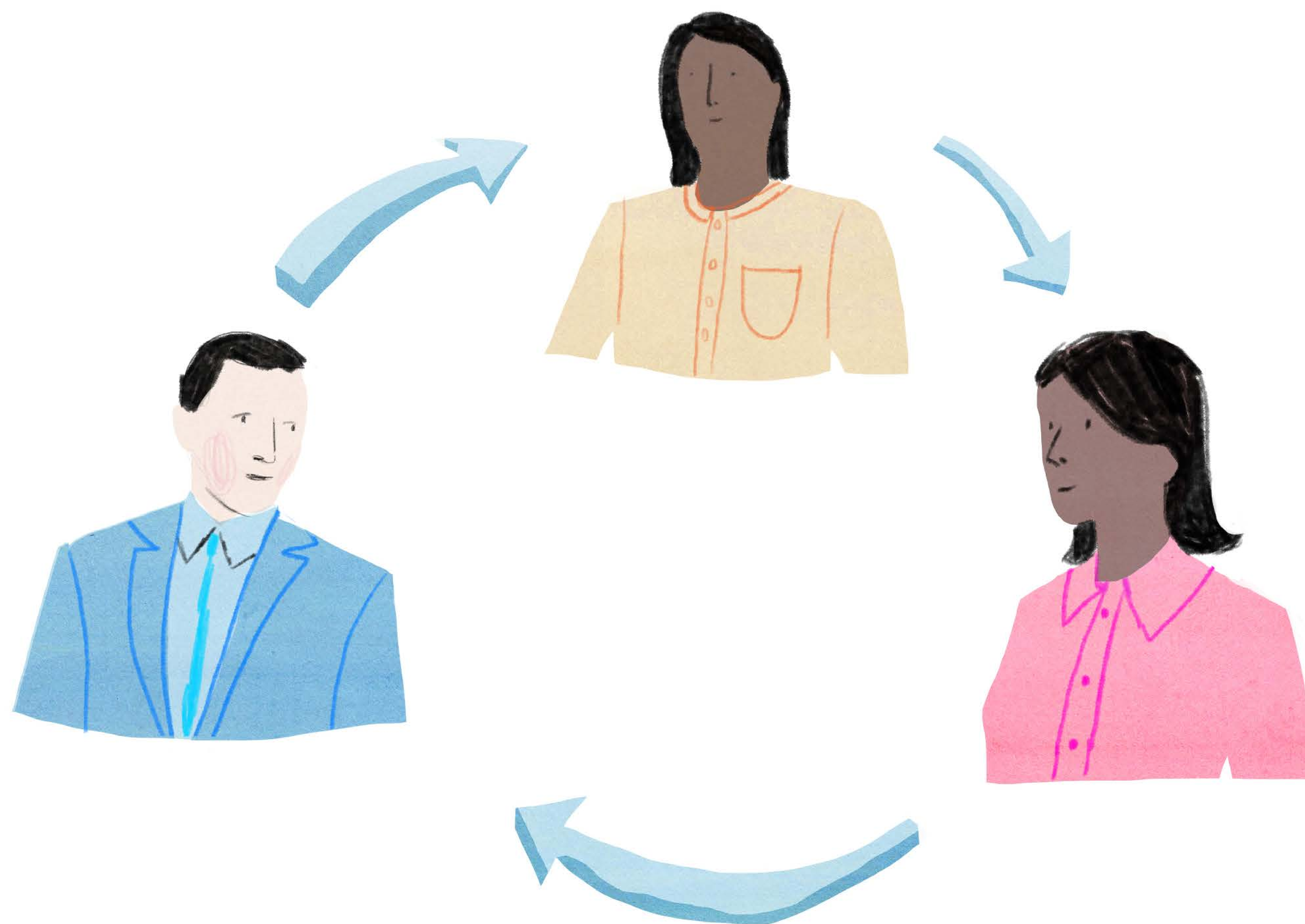
Principle 2: A broad understanding of risk

If we want to prioritise holistic sustainable impact, we will automatically have to adjust our view on risk and return. The biggest risk is then not anticipating and investing in transition on a larger scale. And what counts is the contribution to desired transitions and reducing negative impact and returns: move out of quadrant 1 of the value window shown in Figure 3 (or at least move as far as possible to the right); and in many cases, execute projects in the top of quadrant 4, even if they fall short in terms of financial return. This requires new models (or, at least letting go of old models), a conviction that focuses on financing transitions without requiring guarantees of results and a longer time horizon during which we can work toward broad-based and holistic value growth. Even though this principle is already partially feasible, it also requires major changes in internal working procedures, agreements, data, goals, competences and collaborative relationships. Additionally, new business models are needed for banks (financing, earnings, shareholders, governance).

For this we need a longer time horizon, broader objectives and experimentation with new frameworks so we can learn together. It also requires good interaction at system level between governments (standardising, pricing, subsidising and investing), financial institutions (anticipating, entrepreneurship, financing, investing) and regulators (defining frameworks, reviewing how future-proof risks and business models are). It is 'total football': everything must be interactive and moving simultaneously. For this, we need clear goals but not without trust and dialogue. And ultimately: the willingness to make decisions based on common sense or expertise. The transition cannot be modelled, and yet it must be anticipated: 'Better to do be doing things almost right than to be precisely doing the wrong thing'. We need rigorous and fearless coordination to map the path to a successful transition and to end the waiting game. More about this in the next section.

“ *Be aware that no matter how thoroughly transition paths and scenarios are detailed, the path towards the long-term goals will always be shrouded in uncertainty. The goals are agreed, only the measures change.” – participant*

“ *Ultimately, the economic benefit of investing in sustainability will be greater than the cost, and the cost of doing nothing is greater than focusing on sustainability.” – participant*



Principle 3: Transformative collaboration

Any individual or institution can start focusing on maximum social impact and rethinking risk and return. But there are also limits to what an individual institution can do and what can be done nationally, which is why we need new ways of working together. Within the sector, and with external parties. This means that the various parties in the financial system also need to agree on a new allocation of roles so they can work together to make the transition happen. Saying goodbye to certain economic activities, guiding entrepreneurs and investments from the unsustainable to the desirable and helping to shape and develop new markets requires room for experimentation, trust and social entrepreneurship. You could also call this revaluing relationship banking. Or taking a stakeholder model with accompanying societal council seriously.

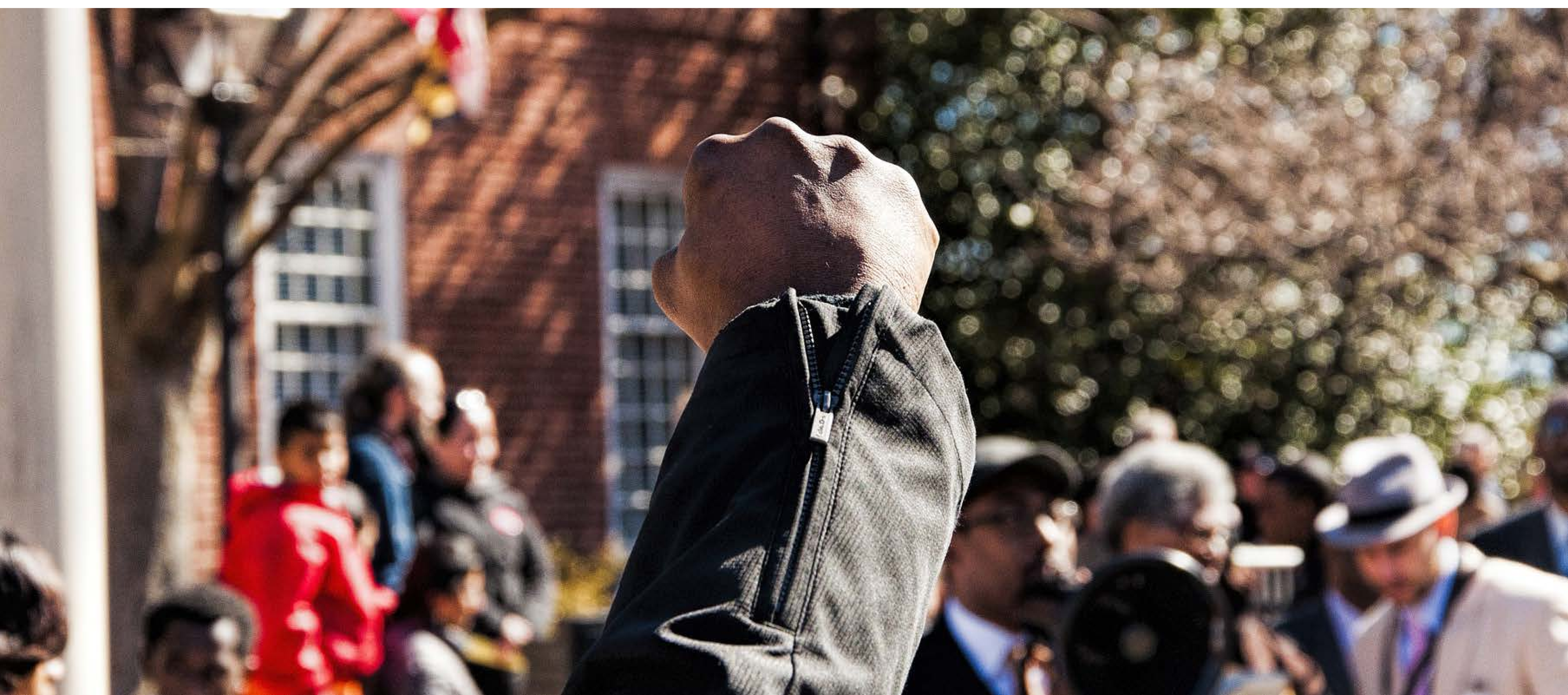
“The financial sector can and must contribute to the transition, and all actors must be prepared to take their responsibility to make it happen. And to realise this, we need coordinated and simultaneous actions from all involved, not just the financial sector. That should be done and dusted well before 2050.” – participant

"An important consideration for this vision of the future is the leakage effect. When Dutch financial institutions no longer can or want to finance something, will an international party take over their role of financier? In the long term, this could even result in more environmental damage." – participant

"A second concern is access. Will we still give financial parties access to the Dutch market if they only manage on financial returns and support impact only in word (but not in deed)?" – participant

Justice and inclusion in the transitions requires careful consideration of the benefits and burdens of the transition. Commitment to a transition to a future in which as many people as possible are heard and seen must take priority. This includes a collective safety net or basic facilities for the parties and people who cannot keep up without assistance.

The scope of these basic facilities will depend on the results of the social deliberations. As we are coming from a period of mainly public-private partnerships which are based on formal relationships and distrust, this cannot be taken for granted. It will require collective confidence and commitment to the transition. With this, the scope of public-private partnerships will need to be broadened to include civil-society players, social partners and new institutions which position themselves between the public and private sectors and thereby firmly safeguard social interests. **New intermediate forms**, where not everything is run on market or government logic, will be needed. Consider here the (recent) discussion about separating the (utility) payment function from banks.



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4. A disruptive change process

The question is how we can proceed if the urgency for change and social discontent increases, but there is no tangible action plan. Currently, politics and society are struggling with this: the transitions in agriculture, energy, healthcare, mobility and construction are coming to a standstill due to resistance, and distrust due to a lack of vision and realistic alternatives. The belief that we will make progress, mainly through technical innovation on these issues, is waning, but for the time being, the alternative of fundamentally reducing the need for raw materials (with the corresponding radical changes in culture and conduct) seems very unappealing to many. This applies to politics and society, but also to the financial sector's own role. Parties point the finger and wait for someone else to make the first move.

In the meantime, the tipping point to that negative vision of the future is getting closer. Warnings from academia, the UN and the climate itself, combined with societal polarisation, (geopolitical) conflicts and the institutional inability to achieve a breakthrough all seem to be leading to an implosion. At the same time, we can see the urgency, awareness and opportunities increasing as exponentially as the concerns. What if we were to look beyond the disruption - from the principles formulated and trust in the momentum. Where do we want to land? And would the current momentum perhaps also offer the opportunity to do things differently at a system level?

For this, we have to start from our desired future. If we construct this from the principles formulated, it means striving for a future economy that meets our basic needs while restoring biodiversity and social relationships. Concepts such as doughnut economics, a nature-positive or circular economy refer to this, as does the concept of broad prosperity. But if we translate all this to the financial system, then it must help achieve this primary ecological and social return, and only when this has happened, give (maximum) financial returns. Considering the earth's capacity to support life, this means a modest but stable return across the board. If the economy is truly sustainable, i.e. in balance with planetary boundaries, then return on investment is determined by what the land and sun yield.

“We need more than just training and education to develop a greening culture; we also need a consistent tone at the top. So not just a single speech on a podium placing a green dot on the horizon, and back to ‘business as usual’ the next day. We also need plenty of scope for green experiments in our organisations. And we shouldn't overestimate employees' capacity and willingness to bring about change. We know from experience that many people say ‘yes’ but act ‘no’. Identifying those forerunners is key, to give them a budget and a mandate to get going with green pilots. Good examples will emerge from the bottom, and will inspire those in the middle group who will take hold and run with these practical ideas for going green.” – participant

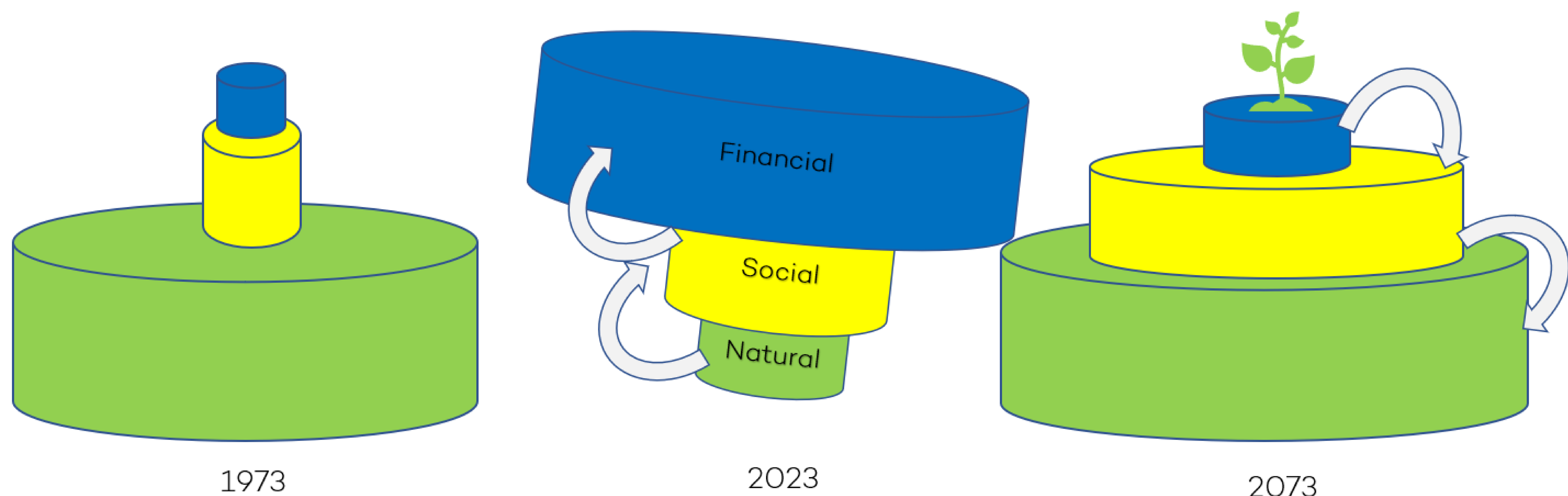


Figure 5. An illustration of the change process: from a financial system focused on extraction of natural and social capital to one that allows this to flourish. Blue: financial, Yellow: social, Green: natural

If we focus on integrated social value as proposed, this will bring about a fundamental shift in the financial system. Where we experienced the historical transition from an assistive system to one of compulsive growth, the transition now has to be to delineated and value-financing. Those historical transitions were 'funded' at the expense of a stable social and ecological foundation, and to such an extent that even the economy and financial system are now faltering. The images of the cakes in Figure 5 attempt to illustrate this: the financial claim on social and ecological capital continues to grow while the social and ecological foundation only shrink further. The aim of the transition is to reverse this trend: resulting in a financial system that grows rather than depletes social and natural capital.

In a way, the transition the financial system now faces, concerns the investment of money in economic processes, infrastructures, business models and products that generate that ecological and social value. These include organic and nature-restoring food systems, collective mobility, decentralised and renewable energy supplies, healthy living environments, (local) economies based on sharing, reuse and circularity. In other words, the financing of a new type of industry, economy and activity aimed at minimising our footprint and maximising sustainable, circular and bio-based production and consumption.

> ***"Move away from all the short-term assessments, which often only focus on the returns achieved. Comparing short-term results achieved without considering the risks and social impact, leads to conduct driving the entire chain back towards the (market) average. Which ultimately does not contribute to the transitions required." – participant***

Collaboration within the sector, as we see within the climate commitment, has not yet yielded sufficient coordination. Almost everyone submits their reports and action plans on time, but there's no peer review of each other's level of ambition. In practice, those lagging behind are not really pulled along by frontrunners. Legislation should reinforce the sector's good initiatives, and place the bar for frontrunners and those lagging behind at a high level of ambition.” – participant

We also lack a systemic perspective: is the system as a whole reducing CO_2 emissions sufficiently? A systemic analysis should also include foreign players.” – participant

With the steps the sector is currently taking towards impact, sustainability, pricing and transparency, it is looking for ways to transform negative effects into positive impact. But it is also looking for ways to divest and help the old economy make the transition. These are cautious steps, but these are still primarily aimed at making the existing system more sustainable, centred around the dominant thinking around risk and return. In other words, these investments are mainly ‘greening’, but they are still driving consumption and production growth (and increasing ecological and social debt). It is time for the financial system itself to seek new paths, interacting with its environment. Paths towards opening up the way to sustainability and exploring the route to the desired transition. Precisely because this cannot be achieved through planning, innovation and inspiration alone, we will also have to take advantage of future expected surprises, and convert the inherent instability into transitions.

The trio of risk, return and impact can be effective if consumers, participants, and investors are willing to take part of their return in the form of impact. If we're honest, it seems that financial parties often cover up this line of thought. Support for such a movement is not guaranteed, standards may change, but it would help if those in a better financial position would set a good example. Unfortunately, disasters help even more.” – participant

Black swans & grey rhinos: Uncontrollable disruptions

In the financial system in particular, where sensitivity to risk and risk control is so strongly ingrained, it does not seem strange that reasoning is based in **control and gradual change**. However, this is at odds with insights from complex system dynamics and transition science, where various **uncontrollable disruptions** and chaotic shifts will occur in response to increasing pressure at system level. This is undesirable from the perspective of the current system balance, but at the same time it provides an opportunity to take unimaginably large steps towards desired configurations of the system, including for the financial sector. For a long time, regulators have placed transition risk higher than intrinsic risk.

Which of these uncontrollable disruptions and chaotic shifts will actually occur remains uncertain, of course, but some will certainly happen at some point. What if a civil war breaks out? What if the Rhine dries up completely? What if agriculture disappears from the Netherlands in the short term because we can no longer comply with the environmental regulations? What if Europe and with it the Netherlands goes into economic and social decline? What if the obsession with crypto currency becomes so intense that investors withdraw the majority of capital from the formal system? These kinds of shocks are not special events, but events we can expect. We know that crises, shocks and disruptions will happen anyway.

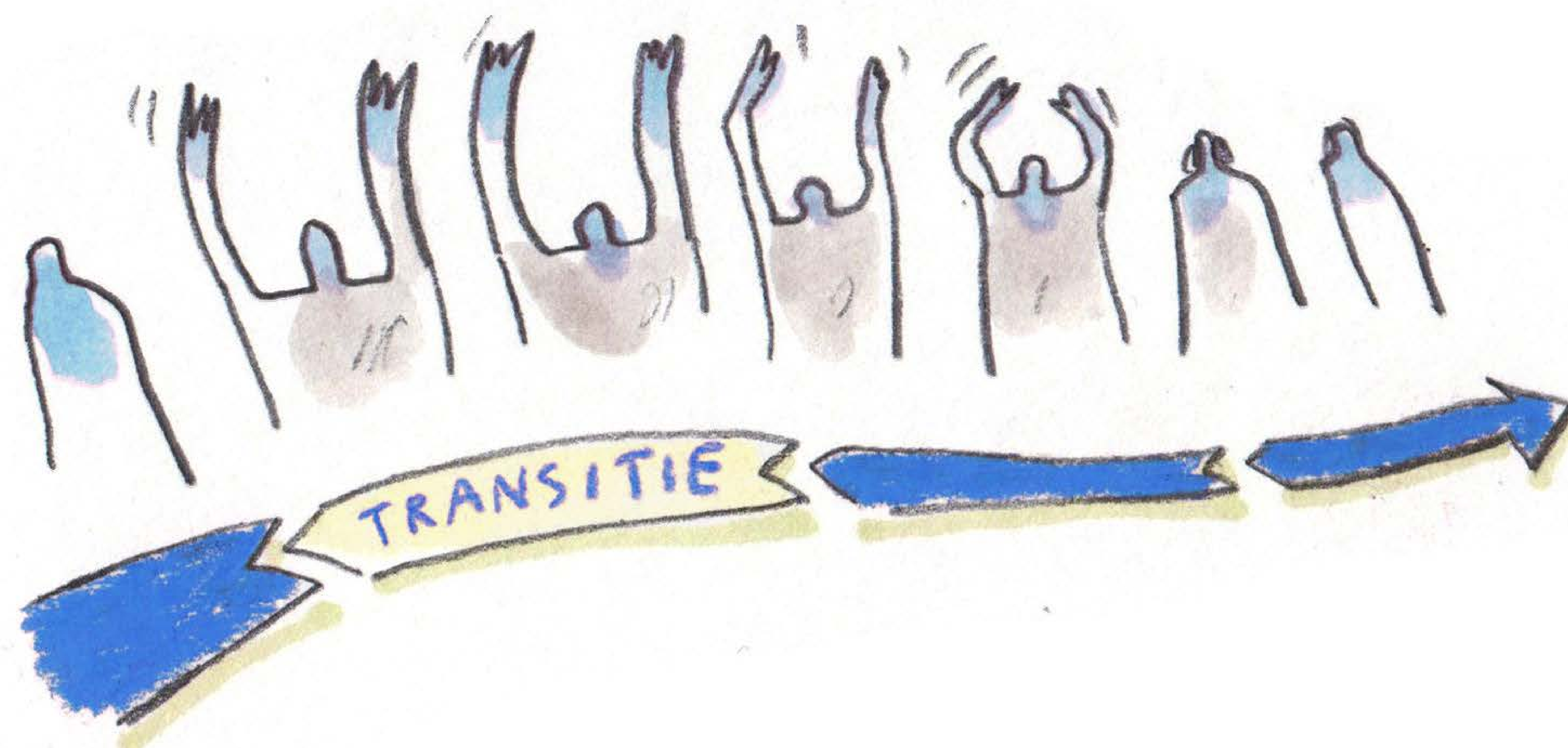
> ***"The (western part of) the Netherlands may become one great big 'stranded asset' along with the Dutch financial institutions (with extensive impact on the Netherlands itself). Investing in adaptation is not merely a luxury." – participant***

“We don't need regulations that exactly prescribe what is good for a transition; but we do need regulations that help define the correct framework. Overly strict regulations reduce a parties' own responsibility. What's more, it's not possible to express the overall complexity of transitions, and their constant dynamics, in strict prescriptive rules.” – participant

It is interesting to discuss with the various actors in the financial system how they would respond to these disruptions, and to discuss how to prepare for the inevitable. During the third meeting of our arena, we noticed that the word **stability** was mentioned frequently: the function of the financial system to guarantee basic needs, such as allowing deferred payments and maintaining a properly-functioning payments system. In addition, it was noted that if such disruption manifested itself only in the Netherlands, then the capital would quickly disappear abroad: too much risk, too little return. Between these two extremes, it also becomes clear that at this level of disruption (social and geopolitical) no stress tests will be conducted, let alone that a strategy is waiting on the shelf.

Some expected disruptions are already evident: the impact on climate, digitalisation and social polarisation are being felt by all. Are these **‘black swans’** (unpredictable events with a high impact) or have they become **‘grey rhinos’** (probable events with a high impact)? The latter: we are already on course to hit the 2°C global warming mark. This will create an impact which no party in the financial sector can withstand. This also has implications for how (investment) risks are measured against the benchmark: based on the past they are measured correctly, but with the emergence of the grey rhinos, this measuring method is increasingly incorrect.

The conclusion is: **new and expected events will bring new uncertainties, and these require structural changes**. This creates scope for collective action and controlled system innovations to tackle the process of change. Because we note that the classic approach for identifying a problem and finding a solution is no longer sufficient for finding a new sustainable balance.



5. A desired transition

Based on the urgency and logic, everyone seems to agree on the direction: a sustainable and equitable future. But what this means exactly and how we should get there is deeply controversial. 'We follow the customer', 'people simply want to buy', 'we need a clear goal'. These remarks are often heard and repeated as if they were laws of nature. The financial system (in the broadest sense) is often primarily seen as facilitating. It enables people to do business, buy, borrow, save, spend and invest. If that has a negative impact, then parties try to reduce or prevent those negative effects from occurring. On a larger scale, parties are looking for ways to direct spending towards 'sustainable' forms of consumption and investment.

From this perspective, sustainability issues are mainly problems regarding allocation, regulation or valuation. In this context, true pricing, a taxonomy or a dashboard are logical steps to help businesses work on sustainability and to help parties with money make the right choices. However, the fundamental question for transition experts is always the same: is this optimising the current system or is it a system transformation? If it is optimisation, then underlying problems remain in place and it is others (the government, the market, citizens, society) who have to adapt. From this perspective, it is not clear how goals concerning climate neutrality and circularity can be achieved, unless such radical breakthrough technology is developed that we can generate infinite energy and source our raw materials from space. After all, the quantity of materials and amount energy needed for our current forms of production and consumption continues to grow, and is maintained through 'sustainability measures', which further fuels increases.

From the transition perspective, a fundamental shift in the financial system itself is essential: if we ensure that all investments are beneficial and contribute to ecological and social value, then a sustainable economy will emerge naturally. In that process, it is inevitable that there will be places where less financial capital accumulates and that companies and consumers no longer operate unimpeded at the expense of the planet and others. But the alternative is worse, more expensive and even less attractive. For the financial system, based on well-understood self-interest, this means settling for lower returns in the short term, whereby temporary recession

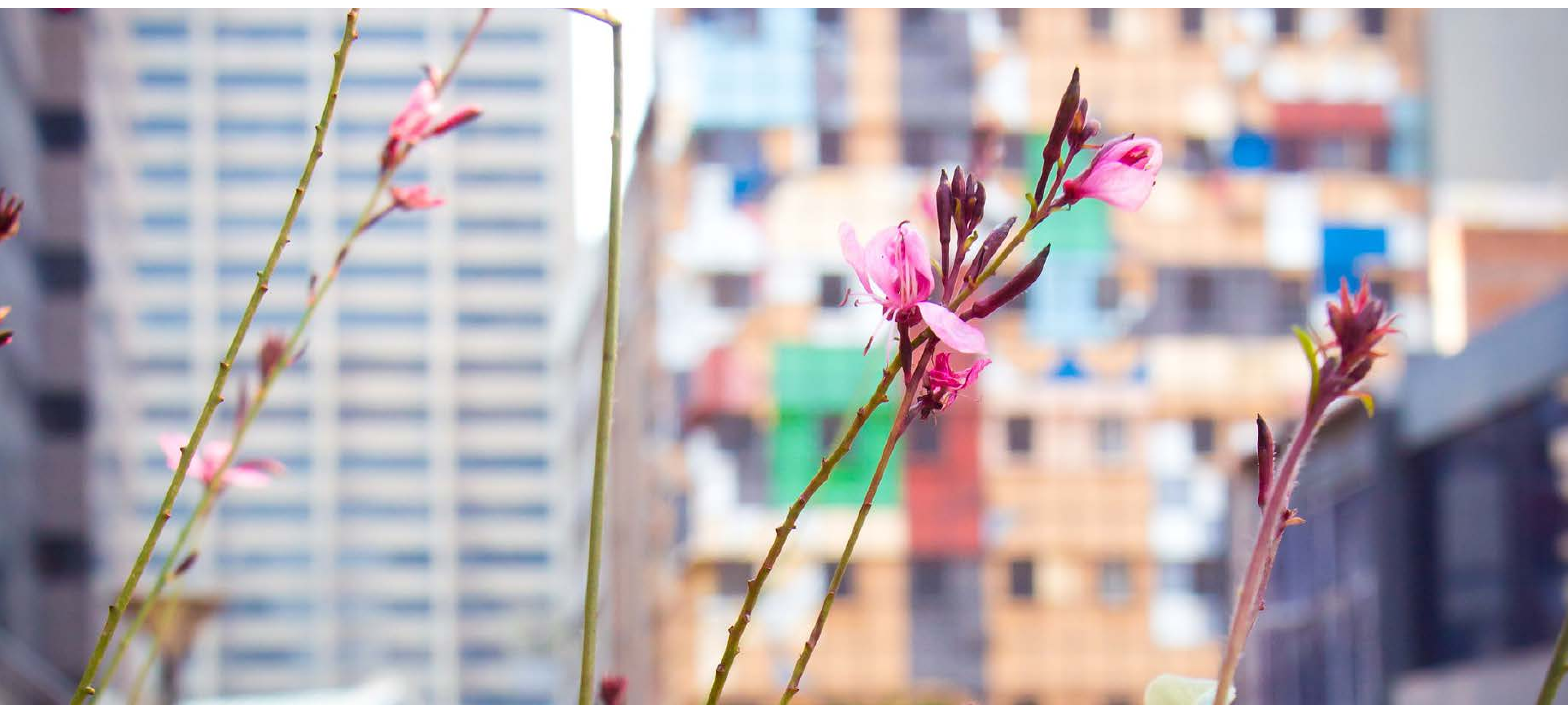
> ***“** Credibility is key, because ‘transition washing’ is lurking around the corner: investing in transition assets and claiming you are doing something, but in actual fact not changing a thing. This is why we need safeguards. In portfolio management, for example: by setting requirements for the quality of engagement, the reporting and working with a maximum number of titles.” – participant***

and transition costs incurred by economic sectors can be absorbed. But by generating sufficient returns and (hopefully) restoring ecological and social value we prevent ecological collapse and/ or social unrest.

The idea of a future where the economy prioritises ecological and social values and is facilitated by the financial system is already present in the core. In thoughts and concepts, but is also demonstrated by how well the many social entrepreneurs, citizens, local initiatives, impact investors, funds and institutions are working. Often counter to dominant economic facts, we see in many places that the economy can be much more decentralised, more collective and cooperative thanks to renewable energy technology, digitisation and new materials.

On a small scale, this involves production within the community for the community, where money is still needed to exchange value and pay for services, but where much of the value produced is social or ecological. Regenerative food systems, decentralised systems for local electricity and heating, public mobility systems, circular construction practices: all examples of a new economy in which value is kept local, negative ecological impact avoided (or positive impact realised) and social relationships restored. Many of these kinds of cooperative, decentralised or sustainable local economies are about preventing things: emissions, waste, and traffic congestion. And they are much less a revenue model: money is earned, but the priority is social and ecological value.

The financial system, especially the public part, should have the ambition to ensure that a sustainable basic economy becomes available to all. To finance the infrastructures, economic



principles and entrepreneurship that run on sustainable energy and allow citizens and consumers to use this at a cost for the service (use and maintenance). This can lead to huge reductions in the need for imports (of fuel/energy, raw materials, foodstuffs and so on) from elsewhere, and therefore to contraction of the mainstream economy and promotion of that which needs to be made more sustainable.

This fits in with the perspective of regime-driven impact: a sustainable basic economy for everybody is the big ticket. This could also be a means to reduce the amount of money and break with the compulsion for returns. From a market' perspective, it calls for new ways of financing, managing and investing: with a focus on entrepreneurship and ecological and social value creation. From a government perspective, it calls for supporting diversity, local and collective ownership and retaining value in the community wherever possible.

It is clear that this implies a considerable shift in conduct, but that is not valid counter-argument. Our conduct is largely determined by our environment, which is now predominantly structured by the market and our governments. If we shift to an environment in which the commons are more dominant, ecological and social values the starting point and the easiest and best choice is a healthy or sustainable option, then even more people will change to a more sustainable lifestyle (which in turn will lead to more people and organisations going green). But this in itself requires a fundamental change in the underlying paradigm and a willingness to question the foundations of the financial system.

Credits and footnotes

1 https://www.rijksoverheid.nl/actueel/nieuws/2023/03/16/minister-kaag-ziet-sleutelrol-voor-financiele-sector-bij-belangrijke-maatschappelijke-transities

2 Kamerbrief voortgang klimaatcommitment financiële sector, 13 March 2023, https://www.rijksoverheid.nl/documenten/kamerstukken/2023/03/13/kamerbrief-voortgang-klimaatcommitment-2023

3 Abbreviations: CSRD: Corporate Sustainability Reporting Directive, CRR/CRD Capital Requirements Regulation/Capital Requirements Directive, SFDR: Sustainable Finance Disclosure Regulation, SBT Science Based Targets initiative

4 For further information about the method, see Loorbach, 2010; or: https://drift.eur.nl/nl/cases/transitie-arenas/

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