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RESEARCH INTO WEALTH MANAGEMENT, CAPITAL MARKETS AND BANKING

BEYOND THE LOCKDOWN: BACK TO THE FUTURE

Time for reflection? Despite the bustling Microsoft Teaming and Zooming that has overtaken the corporate and financial – and many parliamentary – worlds during the virus crisis, there has been more time for reflection. 'Reflective practice', the process by which we analyse our continuing professional development activities, has become a cornerstone of the best-of-breed in lifelong learning. It is how you assess the benefit of the activities to your clients, your firm, and yourself, recognise strengths and weaknesses for self-improvement, and generate further ideas for personal and professional development.

The UK's FCA set an important reflection ball rolling in 2018 when it began a programme on 'purpose in finance', to help firms identify their core reason for being, and how they can have a positive impact on society. The FCA's Jonathan Davidson said then: "Consumer outcomes are driven by the purpose underlying a firm's business model and culture. A firm with a good purpose will perform a stocktake of all their business activities and product lines and eliminate anything that is not consistent with their purpose, even activities that are profitable. Leadership is vital in ensuring a firm's purpose is the right one and setting the tone for the rest of the organisation. Defining culture is much more than a box-ticking, compliance exercise."

Now, in this time of the virus, the world is shifting on this front from the why to the how. In the 2019 Fortune 500 CEO survey – the apparent heartland of red-in-tooth-and-claw capitalism – only 7% believe their companies should "mainly focus on making profits and not be distracted by social goals". While shareholder capitalism has delivered enormous progress, it also has struggled to address troubling issues such as climate change and income inequality. And round the corner come more challenges, notably the employment implications of artificial intelligence. (We cover key results from a recent survey of AI by Cambridge University's Judge Business School and the World Economic Forum on the next page).

Professor Alex Edmans of London Business School has been at the forefront of thinking on purpose for many years, and his latest book, *Grow the pie*, assesses "how great companies deliver both purpose and profit". In this issue of *Review of Financial Markets* (p.58), he outlines some of his key conclusions.

Andy Haldane, chief economist at the Bank of England, declared the book "superb … it makes the case, compellingly and comprehensively, for a radical rethink of how companies operate and indeed why they exist. It is a tour de force." Andrew Lo, professor of finance at the MIT Sloan School of Management, says of the book: "This is capitalism with a human face."

Our distinguished Chartered Fellow Keith Robertson has thoughts nearer home in his masterly review of UK property prices, and their affordability, and what that means for family financial planning in the years to come (p.60). But a box-set of surprises arrived for me just before the virus set in, judging a competition amongst young financial professionals on what the future holds for finance. The winning essay – on bonds for the 'new normal' – has turned out to be surprisingly prescient as the world seeks clarity, energy and purpose in this dreadful corona year. Hats off to the two winners (p.64).

> // THE WORLD IS SHIFTING FROM THE 'WHY' OF PURPOSE TO THE 'HOW' //

Resilience in these awful circumstances is important. But as a forthcoming series on CISI TV will demonstrate, longevity is vital. Resilience is getting through the day; longevity is getting through the decade. (Our poet-in-residence, Nigel Pantling, Chartered FCSI, takes an elegiac look a decade back on the next page at floor-based trading. Remember that?)

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ARTIFICIAL INTELLIGENCE TODAY: THE UPSIDES, THE RISKS

AI IS NOT THE FUTURE, BUT THE PRESENT DAY FOR MUCH OF FINANCIAL SERVICES. TWO FRESH SURVEYS PINPOINT THE OPPORTUNITIES – AND RISKS

According to *Transforming paradigms: a global AI in financial services survey* by the Cambridge Centre for Alternative Finance (CCAF) at Cambridge Judge Business School, and the World Economic Forum, AI is expected to become an essential business driver in the near term. Some 77% of respondents believe that AI will have high or very high overall importance to their businesses within two years and 85% of the surveyed financial firms have already implemented AI in some way. Nearly two-thirds (64%) of respondents expect to become AI mass adopters within two years, simultaneously using AI for revenue generation, process automation, risk management, customer service and client acquisition within two years, compared with a current figure of just 16%.

Some sectors will benefit more than others, at least in the short term. For example, it is expected to turn into a major driver of investment returns for asset managers. The technology gap between high and low spenders is widening as high spenders plan to further increase their research and development investments. These spending ambitions appear to be driven by more-than-linear increases in pay-offs from investing in AI, which are shown to come into effect once AI investment has reached a 'critical' mass of approximately 10% of R&D expenditure.

Fintechs appear to be using AI differently compared with incumbents. A higher share of fintechs tend to create AI-based products and services, employ autonomous decision-making systems, and rely on cloud-based offerings. Incumbents predominantly focus on harnessing AI to improve existing products. This might explain why AI appears to have a higher positive impact on fintech's profitability, with 30% indicating significant AI-induced increases in profitability compared with 7% of incumbents.

THE GROWING AI SKILLS GAP

A report in November 2019 by the Centre for the Study of Financial Innovation on the risks in AI identifies four specific skills gaps facing the purposeful deployment of AI, and at many different levels in organisations:

- **Talent gap:** There is an acute shortage of specialists who can design, develop, deploy, test and maintain AI systems – particularly of those who have knowledge of financial services.
- **Knowledge gap and unrealistic expectations:** AI systems could fail spectacularly if decision-makers who don't understand the technologies do not set appropriate expectations or give AI teams the right resources.
- **Over-reliance on AI:** Resources could be wasted on AI if it is implemented 'for its own sake', or if the people reliant upon it are unable to interpret or work with their outputs effectively.
- **Inadequate strategic alignment and governance:** Institutions that implement AI projects without restructuring their organisational hierarchy to reflect the new technologies expose themselves to risks from poor management and leadership.

CISI TV LINKUP

CISI members will find a programme on CISI TV featuring two of the lead authors of the Cambridge report, one of a series. Keith Bear, now a Fellow at the University of Cambridge, Cambridge Centre for Alternative Finance, was until recently immersed in the sector for two decades at IBM, where he was responsible for the strategy, business development, and large transaction development in the financial markets sector globally. His Cambridge colleague David Kruijff has over 20 years of global experience in the field of financial inclusion.

London Metal Exchange 2012

(i) The Trading Ring

Zinc is having
its five minutes,
dealers calling
bids or offers
for twenty five
or fifty tonnes
with settlement
for tomorrow
or two days' time.
On their benches
the dealers lean
further forward,
fingers jabbing
prices, volumes
across the ring.
The clock's counting
the seconds down
as shouting peaks
and the bell seals
the session's end.
Dealers laugh and
settle contracts,
the market moves
to aluminium.

(ii) The Board Room

The walls are equatorial hardwood,
hung with life-time achievement
awards
and trophies for consistent
excellence.
The management team sit like seers,
debating the long-term implications
of the expected incidence of
contango,
trends in kerb close-out for copper
and the differing spreads to next
December
for nickel, cobalt and molybdenum.

Nigel Pantling, Chartered FCSI, our poet-in-residence, provides strategic advice to chief executives. *nigelpantling.com*

CAPITALISM IN CRISIS?

PROFESSOR ALEX EDMANS OF LONDON BUSINESS SCHOOL MAKES THE CASE FOR A RADICAL RETHINK OF HOW COMPANIES OPERATE AND WHY THEY EXIST

Alex Edmans is professor of finance at London Business School. His new book *Grow the pie: how great companies deliver both purpose and profit* is available at www.growthepie.net, from which these extracts are taken.

See Professor Edmans in action on CISI TV.

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The consensus among politicians, citizens, and even executives themselves is that business just isn't working for ordinary people. It enriches the elites, paying scant attention to worker wages, customer welfare, or climate change.

Citizens, and the politicians that represent them, are fighting back. The precise reaction varies – Occupy movements, restriction of trade and immigration, and revolt against CEO pay. But the sentiment's the same. 'They', are benefiting at the expense of 'us'.

While radical calls to reform business drum up significant support, they risk throwing out the baby with the bathwater and ignore the crucial role that profits play in society. Profits are often portrayed as evil value extraction. But without profits, shareholders wouldn't finance companies, companies couldn't finance investments, and investments couldn't finance shareholders' needs. Shareholders aren't nameless, faceless capitalists, but include parents saving for their children's education, pension schemes investing for their retirees, or insurance companies funding future claims. Investors are not 'them', they are 'us'. So, any serious proposal to reform business must work for investors as well as society.

Viewing investors as 'them' and society as 'us' is an example of the pie-splitting mentality. It sees the value that a company creates as a fixed pie. Thus, any slice of the pie that goes to business reduces the slice enjoyed by society. Under this view, the best way to increase society's take is to straitjacket business so that it doesn't make too much profit.

The pie-splitting mentality is practised by many investors also. They think that the best way to increase profit is to reduce society's slice, by price-gouging customers or exploiting workers, and view a company that takes stakeholder welfare seriously as 'fluffy' and distracted from the bottom line. For example, Costco paid its employees almost double the national average (until its competitors recently increased wages). It also gives 90% of them healthcare – in part due to making part-time employees eligible after just six months of service. Costco is shut on all major US public holidays, even though they may be particularly profitable days for business, to allow its employees to be with their families. All these policies are expensive, and drive some stock analysts and investors crazy. An equity analyst, quoted in *Businessweek,*[1] lamented that "[Costco's] management is focused on ... employees to the detriment of shareholders. To me, why would I want to buy a stock like that?" Similarly, the title of a *Wall Street Journal*[2] article conveys the idea of a fixed pie: 'Costco's dilemma: be kind to its workers, or Wall Street?' The crucial word is 'or'.

But the pie is not fixed. The pie-growing mentality stresses that, by investing in stakeholders, a company doesn't reduce investors' slice of the pie. Instead, it grows the pie, ultimately benefiting investors. A company may improve working conditions out of genuine concern for its employees, yet these employees become more motivated and productive. A company may develop a new drug to solve a public health crisis, without considering whether those affected are able to pay for it, yet end up successfully commercialising it. A company may reduce its emissions far beyond the level that would lead to a fine, due to its sense of responsibility to the environment, yet benefit because customers, employees, and investors are attracted to a firm with such values.

Under the pie-growing mentality, a company's primary goal is to serve society rather than generate profits. Surprisingly, this approach typically ends up more profitable than if profits were the end goal. That's because it enables many investments to be made that end up delivering substantial long-term payoffs. Now a profit-focused company will still invest in stakeholders – but only if it calculates that such an investment will increase profits by more than the cost of the investment. Comparing costs and benefits is how finance textbooks argue companies should decide whether to take an investment.

But real life isn't a finance textbook. In practice, it's difficult to calculate the future payoff of an investment. In the past, this was easier when investments were in tangible assets – if you build a new factory, you can estimate how many new widgets the factory will produce and how much you can sell them for. Most of the value of a 21st-century firm comes from intangible assets, such as brand and corporate culture. If a company improves working conditions, it's impossible to estimate how much more productive workers will be, and how much higher profit this greater productivity will translate into. The same is true for the reputational benefits of a superior environmental record. A company that's free from the shackles of having to justify every investment by a calculation will invest more and may ultimately become more profitable.

> // THE PIE-SPLITTING MENTALITY IS PRACTISED BY MANY INVESTORS, BUT THE PIE IS NOT FIXED //

This new approach to business is the subject of my new book, *Grow the pie:*

[1] *https://hbr.org/2016/03/28-years-of-stock-market-data-shows-a-link-between-employee-satisfaction-and-long-term-value*
[2] *https://www.wsj.com/articles/SB108025917854365904*

how great companies deliver both purpose and profit. I wrote it out of concern for the polarisation between business and society that the world finds itself in. In the face of this conflict, this is a fundamentally optimistic book. This optimism is based on rigorous evidence that this approach to business works – for both investors and society – and an actionable framework to turn it into reality.

Let's turn to the evidence. The idea that both business and society can benefit might seem to be a too-good-to-be-true pipedream. However, rigorous evidence suggests that companies that treat their stakeholders well deliver superior long-term returns to investors. For example, one of my own studies (profiled in my TEDx talk, 'The social responsibility of business'), shows that companies with high employee satisfaction – measured by inclusion in the list of the 100 Best Companies to Work For in America – outperformed their peers by 2.3–3.8% per year over a 28-year period. That's 89–184% compounded. Further tests suggest that it's employee satisfaction that leads to good performance, rather than the reverse. Other studies find that customer satisfaction, environmental stewardship, and sustainability policies are also associated with higher stock returns.

Importantly, all of these measures of social responsibility are public information. So if the market were efficient, they'd already be incorporated in the stock price and investors couldn't make money by trading on them. But, because many investors have the pie-splitting mentality – believing that these measures are at the expense of shareholder value – they ignore them. I found that the 'Best Companies' – a list published by *Fortune* – quarterly profits systematically beat analyst expectations. This suggests that employee satisfaction improves productivity, but the market didn't previously take this into account and so underpredicted the Best Companies' earnings.

> // ALEX EDMANS' SUPERB BOOK MAKES THE CASE, COMPELLINGLY AND COMPREHENSIVELY, FOR A RADICAL RETHINK OF HOW COMPANIES OPERATE AND INDEED WHY THEY EXIST //
>
> **ANDY HALDANE, CHIEF ECONOMIST, BANK OF ENGLAND**

IMPLICATIONS FOR INVESTORS

I'll stress three points. The first is on the role of investors in business reform. As mentioned previously, investors are often viewed as the enemy, extracting profits at the expense of society. One book claims that "Shareholder activists … are more like terrorists who manage through fear and strip the company of its underlying crucial assets … extracting cash out of everything that would otherwise generate long-term value", and politicians in both the UK and US have made proposals to restrict investor rights. But such views aren't backed up by the evidence. Rigorous studies show that, while shareholder activism does indeed increase profits, this doesn't arise from pie-splitting but pie-growing – improved productivity and innovation, which in turn benefits society. So any repurposing of capitalism should place investor engagement front and centre, as the new UK Stewardship Code is aiming to do.

The second is on the role of ESG (environmental, social, and governance) factors in investment decisions. ESG investing is often viewed as a niche area, only to be pursued by investors with an explicitly social mission, under the view that social performance is at the expense of profits. Instead, integrating these dimensions is good practice for all investors, including those with purely financial goals. Good companies aren't always good investments. If a company is good, and everybody knows it's good, then an investor pays for what they get. It makes no sense to buy Facebook because it's a leader in social media – everybody knows this, so its shares are expensive. A good investment is a company that's better than everyone else thinks. Stakeholder capital is a prime example of such hidden treasure: It ultimately leads to profits, but the market doesn't realise this, due to the pie-splitting mentality.

The third implication is more nuanced. While ESG investing isn't at the expense of profits, it's important not to go too far the other way, like some ESG advocates who claim that ESG investing is a panacea. A *Financial Times*[3] article argues that "The outperformance of ESG strategies is beyond doubt" and a leading UK broker recently claimed that "study after study has shown that businesses with positive ESG characteristics have outperformed their lower ranking peers". These claims are often accepted uncritically, given confirmation bias – the temptation to take 'evidence' at face value if it confirms what we'd like to be true. But only certain types of ESG factors are linked to superior financial performance. The ones that are founded on pie-growing. Some ESG investing is based on pie-splitting – the idea that a responsible company is one that doesn't give too much profit to investors (or executives) and instead redistributes it to stakeholders. Indeed, some ESG investors use CEO-worker pay ratios as a criterion, believing that too high a ratio suggests that the CEO is taking too much of the pie from workers.

But the evidence suggests that pay ratios are positively correlated with long-term stock returns. Instead, pay reform should be centred around holding the CEO accountable for growing the pie. This depends not on the level of pay but its structure. If the CEO holds a substantial chunk of equity, they're only rewarded if the pie grows; if it shrinks, so does their wealth. Research finds that companies with high CEO equity ownership outperform those with low CEO equity ownership by 4% to 10% per year. Further tests suggest that high CEO ownership causes firms to outperform.

Business needs to be reformed to regain the public's trust. But the reforms don't involve regulating companies to make them less profitable. Instead, CEOs and investors must take their responsibility to stakeholders seriously and seek to create profits only as a by-product of serving society, rather than through exploiting customers, employees, and the environment. Creating social value isn't simply 'worthy' – it's good business. The highest-quality evidence, not wishful thinking, reaches this conclusion: To reach the land of profit, follow the road of purpose.

[3] *https://www.ft.com/content/9254dfd2-8e4e-11e7-a352-e46f43c5825d*

Introduction to 'The foundations of property'

Keith Robertson writes:

I set about writing 'The foundations of property' in autumn 2019, after leaving London and returning to my Borders roots in north Northumberland. It was intended to be the first in a series of essays reflecting my views and observations of our sector – in particular, investment, risk and retail markets and the people involved. This first article (opposite page) was prompted by the unavoidable realisation that the distortion in London property prices does not indicate that capitalism is working well but rather, that its name is used to justify personal greed at the expense, potentially, of a safe and stable society.

Within my working life there, from 1972 until 2019, buying a home went from being affordable for virtually anyone in stable employment to unaffordable for virtually everyone without a six-figure salary. Council and housing association rents, if you can find one or wait long enough to move up the list, are at levels that make long-term capital accumulation almost impossible. The Office for National Statistics (ONS) data bear this out. Mortgage lending criteria have varied a bit over the years, becoming criminally distorted by 2007, but broadly have remained at about three to five times earnings. This average 3x–5x earnings ratio has pretty much defined the average house price regionally since the 1920s; prices have always been higher in London and other hotspots, but so too have earnings there.

In the past 25 years, however, prices and affordability ratios in London have increased grotesquely for the reasons I describe in the article. The result has been that even moderately well-paid professionals like teachers, solicitors (outside the City's 'magic circle'), police, local administrators, let alone the masses of care workers, nurses, firemen, transport workers, and other essential workers that keep the city going, have been completely priced out of anywhere even half decent to live within reasonable travelling distance of their workplace. I believe this has huge implications for the future working of London and any city that cannot house its key workers in decent accommodation reasonably close to their workplaces. My proposed solution is radical and intended to provoke readers in financial services into thinking critically about these issues. The chart shows not only how the price of property has increased over the decades, but that long-term affordability ratios have been blown out of the water, and the unaffordability of London continues to widen even as we demand key workers turn up to keep our hospitals running.

Between writing and publication, Covid-19 has hit the world and here the NHS has been responding as we have come to hope and expect. But London's hospitals desperately need more trained staff at all levels, right down to the humble cleaner. This crisis will not be over by June, or by June 2021. We are in a new age of trans-species viral mutations, many originating in areas of intensive animal production and crowded markets, mutating from avian and porcine species and crossing readily to humans with poultry, pigs, even bats acting as vectors. SARS, MERS and Covid-19 are all from the coronavirus family. It is a racing certainty that as the human population approaches eight billion (it was about two billion when I was at school) these phenomena will also grow exponentially.

There are more fundamentally important things to think about than whether there will be a V-shaped recovery in the stock markets. Among the many economic, political and social lessons that will have to be learnt over the next few years will be the simple question of who and what matters to us in a crisis, and what needs to be made to happen to ensure that at least our doctors, nurses and other key workers can afford to live close enough to look after us all.

THE FOUNDATIONS OF PROPERTY

KEITH ROBERTSON, CHARTERED FCSI, CASTS HIS EAGLE EYE ON PROPERTY, AND WHAT IT MEANS FOR OUR SECTOR'S CLIENTS, FROM HIS EYRIE IN THE FAR NORTH

Keith Robertson, Chartered FCSI, is a highly qualified practitioner who has spent over 20 years as a practising fee-charging financial planner and investment manager. He continues to sit on the CISI level 7 exam panels and forum committees.

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I've never thought myself a retiring sort of chap, yet here I am – retired, sort of. I now live as far away from London as is possible without technically emigrating. Things look different from here.

We live in a dead-end village. The road stops a couple of hundred metres past our house. Then the only options are to continue along a cliff path by bike or on foot, or swim. I walk. Our house is a source of joy and pride, but is also an embarrassment. It's joyful because it is wacky, built in the 1870s by the local monumental sculptor who took time off from carving gravestones, sarcophagi and guardian angels to do a bit of property development on the side. But once a stone carver always a carver: the wrist action becomes ingrained, one supposes. Built of the local sandstone, the entire visible exterior has been laboriously and deeply carved with a fish scales design and, at every corbelled floor level, busts of the good and the great of the era. So far we've identified an austere Victoria and Albert, pensive Dickens, lyrical Burns and Walter Scott (how did people manage to read him?) among others. There are pelicans rampant standing sentry at the corners, and we found a spare griffin (lizard in mouth) guarding the top of the garden as we trimmed back the brambles. Inside, the ornamental cornices and roses show just how awesome plasterers could be when plastering was a truly skilled trade.

The embarrassment comes because we discovered we paid the highest-ever price for a house in our village, not what we wanted to become known for. But the truth is that our 11-room semi, with high ceilings, phenomenal plasterwork, ornamental staircases and every window shuttered, cost palpably less than a one-bedroom flat where we lived in London.

Of course, house prices have always varied, across the UK and within each urban area. There have been obvious long-term trends of regional decline, as in old heavy industrial areas now semi-derelict. Improving infrastructure and transport (or the opposite) have changed where people live relative to their place of work, everywhere. However, in the past 30 years there has been one gigantic aberration: the explosion of prices in the south-east and London in particular. Something has gone askew. Since the growth of mass owner-occupied homes started after WWI, there has been a remarkably stable long-term relationship between the average price of houses and affordability, measured as a multiple of average income. Across the UK this has been more or less constant in the range of three to five times annual earnings, recognised forever by prudent mortgage lenders. OK, average earnings and multiples have always been higher in London, but not dramatically. Today an 'average' property sells for between 8 and 15 times 'average' London earnings. I'll return to this issue.

// TODAY AN 'AVERAGE' PROPERTY SELLS FOR BETWEEN 8 AND 15 TIMES 'AVERAGE' LONDON EARNINGS //

There are other ways of measuring what is, in effect, a fundamental valuation of residential property. One is the yield, or notional yield, one could get by letting property. This was another constant: roughly a premium of 5% over the benchmark ten-year gilt. This yield premium reflects the greater risks and overheads involved in letting residential property. Thus, in historically 'normal' times with gilt yields of say 4–6%, if you could buy property which would generate rental income of 10% gross, you would be paying a fair price. If you bought at a higher expected yield, other things being equal, you were buying a bargain. Less, and you might be overpaying and would need to rely more on future capital gains for your return. With the benchmark gilt today offering round 0.5% one should, on this measure, be looking for a yield of 5–6%. Many London letting properties today sell at a half or even a third of that yield.

ASSESSING FAIR VALUE

My favourite fundamental valuation metric, Tobin's q ratio, can also be used to assess a fair value for property. Basically, q looks at the replacement value of an asset and compares how that relates to the open market price. This can be particularly helpful when applied to equity markets, the S&P 500 being the benchmark, but the principle can be applied to anything. In the US, when Tobin's q is applied to residential real estate on data since 1900, it shows a virtually flat line all the way till about 2006 when there is a marked blip upwards for a couple of years or so, reflecting the sub-prime scandal. It has now returned to flatline 'normal'.

Other things being equal, this pattern ought to be the same in the UK, but it decidedly is not. That is because other things are not equal. The foundation of property pricing is the price of land, and the US has lots and lots of that; the UK does not. There are many good reasons for restricting where people may build houses in the UK, in parts a densely populated country – south-east England in particular. These are policy issues, and for 50 years and more, political will has been firmly for protecting green belts. London created a green belt before WWII and they became national planning policy in the 1950s. There is no doubt that green belt policy has resulted in inflation in urban land

prices so that land now accounts for more than 70% of the cost, compared with around 25% in the 1950s.

WHAT'S BEEN GOING ON?

But there have been other policy failures going on in London, particularly in the past 30 years. When I bought our four-bed London Georgian terrace house in 1977 in Stoke Newington, it cost £26,650, pretty much four times my earnings of £6,500 at the time: probably an 'average' graduate income after five years in the City. My then next-door neighbour, Andrew, had bought his for under £6,000 in the mid-1960s after coming over from Jamaica and working on the buses for ten years. The point is that London property was generally still affordable on long-term average multiples of earnings and some earnest saving. What's been going on?

In 1980, then housing minister Michael Heseltine introduced Right to Buy as part of the Conservative Party's radical Popper-inspired libertarian reforms. There was social purpose as well as political (tenants who could buy were more likely to vote Tory thereafter). There is something fundamental in owning one's own home, with all the connotations that go with that. It provides a place of stability to bring up a family, physical and financial security, and is the social and psychological bedrock of modern living. Originally, the objective was to recycle the social housing stock, with local councils continually using receipts from sales to build new social housing, thereby providing a route for poorer people to have a stake in the economic growth of the country. Simultaneously, councils could upgrade their new builds. Politics intervened: a cabinet reshuffle allowed then prime minister Margaret Thatcher to move Heseltine out of the way to defence and reverse the reinvestment part of Right to Buy so that councils were expressly prohibited from using all the receipts. Instead of the stock of social housing expanding and modernising in a virtuous cycle, this resulted in a steady reduction in total numbers of available houses and flats, about two million dwellings by now, forcing up prices.

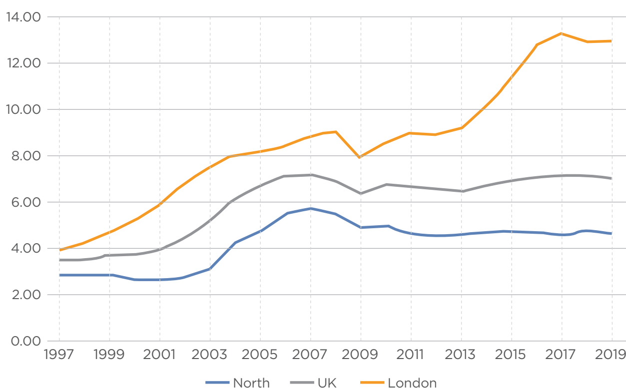
The Thatcher era also brought in Big Bang, creating a massive expansion of the City that continued until Brexit. Large central government subsidies enabled London's infrastructure and public transport systems to become world beaters and helped make London one of the most economically vibrant and attractive cities in the world.

Around this time and into the Blair decade, political philosophy changed and allowed the notion of the power of markets to infuse the Establishment's thinking. Under this way of thinking, governments would need only to provide the right conditions and capitalism and competition would provide the most 'efficient' way to deliver solutions to anything. Accordingly, governments have put out the welcome banners, devalued sterling and opened the doors to anyone who wants to come here to do business. And have they come? Emphatically yes, at least until Brexit, but not exclusively to create economically productive new businesses. It seems irrefutable that a significant part of London's (and the surrounding region's) old and new-build housing has been snapped up by overseas buyers, for whom sterling assets looked cheap. In my view this has been an incalculable public policy error.

> // THE POLICY HAS PRICED OUT ALL MODESTLY PAID KEY WORKERS AND MANY RELATIVELY HIGHLY PAID PEOPLE //

The mistakes and their consequences are egregious and threefold. First, economically illiterate politicians have assumed any foreign money being invested in the UK is a good thing. Second, buying (and selling) property has no productive economic function. Third, and most important, the policy has priced out all modestly paid key workers and many relatively highly paid people. If a city-state with an economy the size of London cannot house its teachers,

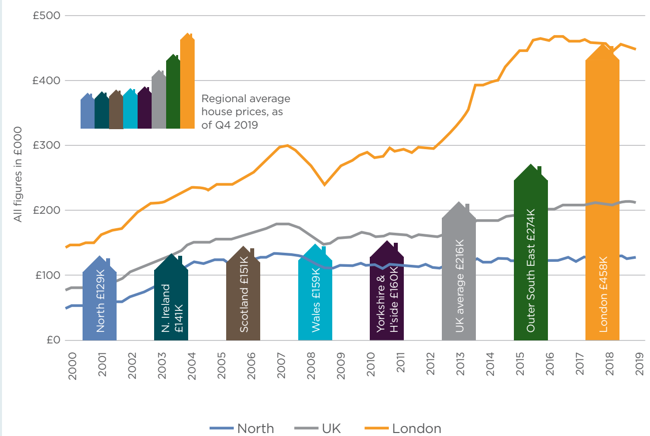
TABLE 1: UK LOWER-QUARTILE HOUSE PRICES VS LOWER-QUARTILE INCOME 1997–2019*



*Ratio of lower-quartile house prices to lower-quartile gross annual (where available) workplace-based earnings by country and region, England and Wales, 1997 to 2019.

Source: ONS

TABLE 2: UK REGIONAL PROPERTY PRICES



Source: Nationwide

nurses, street cleaners, bus drivers and emergency service workers because they've been priced out of renting, let alone buying, somewhere to live close enough to their jobs, sooner or later something catastrophic will happen.

Foreign inward investment is desirable if, and probably only if, the investment is directed to long-term economically productive ventures that boost UK growth. Those create profit and employment, adding to people's incomes and to the Treasury's tax receipts – a genuine virtuous cycle. To open our doors to anyone with money and sell them core capital assets, which are desperately needed to keep our cities and services running, is not helping anyone who lives here. All this policy has done is lead to massive inflation in residential property, pricing out of the market the very people needed to make the whole system work. This is unacceptable.

CLEAR THINKING REQUIRED

Capitalism is about applying capital for productive economic purposes for the greater benefit of the society we live in. Buying and selling property in itself has zero productive economic function, like collecting or dealing in art, wine or classic cars. Any personal profit is merely at the expense of someone else; nothing new has been created in the system. As Mayor of London, Boris Johnson used personal powers to override council planning decisions, and some 400 tower blocks are in the process of being built. Even if we don't care about what London actually looks like or whether it is pleasant and easy to work in, we already build the smallest dwellings in Europe (in square feet per occupant) even as the price for these rabbit hutches soars out of reach of any average earner.

We need to think clearly about what it is that makes a city work and be a provider of jobs. Above all, it is having people living there to fill the jobs and contribute to a growing economy. As council housing and housing association stocks are sold and not replaced, and as land is scarce without a blitzkrieg on the green belt, common sense dictates we need to ensure our key workers have somewhere suitable to live, and in priority to allowing just anybody to buy up properties because they can make a fast buck – as has happened for the past 25 years or more. All this does is create a mega-class of rentiers whose sole purpose in buying is to push up capital prices and rents to enrich themselves. Such parasitism needs to be stopped in its tracks and replaced with rules that favour those who live and work in a city.

Taking New Zealand as a model, we should not allow anyone to buy property here unless they are resident in that property. New sales should be banned. Any individual or corporate entity that owns residential property that they do not personally occupy should be significantly taxed annually on its capital value, with a rider that rents cannot be increased to cover the cost. If offshore owners hide inside complex trust and corporate structures then, with notice and due process, laws should be enacted to allow legal sequestration.

Landlords who own historical portfolios of houses and flats can be tested against criteria including how long they have been in business and how fairly their tenants have been treated. New entrants to the letting market should be blocked for the time being. Formally controlling rents in the private sector appears to be counterproductive, so excess properties should for the time being be taken into public ownership to be let at fair rents. This is not anti-capitalist or xenophobic; it is a rational response to rich people and corporations taking advantage of a shortage of residential property and excluding those at the bottom of the ladder. Speculative buyers could be welcome to invest in any part of the productive capacity of the UK economy, but residential property must be considered a special case and ring-fenced until homes once more become affordable on historical multiples. In any area where there is a shortage of affordable property, there is no need for any person to own more than one home.

> // RETURN TO EQUILIBRIUM A MARKET THAT HAS BECOME DANGEROUSLY AND OBSCENELY SKEWED //

The aim must be radical, not to ban people from ever owning property in our cities or countryside for investment purposes, but to return to equilibrium a market that has become dangerously and obscenely skewed. The outline suggested will gradually persuade rentiers that the game is not worth the candle and properties will come back on to the market. This will gradually lower property prices in real terms and one day they will return to levels where an average person can buy an average property at average multiples of average earnings near where they work. A second home might be possible in rural areas or towns, but this could be controlled by licence depending on local demand and vacancies until first-time buyer demand and supply is in equilibrium.

There would be some severe collateral consequences for this policy over the short to medium term. Recent purchasers (perhaps using the bank of mum and dad) would see the value of their home fall but, using Tokyo's experience in the late 1980s as a model, this phase might last a decade and half the value of property in real terms, but then a recovery towards long-term average valuations would rebalance each market towards normality. This would be painful, but a necessary lesson would be learnt: market cycles are normal and nothing keeps just going up forever.

VIEW FROM THE COUNTRY

If we want to live in a decent society with good services and security, then we must ensure that every member of that society can have the chance to own or rent a decent dwelling without prices being distorted by speculative predatory investors. Having somewhere affordable to live in order to work should be enshrined as a basic right. Imagine if such legislation were introduced in every country: no more than one residential property per person or family group until there is a clear surplus of dwellings over demand. Nobody would be worse off; nobody can live in more than one property at a time. Rich people can spend their money on other things, hopefully invested in economically productive instruments. One person's greed should not cause multiple others to be priced out of a fundamental necessity. If such legislation became universal, minds and money could be focused on genuinely useful and productive ventures, rather than fuelling the next bubble.

Things look different from upcountry.

POST-NORMAL BONDS: FINANCIAL INSTRUMENTS FOR A SUSTAINABLE ECONOMY

YELENA MUZYKINA AND **YELENA NOVIKOVA** CONSIDER THE DEVELOPMENT AND DEPLOYMENT OF NEW TYPES OF FINANCIAL INSTRUMENTS TO HELP PROMOTE A NEW WORLD ORDER IN FINANCE

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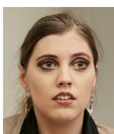
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1. INTRODUCTION

The need for a change in the current pattern of global economic development has been building for decades. By the end of the 20th century, several high-profile international organisations had voiced support for switching from single-indicator analytics that proved sustainability based only on economic growth data. In May 1990, the United Nations Economic Commission for Europe (ECE) raised the issue of the environment and its safety for future generations during the Bergen Conference on Sustainable Development, attended by environment ministers from 34 countries and the EC Commissioner for the Environment (United Nations Information Unit on Climate Change, 1993). Over time, it became increasingly apparent that the idea of sustainability should transcend material concerns and embrace a variety of factors, including quality of life and health, environmental efficiency, strength of communal relationships, fullness of participation in society, and others.

The need for broadening the variables for defining sustainability has become even more acute within recent years, a period that has been defined as 'post-normal times' (PNT) (Sardar, 2010). International society, including the global economy, has changed significantly, and it is necessary to establish new norms, conventions and rules.

This paper aims to discuss feasible contributions to this process in Kazakhstan, a country that lies at the centre of the Belt and Road initiative. With a belief that green finance and Islamic finance instruments can play a critical role in the post-normal Kazakhstani economy, the discussion focuses on financial instruments that we dub 'post-normal bonds', whenever we need to emphasise its relevance to post-normal times framework.

We feel obliged to clarify up front that, to this effect, post-normal bonds are bonds that can effectively address the complex and contradictory needs of post-normal times and economy. That said, the primary focus of this paper is a specific type of post-normal bond that can otherwise be called a 'green sukuk hybrid'. In fact, for the purposes of this discussion 'post-normal bonds' and 'green sukuk hybrids' are used interchangeably.

A green sukuk hybrid, in its turn, can be defined as a participatory proportional ownership instrument, a pledge against existing or future cash flow from the assets used to finance and refinance projects when partners take risks, share profit and loss, and comply with the principles of the International Capital Market Association (ICMA) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

We seek to show how this approach merges the best aspects of green bonds and sukuk, thus addressing the challenges of surviving and flourishing in a post-normal (PN) economy.

2. AMBIGUITY IN SUSTAINABILITY OF CONVENTIONAL BONDS

We first consider how different types of bonds fit into the PN context. Lord Mervyn King, a former governor of the Bank of England, calls the world we are living in a "world of radical uncertainty" (King, 2017, p.136). This highlights that the risks being faced today cannot be defined precisely in the financial world. Expanding on King's idea, radical uncertainty is the key to understanding not only financial markets themselves (2017, p. 140), but also the overall character and dynamics of the PN and post-truth world that are mirrored by the economy.

Ziauddin Sardar, the founder of PNT theory, identifies three primary features of PNT (Sardar, 2019, pp.6–7). The first of these is the extreme interconnectedness of everything in the globalised and networked world. This feature can lead a local event to transform into a global-scale disaster. The rapidity with which this can happen constitutes the second characteristic of PNT. Arising from the elements of speed, scale and scope, the third trend highlighted by Sardar is simultaneity: "This is how we now have to see our world: as an interconnected, networked system, where things accelerate quickly, often simultaneously, and become global in scale." (Sardar, 2019, p.6.)

> // A LOCAL EVENT CAN QUICKLY TRANSFORM INTO A GLOBAL-SCALE DISASTER //

In addition to the '4Ss' mentioned above, other essential features of PNT include the '3Cs' (Sardar, 2019, p.9):

- C1 – *complexity* reflected in multiple ways and employed by interconnectedness, interdependency and networking;
- C2 – *contradiction* that peeps out around us in all sorts of inequality and a simplistic approach to problem-solving of complex issues; and
- C3 – *chaos* that springs up when "glaring contradictions and complexity come together".

The critical question for PNT is how to address the challenges arising in this global context. Sardar answers: "We

must never lose hope and do our utmost to nurture positive, sustainable and life enhancing change" (2019, p.14). To achieve this, people must navigate PNT through the following means, summarised from Sardar's discussion (2019, pp.15–18):

- Work on alternatives that can battle uncertainty.
- Consider multiplicity and inclusivism to cope with complexity.
- Encourage creativity as the best alternative to precise 'mathematical' methods.
- Uplift ethical values (modesty, accountability, humility and community) that connect with knowledge and question technological advancements.
- Promote polylogues to create spaces for multiple perspectives, logics, voices and existences, in order to achieve a new synthesis.

Overall, it is suggested that only new syntheses and knowledge can help humanity to address the wave of uncertainty and build a sustainable life in PNT. Therefore, the PN economy requires new instruments that comply with the prerequisites mentioned above.

It is clear that conventional bonds are losing their position in the PN economy and are not necessarily sustainable. This is due to a number of factors:

- Bonds are debt instruments that generate income primarily for the bond issuer, thus promoting financial (and social) inequality.
- They emerged in times when Western culture and morality were predominant; therefore, their role is increasingly being questioned and contested.
- They prioritise interest payments within a 'get-it-at-any-cost' ethical framework.

While traditional bonds still serve some purpose as instruments within the global economy, the current situation requires stronger complementary alternatives. Among the potential options are green bonds and sukuk, both of which are designed to contribute towards sustainability. The key characteristics of both include:

- Combination of tangible and intangible values to move from a greed-based to a PN economy.
- Focus on specific projects.
- Assets-based nature.
- Third-party verification.
- The credibility of a borrower as the key to success.
- Increased focus on social and environmental responsibility and performance.
- Facilitation of multi-faceted financial inclusivism.
- Reliance on universal human values rooted in spiritual traditions (such as those presented in the Bible for Christianity, or the Qur'an for Islam).

These are the characteristics of green bonds and sukuk that align with environmental, social and governance (ESG) factors that are applied to set standards for socially conscious investors in order to create a positive net sustainability impact.

We will now discuss how the global situation is reflected in the context of Kazakhstan.

TIMELINE 1: BRIEF HISTORY OF SUKUK

Year	Event
1988	Fiqh Academy of the Organization of Islamic Cooperation legitimised the use of sukuk
1990	Malaysia Shell MDS Sdn Bhd issues the first modern sukuk
1991	Establishment of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)
2003	AAOIFI publishes a standard on 'investment sukuk'
2005	World Bank issues its first Islamic bond amounting to US$200m
2014	The International Finance Facility for Immunisation issues the largest supranational entity debit sukuk
2017	Malaysia launches the world's first non-sovereign green sukuk
2018	Indonesia sells the world's first sovereign green sukuk

3. NEW TYPES OF BONDS IN THE KAZAKHSTANI ECONOMY

Green sukuk hybrids establish a middle ground between the green bond definition offered by Astana International Exchange (AIX) in its regulations (2019, p.129) and the definition of sukuk given by the AAOIFI (Afshar, 2013, p.47).

3.1. 'Embryonic' development of green bonds and Islamic bonds

According to Thomson Reuters' *Islamic finance development report 2018* (Mohamed, Goni and Hasan, 2018), the Islamic finance sector is growing at an impressive rate: while the total value of Shariah-compliant assets in 2003 was US$200bn, it had reached US$2.44tn by 2017. The banking sector is gradually responding to the demand of Islamic lenders: during the decade 2003 to 2013, sukuk bond

TIMELINE 2: BRIEF HISTORY OF GREEN BONDS

Year	Event
2007	The European Investment Bank issues the first green bond
2008	The World Bank issues its first green bond
2010	Climate Bond Initiative creates the first Green Bond Standard
2012	African Development Bank issues green bonds to finance climate change solutions in Africa
2013	Credit Agricole becomes the first issuer of corporate green bonds
2014	Green Bond principles released and endorsed by the ICMA
2015	Agricultural Bank of China becomes the first Chinese entity to release green bonds
2018	Poland becomes the first sovereign issuer of green bonds
2019	Green bond issuance surpasses the symbolic benchmark of US$200bn

TIMELINE 3: BRIEF HISTORY OF SUKUK IN KAZAKHSTAN

Year	Event
1992	Al Baraka Bank (Pakistan) opens its branch in Kazakhstan
2011	Kazakhstani government develops legal framework for Islamic bonds
2012	Kazakhstan develops 41-step 'Roadmap for development of Islamic Finance by 2020'. The development Bank of Kazakhstan issues its first sukuk at Malaysian stock market
2015	Kazakhstan introduces amendments to address Islamic insurance, leasing, sukuk and Islamic banking system
2016	Kazakhstan launches its first sovereign sukuk
2017	AIFC launches its Islamic Finance Rules
2019	Astana International Exchange adopts AIX Business rules that include Islamic finance section

issuances rose twentyfold to reach a value of US$120bn (World Finance, 2019). A brief history of modern sukuk can be visualised as presented in Timeline 1, p.65.

Green bonds were launched as a niche product just a decade ago by multilateral institutions such as the World Bank and the European Investment Bank. In November of 2019, the green bonds market reached the milestone value of US$200bn (Climate Bonds Initiative, 2019).

A brief history of green bonds is presented in Timeline 2, p.65.

3.2. Synergy between green bonds and Islamic bonds in Kazakhstan

In Kazakhstan, the history of Islamic bonds began in the 1990s and overlapped with the green bonds' launch in the 2010s, including the significant events outlined in timelines 3 and 4 on this page.

As the graphics on this page demonstrate, the development processes of sukuk and green bonds in Kazakhstan have moved in parallel, with some effort required to synergise them. Astana International Finance Centre (AIFC) and AIX are examples of financial market players taking such steps.

4. WHEN TWO BECOME ONE

4.1. AIFC develops rules for taxonomy of post-normal bonds

Both green and Islamic finance are so crucial for the development of the AIFC that president Nursultan Nazarbayev's foreword to the 2019 Annual Report of the AIFC highlights them as two strategic pillars (AIFC, 2019, p.9).

However, the development and distribution of Islamic finance have been more noticeable in contrast to green finance to date, both across Kazakhstan in general and at the AIFC in particular. This is also indicated by the floor plans of AIFC properties. Nevertheless, overall, these financial innovations seem to follow similar patterns, albeit with some element of delay.

The first mention of Islamic finance within the context of the AIFC dates back to the Islamic Finance News Forum hosted by the AIFC in 2017. Kairat Kelimbetov took on the office of governor of the Islamic Development Bank (IsDB) Group for Kazakhstan in March 2017. In contrast, the AIFC did not adopt its green finance concept and strategy until November that same year.

Due to a mix of logistical, historical and developmental reasons, a similar pattern applies to the speed with which the AIFC was able to secure Islamic finance talent, as opposed to the acquisition of green finance talent.

The AIFC's Bureau for Continuing Professional Development (BCPD) is currently offering a wide variety of Islamic finance qualifications:

- The Islamic Finance Qualification from the Chartered Institute for Securities & Investment
- The Bahrain Institute of Banking & Finance Advanced Diploma in Islamic Finance
- Professional Certificate in Islamic Finance
- Certified Islamic Professional Accountant – flagship qualification of AAOIFI.

Since 2019, the BCPD has also offered the only Chartered Banker Institute's Green Finance Certificate (distributed by the CISI).

Similarly, a justifiable asymmetry between Islamic and green finance exists in terms of the advisory infrastructure at the AIFC. While the AIFC does have an Advisory Council on Green Finance, consisting of four high-profile members including the governor, there are multiple advisory councils available for Islamic finance. Among these are:

- AIFC Advisory Council on Islamic Finance (ten members)
- AIFC Central Shariah Advisory Board (five members).

As one might expect, the AIFC's goal of achieving a higher level of symmetry between the development of green

// THE GREEN BONDS MARKET REACHED US$200BN IN NOVEMBER 2019 //

TIMELINE 4: BRIEF HISTORY OF GREEN BONDS IN KAZAKHSTAN

Year	Event
2013	Kazakhstan adopts national concept policy on green economy
2015	KASE signs agreement with Sustainable Stock Exchanges Initiative
2016	Voluntary methodology for ESG reporting is released at KASE
2017	AIFC develops the national concept policy on 'Transition to Green Financial System'
2018	Kazakhstan-2025 strategy to align with nationally defined contributions
2019	Astana International Exchange adopts AIX business rules that include green finance section; KazPV announces its intent to issue Kazakhstani first green bond

and Islamic finance approaches is particularly noticeable upon examination of its relationships with various international networks and institutions.

The AIFC's membership in Islamic finance networks and institutions includes:

- Member of the Islamic Finance Services Board
- Member of AAOIFI
- Member of the General Council for Islamic Banks and Institutions
- IsDB Governorship in Kazakhstan.

Meanwhile, the AIFC's membership in green finance networks and institutions includes:

- Member of the International Network of Financial Centres for Sustainability
- Member of the Green Finance Committee of the Asian Financial Cooperation Association
- Formal partner of the Climate Bonds Initiative
- Formal Partner of the Centre for the Fourth Industrial Revolution of the World Economic Forum
- Member of the Green Principles of the Belt and Road Initiative.

Overall, while asymmetry does exist in the AIFC's readiness for scalable green and Islamic finance innovation, this does not mean that green finance does not play a critical role in the brand positioning of the AIFC as an international/regional financial hub. The AIFC has already developed a framework for the 'Green Financial System for Kazakhstan', including multiple project components that focus specifically on green bonds.

Although the AIX has already developed a set of rules for green bonds issuance (AIX, 2019), based on the ICMA's Green Bonds Principles, the central role of the AIFC's Green Finance Centre is consulting with the Kazakhstani government and the National Bank of Kazakhstan on the overall transition to the green financial system.

4.2. AIFC to create demand and supply sides

As chief strategic officer of the AIFC, Professor Alexander Van de Putte stated in a recent interview that there is no shortage of ideas in Kazakhstan (Van de Putte, 2019). To date, however, the available ways for obtaining financing to implement those ideas have been limited.

There are several directions the AIFC is exploring in relation to introducing bankable projects to investors and vice versa:

1. Global and local private equity, hedge funds and real estate funds.
2. Family offices and high-net-worth individuals (AIFC, 2019, p.68).
3. Eventually developing a small- and medium-sized enterprises market, so that venture capital firms have an exit option at the end of the cycle (Waverley, 2019).
4. The planned establishment of the Green Finance Fund that is to be modelled after the Green Climate Fund, with a mandate to provide guarantees for green bonds and equity injections in companies implementing green projects, among other purposes (AIFC, 2019, p.98).
5. Capital market development with potential inclusion in Morgan Stanley Capital International emerging market indices (including bond indices) for greater exposure to international investors (Kelimbetov et al., 2019).
6. Public–private financing for risk incentivisation of bankable infrastructure projects (Van de Putte, 2019).

4.3. AIFC and post-normal bonds

The AIX has developed its rules for green bond issuance following the ICMA Green Bonds Principles and CBI systematics (AIX, 2019, p.129; AIFC, 2019, p.71).

Further, to encourage more widespread issuance of new bonds, the AIFC Green Finance Centre guarantees to cover the issuer's expenses upon a mandatory external review of the first five green bonds (AIFC, 2019, p.82).

This incentivisation seems to have worked at an unprecedented speed, as KazPV announced the upcoming issuance of its Green Bond at AIX in 2019, followed by mentions of the potential for green–sukuk hybrid issuance (InBusiness, 2019).

CONCLUSION

Due to a unique combination of historical and cultural factors and the multi-vector positioning of the AIFC as a financial institution, there is great potential for a new hybrid type of bond to be issued at AIX. However, this process requires diligent development of the theoretical and legal framework. Moreover, enough time needs to pass to generate trust and confidence around this financial instrument. That being said, green sukuk hybrid bonds possess apparent advantages:

> // THERE IS GREAT POTENTIAL FOR A NEW HYBRID TYPE OF BOND //

- Doubling impact potential
- Generating interest among a distinctly different pool of investors
- Creating a source of financing for distinctly different projects
- Successfully balancing the profit–conscience dilemma
- Releasing creative potential to survive in the shifting contemporary economy.

As discussed, the AIFC has accumulated sufficient talent and a suitable advisory infrastructure to deliver a green–sukuk hybrid bond. However, in order for this to take place successfully, asymmetries between the development of the green and Islamic tracks at the AIFC need to be addressed.

THE WORLD OF PECHA KUCHA

The competition of which this was the winner involved a variant of 'Pecha Kucha'. What? Well, the entry system required normal essays, judged by a panel of experts. But finalists then presented their results to a conference of their peers using a variant of Pecha Kucha, a storytelling format where presenters show 20 slides with 20 seconds of commentary each. Audience votes tipped the balance of results. For those of us inured to death by PowerPoint, this was a revelation.