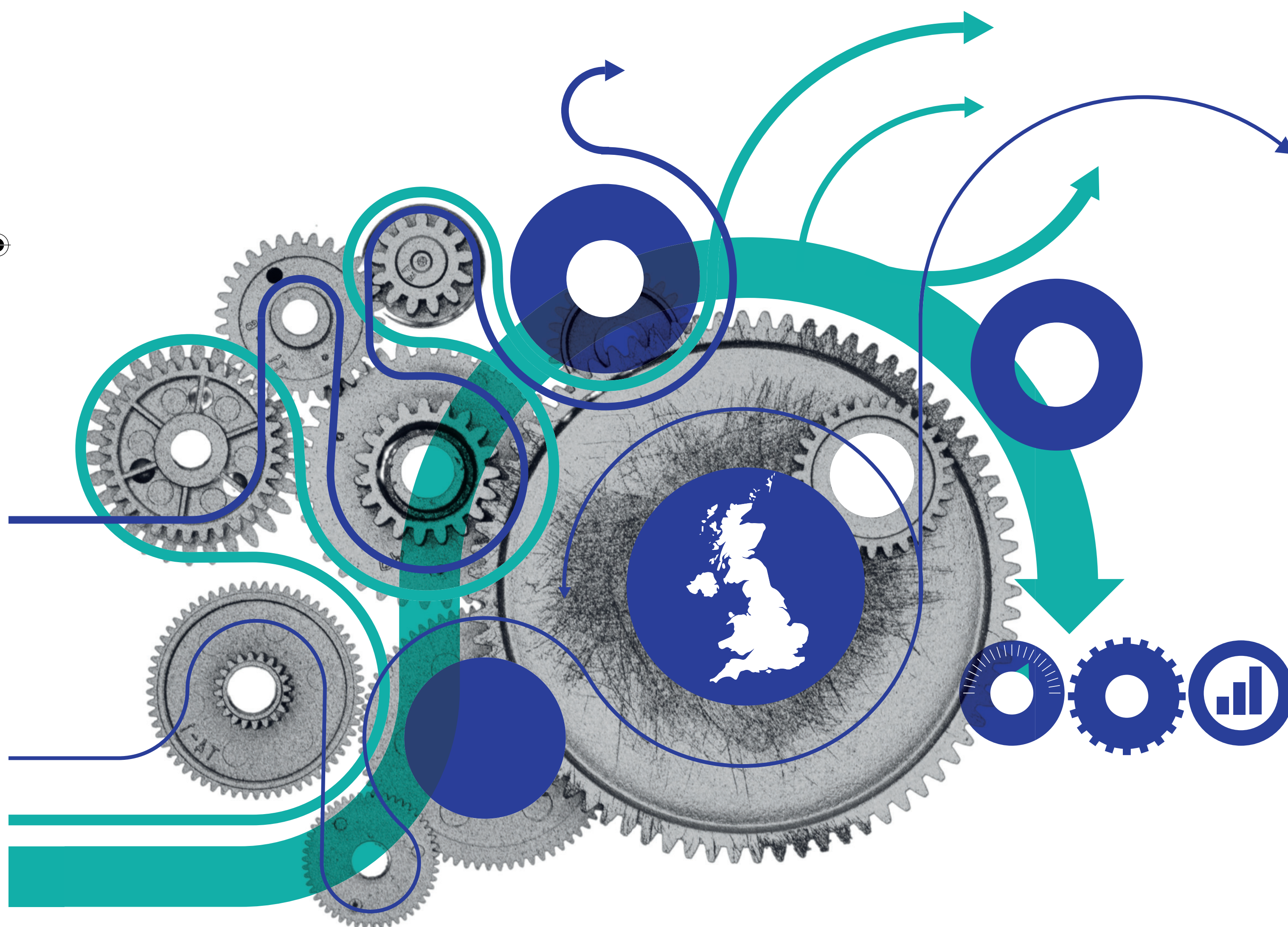
Executive Summary

New Capital Consensus
A better investment system for all

Reviving UK Investment Flows

A Systems Approach to Productivity and Growth



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Executive Summary

The UK's Growth Problem needs a Systems Solution

The new government's desire to place UK sustainable economic growth at the top of its agenda, and to view UK savings and investment as a key driver of this growth, is very welcome. This recognises the investment system's central role in driving sustainable growth and higher-quality retirements, and in improving intergenerational fairness.

Where previous governments have tended to view the investment system either as a source of taxation or systemic risk, the new government has the opportunity to recognise its fundamental function as a critical intermediator, channelling money from UK savers and investors both to UK firms in need of growth capital and toward the UK's wider decabonisation agenda. Such a view correctly locates the investment system at the centre of a what could be a virtuous spiral for the UK economy – with higher rates of investment driving a more productive sustainable economy, in turn driving higher rates of investment.

However, for the investment system to fulfil this potential it needs reform.

New Capital Consensus (NCC) comprises a coalition of organisations who have come together to create an apolitical, not-for-profit, research project and a policy discussion forum for commercial entities, think-tanks, policymakers and regulators. Our shared purpose is to identify and promote stakeholder buy-in to the reforms needed to foster the strongest links between the UK's savings and retirement aspirations and the sustainable growth aspirations that drive long-term prosperity.

Understanding the system's current capital stocks (their size and location) and flows (together with the interconnected set of forces that shape system flow) is key to the development of effective policy solutions.[1]

Historically, the UK has led the way on innovative approaches to the financial system, its competitiveness and its regulation – often establishing global regulatory gold standards in the process.[2] But the UK's current regulatory architecture is complex, complicated and patchwork (as we describe in Section 1). This means that however well-intentioned individual policy interventions may have been over time, in aggregate the UK regulatory system is now delivering unintended and unwelcome consequences for savings and investment in the UK.

Unveiling the Reality of the UK Investment System

Based on approximately 45 'Chatham House Rule' interviews with participants across the system NCC has generated a picture of the UK investment system as it is in reality ('warts and all'), rather than as it should operate according to Efficient Market Theory or other academic / 'rational' models of economic and human behaviour.

In terms of the systems approach of our sub-title, while market participants and regulators continue to look to traditional financial economic theory for their models,[3] in reality, the UK investment system is a classic "complex adaptive system"[4] and like most systems (from corporations to ecosystems) is therefore not the product of conscious design – or rather, is the product of nondesign.[5] The UK investment system has 'emerged' over time out of the networked actions of different and seemingly unrelated system actors, all of whose independent actions, logics and interests roll up into a systemic 'interdependence' whose whole is greater than the sum of its parts.[6] Each system actor, in turn, develops his own behaviours and establishes his own 'mindsets' by responding to incentives, and by learning from 'feedback loops' that either stabilise, dampen or amplify each element of his behaviour.[7]

The UK investment system has thus evolved rather than consciously developed, and continues to evolve from the myriad interdependent actions of otherwise independent participants – from employer-sponsors, pensioners and savers, through legislators, regulators and industry players to the press and other stakeholders.[8] And so a proper interrogation of the investment system must begin with these participants, their actions and behaviours, and their underlying drivers.[9]

This report sets out the results of qualitative analysis and the incentives, disincentives and mindsets that currently govern where and how private UK money gets invested, together with a set of draft policy recommendations for discussion.

Our ultimate objective is to derive a set of firm policy reforms, with wide industry acceptance, that deliver on UK political and social aspirations but do so by working with the grain of the investment system as it operates in often messy reality. This must start with savers as the primary focus; delivery of effective outcomes for them is crucial. But we must also recognise the other crucial role the UK investment system plays, acting as the 'heart' of the UK economy pumping capital to UK regions and sectors.

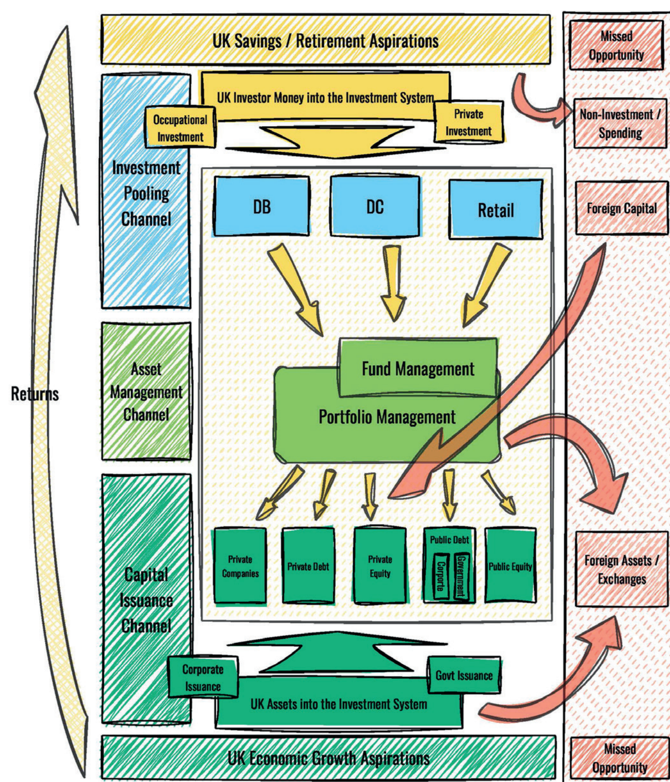
We have consciously focused on the investment system as a sub-set of the wider financial system which also includes banking and general insurance. It is important to appreciate that the bulk of investment within the system relates to retirement saving – that is, pooling within Defined Benefit (DB) and Defined Contribution (DC) schemes and life insurance companies. While mobilising Retail / Private investment pools into more productive investment remains a key policy target, we think the retail reform agenda needs a much more ambitious and considered approach. A root-and-branch review needs to begin with the problem of the UK's poor 'equity culture' and move on to consider: consumer preference for and facility with investment platforms[10], digital customer-journeying and fintech tools; advice / guidance reform fit for a digitally enabling world[11]; product design and availability; and tax incentivisation / wrapping (including ISA, VCT and EIS wrappers both individually and as a 'set').[12]

Although ours is conceptually a 'closed system' (focusing on UK investment flow into UK growth opportunities) we are also mindful of foreign direct investment (FDI) into the UK economy. We believe that boosting the participation of UK investment in the UK economy will pave the way for higher levels of 'crowding in' of both foreign and domestic investment by giving more credence to the UK as an investment destination.[13]

Otherwise over-reliance on international capital significantly reduces the UK's own sovereign resilience, and removes from the country the many social and economic benefits of business ownership within a domestic financial framework.[14] As Nassim Nicholas Taleb notes, networked systems naturally benefit from a host of 'anti-fragile' (resilient) characteristics – from the ability to spread shocks across multiple actors to the Schumpeterian 'natural selection' of poorly managed / high risk institutions made safe by the availability of alternates within the market. And we support Taleb's conclusions that policymaking should shift its focus from predicting failures within systems (Taleb's own 'black swan events') to building systems that can adapt and recover quickly when failures occur.[15] Reform needs to re-orient the UK investment systems towards more socially productive goals, but it needs to retain the system's naturally 'anti-fragile' characteristics at the same time.

The UK Investment System

We present below our picture or map of the investment system as it currently operates – describing both the 'stocks' of capital available to the system and the nature of the 'flow' of capital through the system. It identifies three key operations or channels within the UK investment system. The following diagram may look complicated but over-simplification has itself contributed to the system's current challenges[16]:



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The Investment Pooling Channel – bringing savers' money into the system in the first instance. This channel itself falls into two sub-channels: the Occupational Investment Channel (pooling money via DB and DC workplace investment schemes); and the Private Investment Channel (pooling money via non-workplace schemes such as Personal Pensions, SIPPS, ISAs and General Investment Accounts)

The Asset Management Channel – allocating available money to investment instruments or companies either via segregated portfolio management and/or fund management; and

The Capital Issuance Channel – bringing investment instruments or companies into the system in the first instance via the public and private capital markets.

Insight from System Participants

The complete range of systemic issues identified through approximately 45 interviews with participants across the system is covered in the body of the report. Our key findings are as follows:

- **Frustration over current operations**. Almost without exception, interviewees described with frustration how they were obliged to conduct their business in ways which, whilst profitable for their shareholders, are sub-optimal for their clients or clients of their clients. Many interviewees felt powerless to bring about beneficial change and welcomed the interview as an opportunity to share suggestions which could be of benefit to all.
- **Inadequate or sub-optimal outcomes for savers**. Much of this sprung from sub-optimal risk-bearing and lack of long-termism within the system. The inappropriateness of regulatory, accounting and actuarial risk measurement was a constant refrain. There was a general recognition of the system's failure to support the UK economy, with ambiguity over whether current investment approaches are genuinely in savers' wider interests.
- **Constraints and lack of agency in investment mandates**. Much frustration was also derived from channel interfaces. For example, Fund and Portfolio Managers were frustrated by the lack of long-termism and 'strategy' in the investment mandates provided to them by Asset Owners, who in turn struggled with regulatory and other constraints around the construction of strategic asset allocation. The lack of scale of many Asset Owners has led to clients with insufficient agency, skills and knowledge, so we were told.
- **Liquidity overemphasis in system behaviors**. Whilst regulation, accounting and tax were identified as powerful drivers of behaviour, risk management, the role of employers and market practices were also identified as key, with the latter playing an important part in the system's over-emphasis on liquidity and daily pricing.
- **Absent incentives to generate returns for savers**. Of equal importance, we were told, was the lack of incentives to generate returns for savers, with 'low cost' and 'safetyism' dominating.[17] The incentives to close industry gaps in service (for example, affordable advice/guidance, deccumulation solutions, etc.) are weak, as are those required to provide Private Equity transparency. The system is lacking sufficient incentives to support innovation and creativity, primary requirements for growth.

The System's Ingrained Dynamics

Taken together, we heard that market structures, incentives and feedback loops (the circular cause-and-effect relationships that either stabilise the system or amplify elements of its behaviour) make the UK investment system what it currently is. They are also the drivers of the investment system's nondesign insofar that it has evolved in a manner that is fit for the system itself rather than one that is fit for users of the system and wider social purpose. For example:

- **DB accounting standards have led to short-termism** in DB scheme investment mentality. Artificial volatility from liability measurement has pushed assets

towards bond investments and leveraged LDI strategies. This has been reinforced by both regulation and accounting creating herding behaviours, both obscuring and creating systemic risks, which will only increase with the current rush to buy-out.

- **An over-focus on cost in workplace DC (partly driven by employer and saver preferences) and in Retail/Private investment has led to both a passive mindset and helped to drive consolidation within the asset management industry.** The markets and regulatory focus on 'low cost' has undermined the proper emphasis on performance and outcomes. Global approaches to asset allocation, adopted by larger Asset Managers, have reduced investment in the UK economy, in turn diminishing the UK share in global indices. Industry approaches to 'relative' benchmarking and diversification-seeking further drive the adoption of global indices in setting pension scheme allocation, which reduces investment into the UK. Because global indices are dominated by US companies (and increasingly by US tech companies) UK investment is effectively supporting the US tech / growth agenda rather than the same within the UK.
- **A system-wide focus on short-term volatility over long-term risks has contributed to risk-reward aversion among a wide range of stakeholders** which in conjunction with regulatory safetyism has created a market driven to minimise risk rather than to find the appropriate trade-off between risk and reward/return.

These feedback-loops operate to amplify and lock-in behaviours and are therefore key points of political intervention within the system – or 'leverage points' as Systems Theory describes.[18]

Focus areas for reform

Consolidation of the pension fund industry is needed to reduce herding by creating asset owners of substance. The strength of the Canadian investment system derives from having five pension funds each with over £100 billion of assets and three of the top 15 global life insurers (by market capitalisation). The weakness of the UK investment system derives from having none of either.

Low-cost, short-term, passive, secondary investment mindsets are promulgated through the construction of investment mandates. To counteract this, we need to re-incentivise return-seeking, to counteract the dynamics currently driving low-cost investment, and reduce short-termism by requiring investment mandates to reflect the duration of savers actual requirements for access to their investments; this latter requires reducing the incentives behind liquidity-seeking.

Achieving a better balance between risk and returns, requires revisiting risk measurement and the regulatory and accounting drivers that drive safetyism. Investment in UK primary investment requires new incentives.

Key Reform Recommendations

The new Government has got off to a good start with some long-term vision (GB Energy, a National Wealth Fund and a reinvigorated British Business Bank); the publication of an Industrial Strategy; a Global Investment Summit reaching out to

the world's biggest investors; a Pensions Investment Review led by a Minister sitting across DWP and Treasury; and an Autumn Budget that looks likely to have a number of systemic effects on the DC Investment Pooling channel. Recent announcements on LGPS, DC consolidation and an ongoing focus on 'value for money' in DC are also vital steps in the right direction.

However, while this reform agenda is ambitious it does not primarily focus on the actual incentives, dynamics and practices that drive the system and that reform needs to address, if the UK is to rebuild a sustainable growth economy to the benefit of all. Against this background, NCC makes the following recommendations, while acknowledging that no single policy action will be sufficient or provide a 'silver bullet':

Targeted interventions

- **Facilitate the consolidation of private DB pension schemes** – placing DB Superfunds on a statutory footing in the forthcoming Pension Schemes Bill, and permitting life insurers to set up Superfunds outside their Solvency II ring-fences - to sit alongside other existing and new providers of capital. 5000 sets of Trustees managing £1.2 trillion of assets is highly inefficient, leads to uniform investment strategies and industry herding, which the rush to buy-out will intensify. Superfunds will operate under pension scheme rather than Solvency II rules, effectively freeing up Superfunds with high-quality investment skills and resources (and pursuing a run-on strategy) to make primary investment and investment in illiquid assets. Life insurers are natural consolidators and will block the changes needed if not permitted to participate.
- **Remove the requirement for daily liquidity in the DC and Private / Retail Investment markets** – on the grounds that the benefits of daily dealing (immediate subscription / redemption) are increasingly outweighed by the cost that a daily liquidity mindset brings to asset allocation, and the inhibiting effect on primary investment in real assets.
- **Change the system risk culture by revisiting regulatory and industry risk measures to free up investment strategies and support institutional risk-sharing with clients** – beginning with the system's current unhealthy focus on volatility and liquidity risk at the expense of duration risk and risk to returns. DB schemes should be given greater investment flexibility and DC schemes should be encouraged to seek performance rather than low cost through the planned Value for Money regime and by updating the guidance to employers on the choice of a suitable DC default fund for their workplace scheme. Mechanisms also need to be introduced to support pensions schemes 'run-on' strategies – to extend investment durations and reduce unhealthy derisking. This has the potential to deliver a win-win-win for the UK: improved profits for businesses; improved products and services for consumers (as well as innovative solutions for the environment and society)[19]; and improved investment returns for pensioners.
- **Change tax incentives/disincentives to operate at the asset level as well as at wrapper level** – to boost the appeal of productive UK investment and to put equity investment on a par with debt investment. Savers are rightly given incentives to invest, but not to invest in the UK, to support the communities in which they live and will most likely retire. Re-establishing the social contract

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between society and savers is an appropriate quid pro quo for the valuable tax incentives provided.[20]

"We have created an unconscious ecosystem that feeds on the oxygen which used to grow the system. And then you add in LDI. You add in preventative regulation. You add in tax disincentive, if you will. You create a fire blanket. Now, the thing about fire blankets is they work pretty well when there's a fire, but people forget when there is no fire you've got to take the fire blanket off. Otherwise, you don't get any oxygen to the thing underneath the fire blanket. Because there's no oxygen, there's no investment. So productive investment is the oxygen of the system. It doesn't happen without risk."

NCC interviewee quote*

A Re-Imagined regulatory system

Change is also needed to create the right regulatory incentives for a sustainable growth economy. The current system is only a decade old but was designed to address problems caused by the Global Financial crisis, not the challenges of the next two decades. The industry is already suffering regulatory fatigue so changes will need careful management to achieve buy-in. In the interim, change to regulatory oversight is essential - it is unreasonable to expect regulators to set the rules and also assess the effectiveness of the rules they have themselves imposed on others.

The fragmented and over-complex regulatory system also needs redesign at an architectural level. As we explain in Section 1 the current regulatory architecture is itself over-complicated, fragmented and lacks accountability against system purpose.

- **Short term**, we recommend extending the role of the Regulatory Innovation Office to have responsibility for system oversight measured against system purpose – beginning with a system purpose that delivers on social goals for individuals, the economy and society; while recognising
- **Longer term**, we recommend review of the regulatory architecture and its modus operandi; a rebalancing the role of regulators to create the right trade-off between the achievement of savers' objectives, the security of institutions, democratic parliamentary accountability and a rationalising and modernising of the regulatory approach.

The end result of these recommendations could be transformative:

- A more resilient UK economy and sovereign state;
- Better retirements because of bigger investment pots;
- More UK investment to provide the capital needed to develop green infrastructure for sustainable growth; and
- A growing economy, providing better, more productive jobs.

Our Report

The nature of this study is co-creative and iterative. This report contains our qualitative research and analysis, and initial recommendations. Discussion of these with key stakeholders will enable NCC to identify further considerations and inform final, implementable recommendations.

- **Section 1** sets out why the UK's investment system is current delivering under-investment and low productivity. It makes the case that only a whole systems approach to reform will have a lasting impact;
- **Section 2** identifies the stocks and flows (and their interactions) within the UK investment system. It describes the system as it is today and in reality rather than as it appears in textbooks;
- **Section 3** describes the individual components of the investment systems (pensions, retail investment, asset management, capital markets and corporates etc.) in more detail;
- **Section 4** describes our key learnings about how the system operates in practice and the issues it faces. This is derived from a series of interviews held with senior industry participants;
- **Section 5** analyses the behaviours and incentives that currently drive the investment system and draws out a number of key incentive-chains that need re-orienting back towards 'productive purpose';
- **Section 6** covers the policy opportunities for effective change and sets out NCC's Recommendations.

To read the full report please scan the QR code, go to **www.newcapitalconsensus.org** or order a print copy via **dan.hedley@newcapitalconsensus.org**.

*The drop quotes highlighted throughout this paper are taken from interviews conducted on a Chatham House basis with approximately 45 key industry stakeholders. The views they expressed have greatly informed our thinking. For more findings see the Appendix.

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Notes

1. We view our work as part of the 'heterodox' challenge to / correction of 'orthodox' economic theory and orthodoxy's tendency towards over-rational, over-simple and over-neat conceptions of economic operation (such as the concepts of Efficient Market Theory (EMT), Expected Utility Theory, *homo economicus* and 'the invisible hand' of the market). In his *Irrational Exuberance* (NY, 2001) Robert Shiller argues that speculative bubbles develop for structural reasons, grow for cultural reasons and find their natural boundaries (and burst) for psychological reasons. In other words, markets become exuberant (itself an impossibility within EMT) because of the innately 'irrational' *modus operandi* of the human agents who make up the financial system. Following in the footsteps of Shiller, NCC contends that the UK investment system is currently suffering from an 'Irrational Conservatism' that has similar roots to Shiller's 'Irrational Exuberance' in the system's market structure and 'feedback loops'; in the system's belief-systems and mindsets; and in the human psychology of individual market actors.

   In terms of 'heterodox' challenges to 'orthodox' economic assumptions, Herbert Simon introduced the concept of the market's "bounded rationality" in the 1950s as a shorthand for his brief against neoclassical economics and his call to replace the perfect rationality of EMT with a conception of rationality tailored to "cognitively limited agents" – that is, to homo sapiens rather than homo economicus. See: *Administrative Behaviour: a study of decision-making processes in administrative organisations* (NY, 1947); and Bounded Rationality (MIT, 1982).

   Amos Tversky and Daniel Kahneman extended Simon's logic into 'behavioural economics' in the 1970s. See: '*Judgment Under Uncertainty: heuristics and biases*', in Science 185 (1974): 1124-1131; and 'Advances in Prospect Theory: cumulative representation of uncertainty' in *Journal of Risk and Uncertainty* 5 (1979): 297-323. Richard Thaler and Cass Sunstein added the concepts of 'choice architecture' and 'libertarian paternalism' (or 'nudging') when they popularised behavioural economics in Nudge: improving decisions about money, health and the environment (London, 2008) as Thaler sets out in *Misbehaving: the making of behavioural economics* (London, 2015).

   Sanford Grossman and Joseph Stiglitz developed a critique of EMT in the 1980s by arguing that if markets were truly efficient there would be no incentive for information-gathering – as there clearly is contra Eugene Fama's view that markets are 'informationally efficient' because prices always incorporate all available information. For Fama's belief in market efficiency (which significantly influenced the emergence of index funds) see: '*Efficient Capital Markets: a review of theory and empirical work*' in The Journal of Finance 25:2 (1970): 383-417. For Grossman / Stiglitz's rebuttal, see: '*On the Impossibility of Informationally Efficient Markets*' in The American Economic Review 70:3 (1980): 393-408.

   In *Narrative Economics: how stories go viral and drive major economic events* (Princeton, 2019) Robert Schiller continues to debunk Fama's theory of an 'informationally efficient' marketplace, replacing it with an 'informationally competitive' one in which investors compete for market information as fiercely as they compete for actual assets. But he also argues that market events are driven as much by human narratives as by market data. The 'stories we tell ourselves' do more than simply describe the economic events around us – in terms of bubbles, crashes, recessions and panics – Shiller maintains: they actively shape the economic behaviour that produces these same events by encouraging investors to follow the prevailing narrative rather than the underlying data. Shiller's insights are important

   Finally, Karl Polyani has long argued that markets are inherently embedded in social relations and institutions, and thus argued against the "economistic fallacy" that reduces all economic behavior to rational, profit-maximizing actions. *In The Great Transformation* (1944) Polyani rejects the idea that markets can exist as separate, self-regulating entities divorced from society, and instead posits the concept of 'double movement': as markets expand and attempt to self-regulate, society responds with protective measures to mitigate the negative effects. This ongoing tension between market expansion and social protection is therefore a central feature of market societies for Polyani and instructive for the current debate about UK political and regulatory risk appetite. Polyani's concept of 'fictitious commodities' is another important concept: Polyani argues that treating land, labour, and money as market commodities is problematic because they were not originally produced for sale. This commodification, he contends, can lead to social and environmental destruction if left unchecked.

   Kate Raworth effectively extends Polyani's insight in her *Donut Economics: seven ways to think like a 21st Century Economist* (London, 2017). In the book's central metaphor Raworth imagines the priorities of economic policy as a ring-shaped doughnut: the inner circle represents the "zone of deprivation" (an economy that does not produce enough of the necessary goods and services to sustain populations); the outer circle represents the limits of economic growth (beyond which the economy begins to outstrip the planet's natural and social resources). In this respect, Raworth is engaged in a (heterodox) 'Systems Theory' analysis of the discipline of orthodox economics itself. The outer edge of Raworth's doughnut (where the financial economy meets and effectively 'spends' environmental and social resources) is the particular focus of 'ecological economics'. See: Robert Castanza, John Cumberland, Herman Daly, Robert Goodland & Richard Norgaard, *An Introduction to Ecological Economics* (London, 2015) and Richard Wagner, *Macroeconomics as Systems Theory: transcending the micro-macro dichotomy* (London, 2020).

   For the most recent contribution to the heterodox / orthodox debate see: Nicola Gennaioli and Andrei Schleifer, *A Crisis of Beliefs*:

investor psychology and financial fragility (Princeton, 2018), ch.7.

2. Not least within the EU policymaking machine (e.g. Lord Jonathan Hill). See: Anu Bradford, *The Brussels Effect: how the EU rules the world* (Oxford, 2020), ch.4.

3. For the hegemonic grip that traditional financial economic theory has on the design of markets and operation of regulation and supervision, see David Rouch: *The Social Licence for Financial Markets: reaching for the end and why it counts* (London, 2020). Rouch's point is that the hegemony of economic orthodoxy in academic and policy debate is itself the product of the discipline's strong reinforcing 'feedback loops'. These 'feedback loops' need breaking / re-orienting within the discipline if a more humane and environmentally responsible (heterodox) economic discipline is to emerge.

4. According to Systems Theory, "complex adaptive systems are nested; they exist as systems within systems. Each layer of these systems is coherent within itself and capable of interacting with systems at higher and lower levels. Each part of a complex adaptive system is in constant learning, adaptation, and evolution, and the system itself is capable of self-organization and emergence", Donella Meadows, Systems Theory: a primer (London, 2017). See also, L. von Bertalanffy, *General System Theory: foundations, development, applications* (London, 1968).

5. Nondesign is a term NCC has borrowed from architectural theory alongside undesign. See: James Pierce, '*Undesigning Interation*', in Interactions (2014) 21:4, 36-40. Where undesign is a conscious rejection of design principles, nondesign is when rational design principles do not apply in the first instance – as with complex adaptive systems that 'emerge' rather than being designed.

6. In Systems Theory 'emergence' refers to how complex behaviours or patterns emerge from the interaction of similar components. 'Wholeness' maintains that every system is more than the sum of its parts, while 'interdependence' maintains that each part of the system is interdependent on others – even when acting independently.

7. In Systems Theory 'mindsets' develop in systems and can frequently harden into axiomatic or archetypal ways of thinking ('this is simply what's done…). 'Feedback loops' are the processes by which the output of a system influences its own behavior. Feedback can be positive (amplifying a process) or negative (stabilizing or dampening a process).

8. Daniel Dennett reminds us that evolution is blind, random and accidental (that is, nondesigned) rather than some form of 'natural design' in *Darwin's Dangerous Idea: evolution and the meaning of life* (NY, 1995).

9. Our approach takes some inspiration from 'organisational' or 'institutional' psychoanalysis as developed by the Tavistock Clinic. See: A Obholzer & V.Z. Roberts, *The Unconscious at Work: a Tavistock approach to making sense of organisational life* (London, 2019). Gillian Tett's *Anthro-Vision: how anthropology can explain business and life* (London, 2021) takes a similar approach, but the cutting-edge in the application of 'softer' (psychoanalytic and anthropological) disciplines to socio-economic problems can be found in approaches to climate change specifically. This is unsurprising given the man-made nature of the climate crisis itself (for example, Gaia Vince, *Adventures in the Anthropocene: a journey to the heart of the planet we made* (London, 2014)). See: Michael E. Mann and Tom Toles, *The Madhouse Effect: how climate change denial is threatening our planet, destroying our politics and driving us crazy* (NY, 2016); Gregory Bateson, *Steps to an Ecology of Mind: collected essays in anthropology, psychiatry, evolution and epistemology* (Chicago, 2000); and Adrienne Maree Brown, *Emergent Strategy: shaping changes, changing worlds* (London, 2017).

10. See: Geoffrey G. Parker, Marshall W. Van Alstyne and Sangeet Paul Choudray, *Platform Revolution: how networked markets are transforming the economy and how to make them work for you* (NY, 2016).

11. A retail / equity culture reform agenda should begin where UK citizens are already managing all other aspects of their lives – on tech-enabled online platforms: See Seth Stephens-Davidowitz, *Everybody Lies: what the internet can tell us about who we really are* (London, 2017); Edward C. Rosenthal, *The Era of Choice: the ability to choose and its transformation of contemporary life* (Cambridge Mass., 2005) and Bernard Marr, *Big Data: using smart big data analytics and metrics to make better decisions and improve performance* (Chichester, 2015). Conversely, see: Barry Schwartz *The Paradox of Choice: why more is less* (NY, 2004) and Shoshana Zuboff, *The Age of Surveillance Capitalism: the fight for a human future at the new frontier of power* (NY, 2019). It should then work with the incentives that dictate retail investment flow in particularly (and as distinct from institutional investment flow) – namely, advice / guidance / nudging and tax incentivisation.

12. Reform of the retail investment system also needs to interact more closely with the social contexts of savers, investors and pensioners as real people rather than as homines economici – for example, the increasing need to self-fund social care in later life or the changing dynamics of the housing market. Where the former alters the longevity risk dynamic that pensioners are required to manage the latter alters investors' liquidity risk dynamic. Intergenerational concerns will also need addressing.

13. See Benn Steil and Manuel Hinds, *Money, Markets, and Sovereignty* (Yale, 2009), ch.1.

14. '*Rebuilding the UK's Investment Strengths – a priority for the new government*' (July 2024): https://www.herbertsmithfreehills.com/news/2024-07/rebuilding-the-uk-investment-strengths-a-priority-for-the-new-government.

15. Nassim Nicholas Taleb, *Anti-Fragile: things that gain from disorder* (London, 2012) and *The Black Swan: the impact of highly improbable events* (London, 2017).

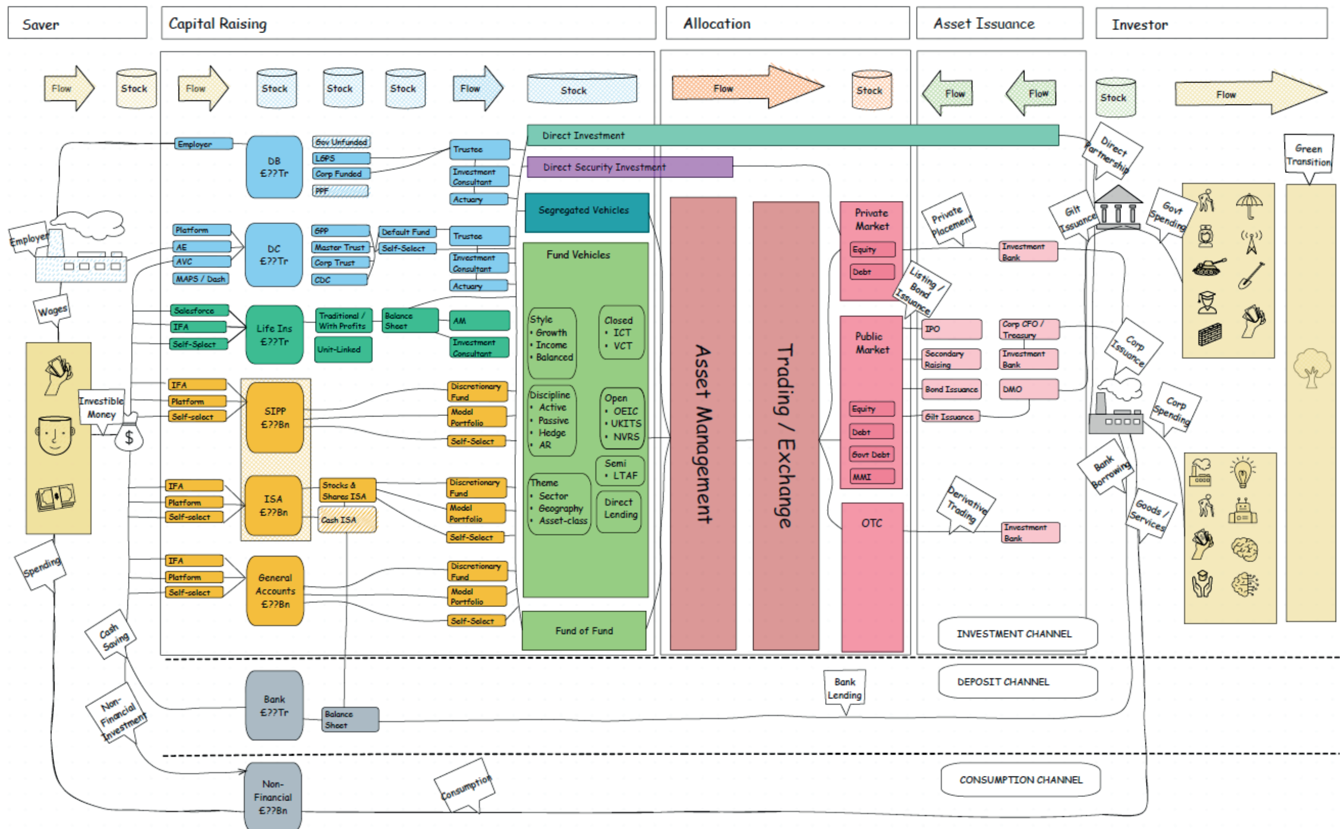
16. Our original 'rich picture' was even more complicated (see opposite page). It was designed to be read simultaneously from the left-side inwards (money flowing from savers into the system) and from the right-side inwards (assets entering the system via capital markets or other forms of exchange) with the asset allocation industry sitting between the two movements fulfilling an intermediating or connecting role:

17. The concept of 'safetyism' was coined by Paul Collier to describe the way in which especially regulatory systems tend to reduce complex decision-making to over-simple check-boxes as a means of managing their own liability. 'Safetyism' for Collier is "the displacement of judgement by procedure" and has numerous systemic knock-on effects:

- Pretense of Complete Understanding: Safetyism operates under the false assumption that we can fully understand and control our environment.
- Risk Shifting: Instead of eliminating risks, safetyism often shifts risks from known areas to unknown ones, potentially creating more dangerous situations.
- Procedural Focus: It replaces human judgment with rigid procedures and tick-box rules, leading to decisions that may not consider the broader context or long-term consequences.
- Worst-Case Scenario Emphasis: Safetyism tends to focus exclusively on foreseeable worst-case scenarios, ignoring potential positive outcomes or more likely scenarios.
- Bureaucratic Self-Protection: While ostensibly aimed at protecting individuals, safetyism often serves to protect bureaucracies from liability rather than truly safeguarding people.

Collier's 'safetyism' might be viewed as a species of the 'unaccountability' that Dan Davies identifies arising in all complex organisations / institutions. See: Paul Collier '*Can Bureaucracies Ever Protect You?*' in Prospect (Nov 2023); and Dan Davies, *The Unaccountability Machine: why big systems make terrible decisions and how the world lost its mind* (London, 2024).

'Safetyism' in its strict sense has a structural character ("the displacement of judgement by procedure") but has been adapted recently to cover a generally perceived conservatism, risk aversion or even 'risk off' mindset at work in the UK regulatory system. For example, see: Brightwell's '*The Price of Risk Aversion for Defined Benefit Pensions Schemes*': https://brightwellpensions.com/our-



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insights/the-price-of-risk-aversion-for-defined-benefit-pension-schemes/.

18. Systems Theory has developed a hierarchy of leverage running from the least effective to most effective types of levers for use in system change:

- Least effective - Constants, parameters, numbers (subsidies, taxes, standards).
- Regulating negative feedback loops.
- Driving positive feedback loops.
- Material flows and nodes of material intersection.
- Information flows.
- The rules of the system (incentives, punishments, constraints).
- The distribution of power over the rules of the system.
- The goals of the system
- Most effective - The mindset or paradigm out of which the system — its goals, power structure, rules, its culture.

See: Donella Meadows, '*Leverage points: places to intervene in a system*' (1997): https://donellameadows.org/archives/leverage-points-places-to-intervene-in-a-system/.

19. See Lynda Gratton, *The Key: how corporations succeed by solving the world's toughest problems* (London, 2015) and Colin Mayer, *Prosperity: better business makes the greater good* (Oxford, 2018).

20. See: Minouche Shafik, What We Owe Each Other: a new social contract (London, 2021) chs. 5 & 6; and Mark Carney, *Value(s): building a better world for all* (London, 2021).

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New Capital Consensus
A better investment system for all

About New Capital Consensus

New Capital Consensus is a coalition of not-for-profit, apolitical organisations that have come together to explore how the current UK investment system contributes to the country's current problems of low productivity, inequality and low levels of investment. Its objective is to find ways to release investment capital to address societal problems, like those above and in particular, to green the economy.

We believe addressing these problems requires us to:

- Understand how the system operates holistically and as a complex adaptive system;
- Recognise the source of private investment resides predominantly in consumers retirement savings;
- Develop a clear map of the system and an accurate quantification of and view on system stocks and flows;
- Through this, identify the policy levers capable of redirecting system flows toward more productive uses that benefit savers.

We will focus not only on those beneficial policy changes that can be effected within the current system but - recognising that current market structures have developed in an anachronistic way - also those that require changes to current market structures, approaches and beliefs.

The NCC coalition of organisations comprises **Finstic** (Financial Systems Thinking Innovation Centre), **University of Leeds** and **Radix Big Tent** and is incubated at **Chatham House Sustainability Accelerator**.

Chatham House, the Royal Institute of International Affairs, is an independent policy institute based in London. Its mission is to help build a sustainably secure, prosperous and just world. Chatham House does not express opinions of its own. The opinions expressed in this publication are the responsibility of the authors.

For further information about New Capital Consensus and its work please contact Ben Rich on **07469 159 134** or **ben.rich@radixuk.org**

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