THE Review

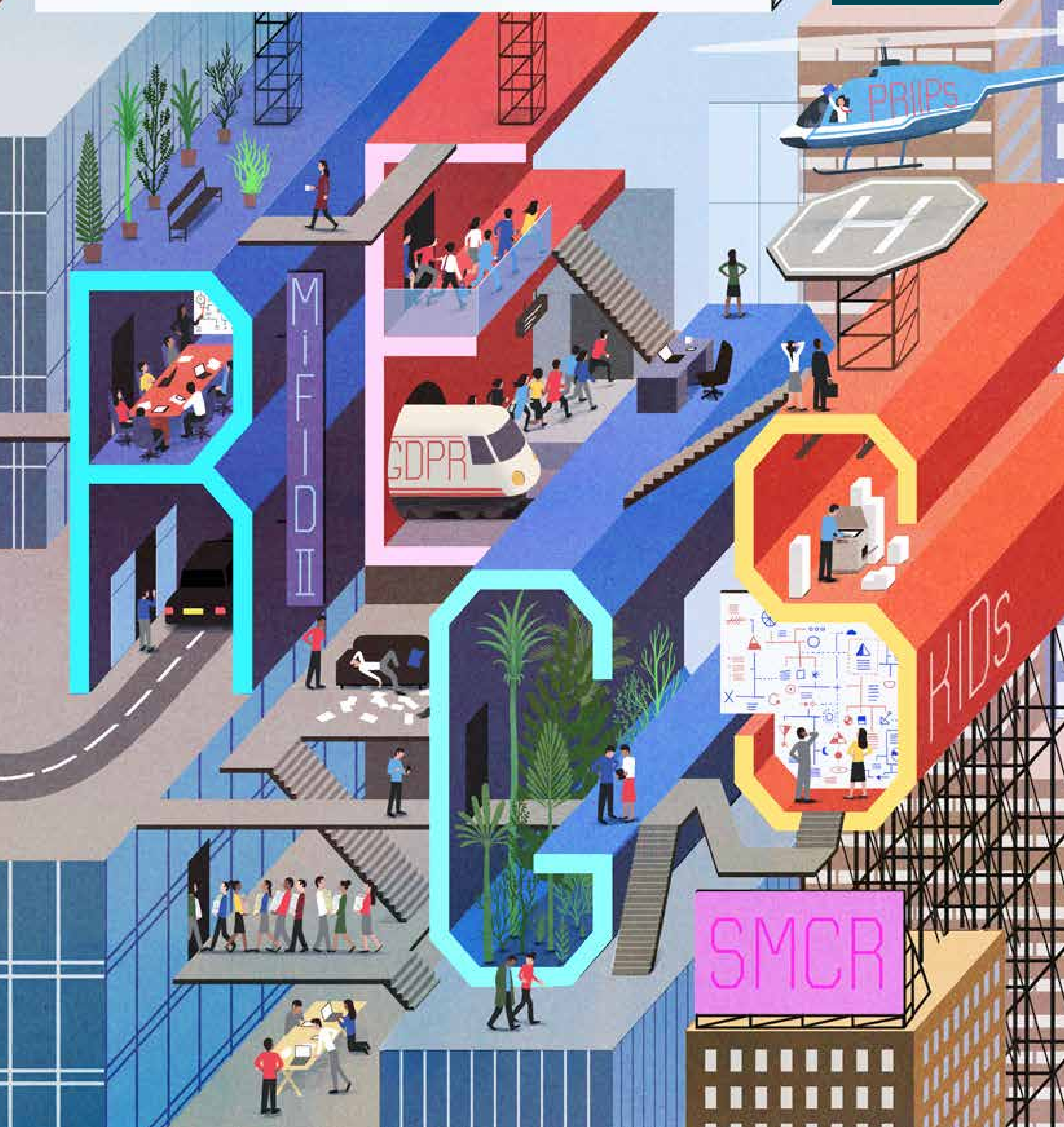
Q2 2018

CISI.ORG/REVIEW

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

ifp INSTITUTE OF FINANCIAL PLANNING



welcome

Poll results from *The Review* digital platform reveal that 96% of respondents have experienced an increased workload over the past year due to regulatory rollout.

The flurry of activity on the cover this quarter depicts the impact that simultaneous rollout of regulation – General Data Protection Regulation; Markets in Financial Instruments Directive II (MiFID II); Key Information Documents, to name a few – has had, and is having, on financial services firms. Turn to pages 18–21 for our cover story on this, based largely on poll results from *The Review* digital platform, which reveal that 96% of respondents have experienced an increased workload over the past year due to regulatory rollout.

Not least because of MiFID II. Our related feature on 'The new research regime' looks at its impact on fund management and research in the first quarter after its implementation in January 2018 (pp.26–28).

Meanwhile, the environmental, social and governance (ESG) agenda among institutional investors is on the increase, with reports of value at risk from climate change and stranded assets, but also "extraordinary opportunities", writes John Plender, a columnist for the *Financial Times* and guest writer (p.13).

Stephen Jones, CEO of UK Finance, a newly-formed body representing the UK financial services sector, explains how it has laid the groundwork to achieve its goals since inception in July 2017 – goals which include inclusivity; preventing economic crime; and improving the image of the UK banking sector (pp.14–17).

Other highlights include our CPD feature on 'Brexit: What next?' by European financial affairs adviser Graham Bishop (pp.44–45); choosing between a lifestyle or an enterprise type business (pp.29–31); and an example of optimum work-life balance in 'My business' (pp.38–39).

As ever, please get in touch with any comments or suggestions.

Jane Playdon
***Review* editor, CISI**
jane.playdon@cisi.org

***Review* Editor, Chartered Institute for Securities & Investment**
Jane Playdon
20 Fenchurch Street, London EC3M 3BY
T: +44 20 7645 0648
jane.playdon@cisi.org

Wardour contacts
Editor-in-Chief
Eila Madden
Online Editor
Bethan Rees
Group Art Director
Steven Gibbon
Account Director
David Poulton
Production Director
Angela Derbyshire
Managing Director
Claire Oldfield
Chief Executive
Martin MacConnol

Advertising sales enquiries
David Poulton
T: +44 20 7010 0915
Cover illustration
Michael Kirkham
Published on behalf of the Chartered Institute for Securities & Investment by Wardour, Drury House, 34–43 Russell Street, London WC2B 5HA
T: +44 20 7010 0999
Fax: +44 20 7010 0900
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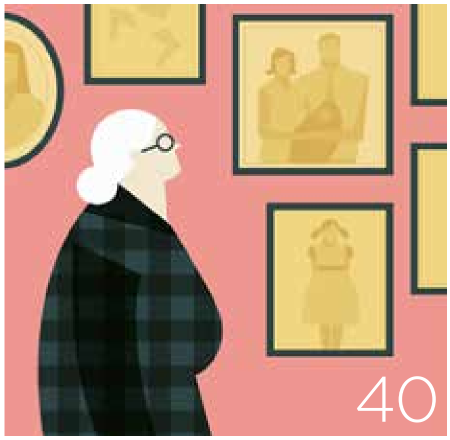

FEATURES

REGULARS

City view

Holding big tech to account

ROBERT MERRIFIELD, CHARTERED FCSI

The furore over Facebook's alleged mishandling of 50 million of its users' personal information illustrates the poor ethical, cultural and governance record of a large group of tech-enabled and multinational companies that play an increasing part in our daily lives. Most have yet to fully take on board the values, responsibilities and behaviours that come with that territory or to accept that being tech-enabled does not release them from society's expectation that they are honest, open, transparent and fair in their dealings with all their stakeholders.

These are the values that generate the trust that allows society and commerce to flourish, that are observed by the vast majority of our planet's inhabitants and that underlie ethical and professional codes of conduct, including those of the CISI.

Facebook exemplifies how many disruptors believe they are different and free to circumvent employment and tax laws and ignore generally accepted standards of ethical behaviour, conduct and governance.

Historically, we have trusted very few with unfettered access to our personal information. We have given doctors access to our medical history, financial advisers access to our financial and spending habits and solicitors access to our wills and family information. One reason we have felt comfortable doing so is their regulated status and the knowledge that as members of a professional body, they have a responsibility to adhere to a code of conduct or ethics and act in our best interests.

We treat regulated firms similarly. But while Facebook and other tech companies have no such obligations, we have, until now perhaps, been more than happy to share even more extensive information with them than we have previously.

Until recently, the misuse and theft of data seems to have been considered an almost victimless crime by some. The new General Data Protection Regulation (GDPR) increases our obligations for securing and using data together with the penalties for failing to do so. But the alleged misuse of Facebook data to influence the US presidential election highlighted how open to abuse social media is and how it sidesteps the issue by disowning any responsibility for content or its impact on its customers.

> It seems that at the moment, unethical, anti-social behaviour pays well

It might be more profitable and cheap for a media company to use algorithms to target related content and advertisements at those who look at a particular topic or channel, but the ability to do so comes at a cost to society. At its simplest, for as long as there are no controls over these algorithms, we will continue to see invitations to gamble targeted at those with gambling problems. At its worst, we will continue to see those with extreme views fed a larger stream of related material and those wanting to publish subversive information or fake news free to do so with impunity.

It is time to hold these companies to the same standards we expect of the companies and professionals we already entrust with our most intimate information.

It is unlikely that Facebook and other tech-enabled companies will come up with an acceptable solution on their own. Indeed, this looks to be just another example in a pattern of unethical behaviour where tech-enabled and multinational companies deliberately avoid the responsibilities of citizenship until forced to do so by specific legislation. For example, multinationals have always used transfer pricing to reduce tax bills, but tech-enabled companies eliminating them completely shows a remarkable disdain for stakeholders that include their customers and host nations.

In 2015 the UK was forced to put in place a 'diverted profits tax', and in March 2018 the EU announced plans for a 3% tax on digital businesses' revenue. While this is expected to bring in some €5bn, it seems that at the moment, unethical, antisocial behaviour pays well.

Having brought data privacy up to speed with GDPR, the focus must now turn to bringing social and other new media into line, introducing measures to improve ethical and professional standards, to protect the consumer and to reduce the opportunity for abuse. But the Facebook and Cambridge Analytica incident is also a wake-up call to politicians that our laws urgently need updating to ensure our values are reflected in the tech-enabled, global economy. Government must act quickly.

BACK STORY

William Vaughan, Chartered MCSI, client associate, Brown Shipley

William Vaughan (pictured left) received the overall award for the Chartered Wealth Manager qualification (level 7), at the CISI Annual Awards Ceremony held at Mansion House, London on 9 April 2018.

He considers the award to be his biggest achievement to date, and is particularly proud of completing not only our highest-level qualification, but also doing so "alongside a demanding work schedule". The award follows another exceptional achievement that helped him kick-start his career in finance almost three years ago: a First Class Honours Bachelor of Science in Accounting and Finance at the University of York.

William's interest in finance was instilled in him from a young age by his parents, who work in the sector. He was further inspired by a mock share trading game he participated in while at university. The game involved identifying macro movements, sector and geographical trends, researching companies and allocating weightings to companies in his team's portfolio. The game may have been only theoretical, but there were real-life lessons to be learnt from it and it set him on the path to a career in financial services.

While at university, he completed a 14-month industrial placement within UBS Global Asset Management. "I worked within the financial reporting team, responsible for compiling and distributing reports across the many business areas. Realising that I enjoyed working closely with colleagues more than interpreting and refining financial data, I decided I wanted to be in a client-facing role, which guided me towards a role in investment management."

He joined Brown Shipley on a graduate scheme in September 2015. "Working within the investment management team, I am heavily involved in the process of managing our clients' portfolios. This requires a strong understanding of financial instruments and ultimately of the investments that we use to manage our client portfolios, which the CISI qualification provides. What I also liked about the qualification was the application of the knowledge learnt to practical examples and how the objectives of clients can be best met."

> Realising that I enjoyed working with colleagues, I decided I wanted to be in a client-facing role

William intends to focus now on moving forward at Brown Shipley, achieving training and competence sign-off and beginning the process of gaining the requisite experience and knowledge to build his own client book. "As part of the process, I am also aiming to become a client manager," he says.

"Another focus I have revolves around technology and the impact that it will have on our sector. Over the coming years, as the digitalisation process expands, technology will become increasingly influential in guiding the offering and services that firms provide. With this in mind and in the context of my existing good technological knowledge, I have begun to learn Swift code – Apple's coding language. As the financial services sector changes, I am aiming to help it move forward by developing apps that can be utilised to improve efficiency and the way people work."

- Read about the CISI Annual Awards Ceremony 2018 at *cisi.org/awards18*

Congratulations to our winter 2017 narrative exam achievers

In an edited extract from a feature that first appeared in Citywire's *Wealth Manager* magazine, March 2018, two narrative exam achievers explain why they chose CISI qualifications. Published with permission from Citywire

NORMAN SINCLAIR ACSI, ASSISTANT INVESTMENT MANAGER, CUNNINGHAM COATES – SMITH & WILLIAMSON

Chartered Wealth Manager qualification (level 7)

"Although combining your day-to-day role with study towards the Chartered Wealth Manager qualification requires dedication and discipline, I believe intertwining the two accelerates the accumulation of knowledge on both fronts. The personal relationship with the client is paramount, and having this qualification heightens clients' trust in your expertise as an investment manager."

ELLIE INGILBY MCSI, JUNIOR PORTFOLIO MANAGER, SANLAM GROUP UK

Private Client Investment Advice & Management (level 6)

"Taking the CISI exams has increased my understanding of the area I work within, while also increasing my knowledge of the wider financial sector. This enhances the service I can offer to clients. My designatory letters can indicate to clients and intermediaries my standing within the financial services sector and my membership of a respected organisation."

Chartered Body Alliance event: The ethics of artificial intelligence in financial services

Antony Jenkins, former CEO of Barclays and founder of 10x Future Technologies, was guest speaker at the event on 8 May at America Square, London, alongside his colleague Dr Emma Byrne, a technical expert with a PhD in AI (pictured above).

In a fascinating talk at the fully-booked event, they outlined some potential ethical issues with AI, with Antony saying it should come with a warning.

One reason for this is the introduction of bias to AI.

“Deep learning is only as good as the dataset you feed it,” said Emma, and bias can exist in a dataset.

She explained that taking complex variables and reducing them to binary could result in some unexpected outcomes, such as a deep learning system interpreting the requirement to minimise loan defaults as a reason to not issue any loans at all; or a predictive policing system sending police to areas based on the incidence of crime reported – more police equals more crimes reported.

A solution would be to isolate bits of the data, varying inputs to see how it affects outputs. This would identify, for example, whether the system is perpetuating human biases in selecting candidates for employment.

Antony outlined another issue arising from the stacking of different technologies in machine learning. You can take the data from, say, the sequencing of genomes and apply this to other datasets to gain a fairly accurate picture of how long someone is likely to live or how likely they are to develop a disease, which could have significant repercussions for loans and insurance, for example.

The session concluded with some tough questions from the audience. Members can view the event on CISI TV.

IN THE KNOW

The Review's quick quiz features questions from CISI Professional Refresher, an online learning tool. The popular product consists of more than 90 modules covering topics including anti-money laundering, the UK Bribery Act, information security and data protection. The answers are on page 13.

1. Which type of investment is described as a financial instrument for the first time under MiFID II?

A Shares
B Emissions allowances
C Options
D Gilts

2. What is the time frame for completion of cash transfers between ISAs?

A 5 days
B 30 days
C 90 days
D 15 days

3. Who has overall responsibility for the investment of a charity's assets?

A Board of directors
B Finance director
C Board of trustees
D Investment manager

4. Which of the following statements is incorrect?

A The GDPR introduces a new concept of accountability
B A personal data breach must be reported to the data protection supervisory authority within seven days of the breach, where there has been a loss of personal information
C The maximum penalty for non-compliance under the GDPR is the greater of €20 million or 4% of total worldwide annual turnover
D The GDPR gives individuals more powerful rights against organisations

Access to Professional Refresher is available on an annual licence basis. The full suite of modules is free to CISI members or £250 for non-members. If you or your firm would like to find out more, visit *cisi.org/refresher* or contact the CISI on *+44 20 7645 0777.*

Events preview

The CISI offers many opportunities to help you meet your requirements for professional development. Below are just some of the highlights of the Institute's CPD events programme, but for comprehensive details and to book, please visit *cisi.org* and click on the 'Networking & events' section.

LONDON CPD

6 JUNE Vision, mission, function and purpose: How you create them will create you
7 JUNE Annual Integrity Debate: Artificial intelligence, social media and whistleblowing
12 JUNE The ethics of secret intelligence
20 JUNE Managing uncertainty in finance – the role of CPD
25 JUNE Absolute focus on alpha
27 JUNE Compeer: Wealth management – the yearly review 2018

REGIONAL CPD

6 JUNE Bitcoin and blockchain (Essex)
7 JUNE Developing trends in investment companies & Best practice makes perfect (Preston)
12 JUNE Cryptocurrencies: when life is light years ahead of the law (Jersey)
13 JUNE South Coast full-day conference (Bournemouth)
12–13 JUNE CISI Paraplanner Conference (Leicestershire)
14 JUNE Communicate and connect – people skills for teams that work & Market update: from Goldilocks to reflation (Nottingham)

SOCIAL EVENTS

6 JUNE Essex Summer Social
19 JUNE CISI Wales Summer Social
20 JUNE South East Summer Social

- If you have an idea for an event or would like to contribute at one of our events, please email *cpdevents@cisi.org*
- For details of conferences, and social events available to members, please visit *cisi.org/events*

CITY OF LONDON CORPORATION NETWORKING LUNCH FOR CISI STUDENTS

Sir Mark Boleat, deputy chairman of the City of London Policy and Resources Committee, hosted a networking lunch for CISI students at the Guildhall, the City of London Corporation's historic building, on 21 May 2018.

Professionals from several top financial firms attended, allowing young learners the opportunity to hone their networking skills and gain insights into careers in the financial services sector. Elizabeth Rowan, CISI head of education development, and Matthew Bolton, CISI teaching and learning specialist, attended on behalf of the CISI.

Matthew teaches the CISI's foundation qualification, Fundamentals of Financial Services (level 2), to the students, who come from schools across London to attend weekly classes at the Guildhall.

Correction and apology

In 'Open for business', published in the Q1 2018 edition, on page 19 we reported that the Open Banking Working Group estimated that UK consumer uptake of personal financial management tools could reach US levels of circa 32%, suggesting a £10–15m potential. This should have read 'a 10–15 million potential'. The CISI apologises for the error.

The CISI disciplinary process

In the second of a two-part article on the CISI disciplinary process, Andrew Hall, senior adviser to the CISI, provides some case studies of past decisions made and the reasoning behind the sanctions.

In our previous article in the Q4 2017 edition of *The Review* (p.7), we explain the principles and processes behind the CISI disciplinary process. Our members and other readers will, hopefully, understand why the process is necessary. In part two we outline what the available sanctions are and provide some disciplinary case studies, explaining how the findings were reached.

Available sanctions:	Factors to consider when determining level of sanction:
• Completion, within a specified period, of additional CPD hours • Completion of the Institute's IntegrityMatters test • Denial of some or all CISI facilities for a specified time • Reprimand or severe reprimand • Reduction in membership status • Suspension from membership for a specified period and/or of the personal Charter designation while retaining non-Chartered membership • Expulsion for a period • Permanent expulsion	• Premeditation • Severity of offence • Professional standing • Membership status • Criminal conviction • Code of Conduct • Mitigating/aggravating factors

Case study one: Driving under the influence	
The CISI received an anonymous letter advising that Mr X, an MCSI member, had appeared in court on a charge of 'driving with excess alcohol'. His car had developed a puncture on the way home from the golf club, and, when a policeman stopped to help, he became suspicious that Mr X had been drinking and breathalysed him. Mr X was found to be over the limit, and was disqualified from driving for six months. It was felt that Mr X was in breach of Principle 8 of the CISI Code of Conduct ('Uphold the highest personal and professional standards at all times') and he was invited to appear before the Disciplinary Panel. Having listened to the explanation of the member, the panel found Mr X to be in breach and determined that he should be sent a letter of reprimand.	Factors considered by the panel included: • Severity of offence • Professional standing • Membership status • Criminal conviction • Code of Conduct • Mitigating factors

Case study two: Questionable expense claims	
An MCSI is reported by his employer to have been dismissed following a dispute about his expenses. He had been an approved person but was deregistered with the FCA. The member appeared before the panel and argued that his employer, in which he was a stakeholder, had previously accepted his way of doing business and his expense claims. It became apparent at the panel that there were several further instances of which the employer was not aware, and where the member had an undeclared conflict of interest. The panel was not impressed by the member's arguments and felt that several of his actions were close to fraud. The panel determined that he should be permanently expelled.	Factors considered by the panel included: • Premeditation • Severity of offence • Professional standing • Membership status • Code of Conduct • Mitigating/aggravating factors

Case study three: Paper trail	
An MCSI member's name appears in the local regulatory gazette, which says that she has been banned for five years. Enquiries revealed her to have come to the attention of the regulator originally for exaggerating her qualifications in a job application. She was then found to have performed her professional duties in a manner that called into question her professional competence and integrity. As a result, she had been banned from undertaking any financial service activity for five years. It was not suggested that the member had derived any financial benefit from her activities or that there had been any consumer detriment. The panel felt that the member had shown a pattern of irresponsible behaviour and that expulsion for a five-year period, matching that of the regulator, was adequate.	Factors considered by the panel included: • Premeditation • Severity of offence • Professional standing • Membership status • Code of Conduct • Mitigating/aggravating factors

Case study four: A sorry state	
Following a CISI regional dinner held in a hotel, two members are alleged to have verbally abused fellow guests in the bar and threatened bar staff, who had asked them to leave. The hotel complained to the Institute. Without any prompting by the Institute, the members (an ACSI and an MCSI) apologised to the hotel. The panel felt that the private behaviour of all professionals is increasingly considered by the public to be as important as their professional skills, as acknowledged by Principle 8 of the Code of Conduct. The members were reprimanded.	Factors considered by the panel included: • Severity of offence • Professional standing • Membership status • Code of Conduct • Mitigating/aggravating factors

These examples represent the views of the Disciplinary Panel members and the CISI at the time when the cases were heard. However, what may or may not be considered acceptable one year will not necessarily be regarded in the same light in the next. Consequently, it cannot be assumed from these case studies that future offences with broadly similar facts will necessarily garner the same outcome.

Financial planning news

A snapshot of financial planning news and events, by Jacqueline Lockie CFP™ Chartered FCSI, CISI head of financial planning

2018 CONFERENCES LAUNCHED

After a flurry of activity here, we launched all three of our main financial planning conference programmes. Record numbers have already booked to attend the Annual Financial Planning Conference, six months ahead of it taking place on 1–2 October. There are three themed streams this year: 'Focus on your client'; 'Spotlight on your business'; and 'Get ahead technically'. Two out of three of these themes apply to us all, whether we are paraplanners, financial planners or wealth managers.

The Paraplanner conference will be a unique event, with paraplanners sharing their inspirational stories and experiences, as well as concerns and difficulties, in an open forum. With the added relaxed element of a fun theme and competitions, it will be a memorable event.

We held our annual Accredited Financial Planning Firms™ Conference on Monday 21 May, which saw quite a change from previous years. This year there was just one theme: 'Improving your client experience'. It included interactive sessions designed to help our top financial planning firms share ideas to help them improve their business proposition for clients. This was followed by a relaxed dinner, with plenty of time for networking.

Our Financial Planning Corporate Supporters are supporting us this year, offering CISI TV videos along with face-to-face training and support. They all know and understand that as members, there is a host of information out there for you, and what they want to offer is specifically tailored sessions to help your planning for clients. So, look out for conference videos with a difference. Visit *cisi.org/conferences* for more information.

Gala awards

Don't forget to enter one of the prestigious financial planning awards this year – check *cisi.org/conferences* for more details. Award categories this year are: CFP™ Professional of the Year; Paraplanner of the Year; Accredited Financial Planning Firm™ of the Year; David Norton Award; and the Tony Sellon 'Good Egg' Award. The awards will be presented at the Annual Conference Gala awards dinner on Monday 1 October at the Hilton Birmingham Metropole, with finalists' interviews taking place in early September. I'm very much looking forward to seeing many of you at one of the events this year.

We have been working hard, as usual, to engage the membership, and most of your suggestions for subjects for *The Review* magazine, through to conference programme content, are being used.

CERTIFIED FINANCIAL PLANNER™ certification redevelopment

CFP certification redevelopment is rolling along in conjunction with the Financial Planning Standards Board (FPSB), the owner of the international designation. You may have seen that there are now over 175,500 CFP professionals across 26 countries. Here in the UK, numbers are still relatively low, but we are working hard to change that. Meanwhile, we are putting assistance in place to support candidates wishing to sit the CFP examination this year. We have begun offering five-day training courses and will be building from there. The CISI and its board is fully committed to supporting the growth of financial planning in the UK.

WORLD FINANCIAL PLANNING DAY

World Financial Planning Day (WFPD) is on Wednesday 3 October 2018 in conjunction with IOSCO (the international securities regulator) and the FPSB. We run the UK WFPD, with most of the other 25 countries that use the FPSB CFP mark participating. WFPD marks the start of our annual Financial Planning Week, which runs from 3 to 10 October.

HELP US COMPLY WITH GDPR

As I'm sure you are all fully aware, the General Data Protection Regulation (GDPR) is now in force. If you want to receive communications from the CISI, log in to MyCISI and check your Communication preferences. If you don't do this, you will only get this page of updates from me and will undoubtedly miss out on developments and news.

FINANCIAL PLANNING IN YOUR LOCAL BRANCHES

I hope by now that you have got involved with your local CISI branch. If so, you will have seen lots of relevant and varied financial planning topics being discussed. Many more are planned for this year, so log in to MyCISI for more information. MyCISI will tell you who your financial planning representative is on the regional committee. Get in touch with ideas and thoughts to support them.

A MESSAGE FROM NOEL BUTWELL, DIRECTOR, STANDARD LIFE UK DISTRIBUTION

Standard Life

There's a lot to look forward to

Standard Life is delighted to be involved with the CISI this year, and I'm really looking forward to us working together to support expert financial advice. I'm particularly excited about the CISI Paraplanner and adviser conferences in 2018 – look out for us there.

It has been a busy year so far for the adviser community, with the challenges of MiFID II and GDPR to think about. It's also been a busy time for Standard Life, with the announcement of the proposed sale of our insurance business to the Phoenix Group, so I'd like to give a clear picture of what this means to you and your clients.

Our platform businesses are not part of this deal. They will remain with Standard Life and that includes the associated adviser relationship management and all servicing.

Similarly, our financial planning business 1825 will remain with Standard Life.

All other business will move to Phoenix, and our retail SIPP, onshore and offshore bonds, and our workplace proposition will remain open for business. Standard Life will continue to design, market and distribute the Standard Life-branded propositions, and importantly, if you deal with us now, you will continue to work with the same relationship managers.

The Standard Life employees who are transferring across to Phoenix will continue to administer this business and they will continue to use Standard Life systems. Phoenix is intent on protecting our reputation for excellent customer service.

This change represents the start of an exciting and innovative partnership, but one thing that won't change is our support for the financial planning profession, which has never been stronger. Supporting CISI this year is just part of that commitment.

standardlife.co.uk

CISI FINANCIAL PLANNING CORPORATE SUPPORTERS Q2 2018

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Aegon
www.aegon.co.uk

Standard Life
www.standardlife.co.uk

Corporate

AIC
www.theaic.co.uk

Dimensional Fund Advisors
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First Trust Global Portfolios
www.ftglobalportfolios.com

Just
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NS&I
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Parmenion
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Royal London
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Schroders Investment Management
www.schroders.co.uk/adviser

Transact
www.transact-online.co.uk

Vanguard
www.vanguard.co.uk

AEGON – SUPPORTING FINANCIAL ADVICE

We're delighted to continue our association with the CISI and its membership as Gold Financial Planning Corporate Supporters in 2018. We support the CISI's drive for continuing professional development, excellence and integrity within financial planning.

The largest platform in the market

We're focused on helping intermediaries grow their business and profitability, while lowering risk and cost. As the largest platform in the UK, following our acquisition of Cofunds, we continue to work on developing our platform and supporting financial advice.

Through combining the scale and experience of Cofunds, with the innovation, financial strength and product know-how of Aegon, we're aiming to become the most trusted platform in the intermediated market.

Users of our award-winning platform, Aegon Retirement Choices, benefit from:

- access to over 4,800 investment options;
- a workplace savings platform, providing access to multiple product wrappers;
- a tailored approach for platform pricing to meet intermediary and customer needs, and
- two-way new business integration with major back office providers.

Award-winning protection products

Our deep knowledge of protection means we're well-positioned to help you build comprehensive protection solutions to meet your clients' individual needs.

- Our team of protection specialists have the knowledge and expertise to help you build bespoke solutions for your clients.
- Our underwriting approach is designed to deliver the best decision for your clients – in 2017 we were able to offer terms to 97% of applicants.
- All protection customers have access to our health and wellbeing service, provided by Health Assured, throughout the term of their policy – not just at claims stage.
- Business Protection customers also have access to our key person replacement service, provided by Cazden.
- In 2017, we paid £120.6 million in protection claims.
- We won the Life and Health Claims award and were named Underwriter of the Year at the Protection Review awards 2017.

aegon.co.uk/advisers

ASK THE EXPERTS: WHY ARE SHARE BUYBACKS UNDER THE SPOTLIGHT?

Jonathan Beastall is a senior adviser to Pinsent Masons corporate practice. He has more than 30 years' experience of advising clients on company law, IPOs, equity issues, listing rules and corporate compliance, M&A and reorganisations.

What is a share buyback?

A public listed company can buy back its own shares if it has shareholder approval. Most public companies will seek approval at their AGM. Investment Association guidelines say if a company is going to buy back its shares, it should limit it to 10% of capital in any one year and that the approval should be given by a 75% majority.

Once purchased, the company has the choice of keeping the shares in treasury or cancelling them. Keeping them in treasury can help liquidity in the market, reduce the cost of issuing shares in the future, or satisfy share option scheme arrangements. But it's more common for companies to cancel shares because reducing the amount of shares in issue can enhance certain performance measures. Earnings per share is the obvious one.

Why do companies buy back their shares?

Mainly to return capital to shareholders. To buy back its shares, a public company has to use its distributable profits. In that regard, it is exactly the same as if the company pays a dividend.

But there can be several other reasons. Alongside enhancing certain performance measures, as mentioned, buying back shares can be a useful tool for making sure the capital of a company is being used efficiently. It's often said that equity is expensive because of the expected return on the riskiest level of capital whereas right now debt is cheap. If a company could have more debt and less equity, that should result in the return on equity in the business being enhanced. So, shares are bought back to reduce the amount of equity and debt is increased to finance that buyback.

Share buybacks can also reduce the number of owners, giving shareholders that remain a greater incentive to scrutinise what management is doing, because they have a higher percentage of the share capital. So it can be an encouragement to more active stewardship on the part of shareholders.

How do investors benefit from share buybacks?

There are tax advantages to some shareholders in receiving payments in respect of the capital of their shares, rather than receiving dividends, which are usually treated as income in shareholders' hands. Share buybacks, by returning surplus cash to shareholders, empower investors to make their own financial choices in deciding where to allocate their capital and where they want to invest. Shareholders do not like having their capital trapped in the bank accounts of investee companies when they could get better returns elsewhere.

> "To buy back its shares, a public company has to use its distributable profits"

What are the concerns about share buybacks?

The commonly held concern is that they can be used to artifically enhance performance and that in turn is important because quite a lot of executive remuneration arrangements can be tied to whether certain performance targets are met.

There can also be a concern that company directors are not always the best judges of when it is the right time to buy shares back. They are employed because they are good at running the businesses of which they are directors, but they are not necessarily good at being investment managers or determining when the market is right or wrong about the value of their company.

There is a view that buybacks crowd out other investment decisions. So companies engaging in buybacks don't adequately invest in their underlying businesses. That's a bit dangerous in terms of argument because a company buying back its shares would regard the funds as surplus to requirements and not for use in the business, but that is nonetheless a view that is out there.

I also mentioned that equity is expensive and debt is cheap. In increasing the level of debt in a company to enable it to buy back its own shares, there is a possibility that you make it a bit more fragile in being able to weather external events.

What are the ethical issues raised by share buybacks?

I don't think there are ethical issues as such, but I think a board does have to take into account a number of different factors before it decides whether using the company's resources to buy back its shares is the right thing to do in the circumstances. That will probably become even more relevant because there is a lot of focus at the moment around the general duty under Section 172 of the Companies Act. This requires directors to act in good faith to promote the success of the company and to take into account different stakeholder views on what they're doing in discharging that duty.

The UK government has commissioned research into share buybacks, with a view to taking action to prevent them from being abused. Findings are due in summer 2018. What can we expect?

None of us know what this research is going to conclude. If it turns over some stones and finds things it doesn't like, there could be a need for share buybacks to be revisited and either refined or defended. I think companies are going to have to keep an eye open for the publication of this research and put themselves in a position to be able to answer comments or questions about how it affects them. It's very topical at the moment.

A changing investment climate

ESG PERFORMANCE IS CLIMBING UP THE INVESTOR AGENDA AS MORE SHAREHOLDERS TAKE ACTION ON CLIMATE CHANGE AND THE TRANSITION TO A LOW-CARBON ECONOMY STARTS TO LOOK LESS RISKY

JOHN PLENDER FINANCIAL TIMES

For a majority of institutional investors, the environmental, social and governance (ESG) agenda has been a strictly minority pursuit. Many fear that investing sustainably will hurt performance. Their reluctance to integrate ESG criteria into portfolio management practice is further exacerbated by conflicts of interest. Some of the biggest fund management groups have been unwilling to support dissident shareholder resolutions calling on energy groups to spell out the financial implications of global warming because they hope to win pension fund mandates from these companies. They claim that academic research has been inconclusive on the correlation between ESG and financial performance.

Yet the mood among professional investors has changed over the past year or so, not least because of the agreement by 195 countries in Paris in December 2015 to reduce greenhouse gas emissions and accelerate the transition to a lower carbon economy. This legally binding action plan has a goal of keeping the increase in global average temperature to below two degrees celsius above pre-industrial levels. Adherence to the Paris targets implies new risks and opportunities for companies and investors as a result of climate change, climate policy and new technologies.

A study by The Economist Intelligence Unit has estimated the value at risk from climate change to the global stock of manageable assets as ranging from US$4.2tn to US$43tn between now and the end of the century. Many assets will be 'stranded' – that is, they will lose value or turn into liabilities before the end of their expected economic lives. Much fossil fuel will not be burned and will remain stranded in the ground because its use would result in breaches of globally agreed and country-based temperature goals. Stranding will also be increased by advances in battery storage, renewables and enhanced oil recovery.

EXTRAORDINARY OPPORTUNITIES

That said, there are extraordinary opportunities, too. According to the Basel-based Task Force on Climate-related Financial Disclosures, the expected transition to a lower carbon economy could require around US$1tn of investments a year for the foreseeable future. In short, the risk-return profile of companies exposed to the impact of climate change could see a dramatic metamorphosis. And as Mark Carney, governor of the Bank of England, has emphasised, the risks include potential shocks to the financial system.

All of this makes any discussion of historical correlations between ESG and financial performance irrelevant. For institutional investors, the new imperative is to identify those assets that are most at risk from stranding and the opportunities that will be thrown up during the transition. A growing number are working out how to integrate ESG into their investment process. And some of the biggest funds have already conducted extensive exercises to identify their carbon footprint by examining every company in their portfolio. The question then is whether to divest fossil fuel stocks, at the cost of some loss of dividend yield, or to hold on to encourage best practice. In many carbon-sensitive industries outside the energy area, engagement will be the natural avenue.

SHAREHOLDER ACTION

Increasingly, large global institutional investors are combining forces to address the environmental challenge. In 2017, 225 funds controlling assets worth US$26.3tn launched Climate Action 100+, a campaign to put pressure on 100 of the world's more carbon intensive companies to step up their actions on climate change. This shareholder action plan is the biggest ever attempted. To meet the Paris commitments these companies will have to cut emissions by 80% by 2050.

Are those investors who have, until now, been ambivalent in their response to climate change turning? In May 2017, BlackRock and Vanguard helped secure a 62% majority at the ExxonMobil annual meeting in calling for a yearly assessment of the long-term portfolio impact of climate change policies. Both supported a similar motion against the board at Occidental. ESG activism is not confined to the energy sector. Activist investor Jana Partners recently joined US pension fund giant CalSTRS in calling on Apple to recognise the potential dangers to children of excessive use of its iPhones.

A conundrum in all this is how far the market is already discounting the transformation of risk and return profiles across the corporate sector. As yet, carbon-related disclosure is patchy. There remains a risk that, in the transition to a lower carbon economy, capital will be seriously misallocated.

John Plender is a *Financial Times* columnist.

In the know answers: 1.B, 2.D, 3.C, 4.B

“Delivering value for our members’ customers, and protecting their interests, is at the heart of our work”

THE START OF SOMETHING NEW

Since its formation on 1 July 2017, UK Finance has brought together six trade bodies under one umbrella organisation. This is no easy feat. Stephen Jones, CEO, talks us through progress on the integration and how UK Finance is focused on rebuilding trust in the financial services sector

BETHAN REES CHARLIE SURBEY

UK Finance has a significant role to play in financial services. The institution, formed by a merger of six individual trade bodies, represents close to 300 firms in the UK that provide credit banking, markets and payment-related services. Stephen Jones, former executive director and chief financial officer of Santander, is the head.

"Creating a homogenous company means hand-delivering the benefits of belonging to a larger whole, while making sure members – who are all different sizes – don't get lost in a bigger organisation," says Stephen. "That means setting up governance and consultation structures."

Stephen's role at UK Finance has evolved since its inception. Initially, he managed the integration of the six trade bodies: the British Bankers' Association; Payments UK; the Council of Mortgage Lenders; the UK Cards Association; Financial Fraud Action UK and the Asset Based Finance Association. "There was a well-formulated delivery plan that an integration team before me had put in place, which I executed," he says.

UK Finance was created after a 2015 review – the Financial Services Trade Association Review – found that a single body representing the financial services sector would have more of an impact and act more efficiently.

Nine major UK retail banks and a building society launched the review: Barclays; Clydesdale Bank and Yorkshire Bank; Co-operative Bank; HSBC; Lloyds Banking Group; Nationwide Building Society; RBS; Santander; TSB; and Virgin Money. At the time the lenders said they wanted to review the current trade body setup because they wished to cut costs and avoid duplication of work. The review suggested the merger could deliver efficiency savings of £32.6m over 25 years.

"The primary role of UK Finance is to help our members ensure that the UK retains its position as a global leader in financial services and to this end offers outstanding global, national, regional and rural coverage and infrastructure," says Stephen.

"In terms of policy, we also intend to focus on areas that are of key importance to our members and their customers. These are financial inclusion, preventing economic crime and financial fraud, access to markets, and diversity. Ultimately, delivering value for our members' customers, and protecting their interests, is at the heart of our work," he continues.

UK Finance's behaviour is a priority too: "We aim to be inclusive, collaborative and to act with one voice and integrity at all times. We are operationally efficient, results-driven and accountable, engaging only where we can make a difference."

A LOOK BACK

Stephen decided to take the job at UK Finance after hearing that Bob Wigley would be chairman. "I knew him a little. We shared the vision for what we thought this trade association could be. For example, we both thought it should be serving members better, delivering a practical service on behalf of the sector as a whole."

This vision is based on the foundation of a near lifelong career in financial services. Having read law at the University of Cambridge, Stephen trained as a lawyer with Baker McKenzie. "They were the biggest law firm in the world at the time," he says. "I got to the end of my fourth year of professional exams and there was a lot of merger and acquisition activity, and I realised I wanted to be on the financial structure side of the deals being done, rather than the legal side. I joined Schroders in 1998 and worked there until it was taken over by Citigroup, and we became Schroder Salomon Smith Barney."

THE GREAT AND THE GOOD: UK FINANCE'S SENIOR MANAGEMENT TEAM

- COO: Alastair Gilmartin-Smith, former CFO at Ofcom
- Chief of staff: Hannah Gurga, former chief of staff at LCH
- Managing director, external affairs: Rebecca Park, former executive director of external affairs at British Bankers' Association
- Managing director, economic crime: Katy Worobec, former director of Financial Fraud Action UK
- Managing director, commercial finance: Stephen Pegge, former director at UK Business Angels Association
- Managing director, capital markets, wholesale and Brexit: Ronald Kent, former managing director for wholesale and financial policy at British Bankers' Association
- Managing director, personal insurance: Eric Leenders, former managing director for retail and commercial banking at the British Bankers' Association
- Managing director, membership and training: Jeff Longhurst, former CEO of Asset Based Finance Association

Stephen joined Barclays Capital in 2002, where he learnt about building an investment banking business in Europe, serving large corporate clients and how to run a treasury. He moved to Barclays in 2009, where he was in charge of investor relations after the financial crisis, before moving to Santander UK in 2012 as the chief financial officer. There, he established a restructured senior management team to address the challenges the bank faced – a complex task that he also faced in his current role at UK Finance. After about four years at Santander, Stephen took a year or so out. "I did some advisory work for myself, including spending a year at Cerberus, which is active in buying portfolios of debt in the UK, including the Northern Rock portfolio," he says.

Stephen also chaired a mortgage servicing company called CGL and was on the board of Landmark Mortgages and the old GE Money Bank. He then had the call offering him the CEO job at UK Finance.

CREATING THE TEAM

The 300 (or so) members of UK Finance cover a huge breadth of sectors, from personal banking to commercial finance and wholesale capital markets, to specialist groups covering fraud and economic crime. UK Finance also has two separate advisory groups that represent consumers and small and medium-sized enterprises (SMEs): the Consumer Advisory Group and the SME Advisory Group. Gillian Guy, former chief executive of Citizens Advice, is chair of the former and Teresa Graham CBE, former non-executive director of the British Business Bank, chairs the latter.

"[The advisory groups] essentially inform everything that we do in the policy space for our members. In the consumer space, for example, this could be inclusion, vulnerability or capability. In the SME space, an example would be access to finance and dispute resolution. It's good to have a close dialogue on this," says Stephen.

"As a sector, we are part of helping people feel the UK is still a good place to do business"

For the executive team, Stephen has had to consolidate six trade associations and six chief executives into a single organisation and leadership team with just one head. "It's important for me that I established a senior management team around me who trust one another and can act interchangeably, to represent the company externally," he says (see boxout, top left).

In addition to this, the UK Finance board has been developed to ensure senior and fair representation across the sector. It will also ensure the consumer voice is represented via the inclusion of a strong, independent consumer champion, while significant overlap of board members with the Banking Standards Board will support a close cooperation with its work to promote high standards across the sector. These members include Jayne-Anne Gadhia, CEO of Virgin Money, leading on diversity, and Clare Woodman, recently appointed as Morgan Stanley's head for the Europe, Middle East and Africa region, leading on ethics.

AN EMPHASIS ON DIVERSITY

"Diversity is massively important in the workplace," says Stephen. "Women represent 50% of our society and 50% of the customer base of our members. Having a diverse workforce can have a positive impact on any business. Women bring an equal pool of talent, complementary skills and different skills to a role. To

STEPHEN JONES, CEO, UK FINANCE

JULY 2017–PRESENT CEO, UK FINANCE

JAN 2017–JUNE 2017 CHAIRMAN, CAPITAL HOME LOANS LIMITED

AUG 2016–JUNE 2017 SENIOR ADVISER, CERBERUS GLOBAL INVESTMENT ADVISORS

2012–2015 EXECUTIVE DIRECTOR AND CHIEF FINANCIAL OFFICER, SANTANDER UK

2012 DIRECTOR OF STRATEGY, CORPORATE DEVELOPMENT AND REGULATORY AFFAIRS, SANTANDER UK

2009–2011 HEAD OF INVESTOR RELATIONS, BARCLAYS

2002–2009 MANAGING DIRECTOR, BARCLAYS CAPITAL

1987–2002 VARIOUS ROLES, SCHRODERS

have a better workplace, it needs to be more representative of society as a whole; it needs to look more like a classroom, or the street."

UK Finance has committed to the HM Treasury Women in Finance Charter, which is a pledge to work together with HM Treasury to build a more balanced and fair financial services sector. The Charter was a recommendation following a review by Gadhia into harnessing the talents of women in finance, with a focus on fairness, equality and inclusion.

UK Finance aims to have a 40% female senior management team within three years. "It's not just about gender, but women in finance is a great first step. Diversity in general is important. If we make decisions that aren't right for the wider community, we're frankly cutting off our nose to spite our face in terms of the talent pool out there," Stephen explains. Encouraging firms to bring gender parity to the forefront of discussion is also on the agenda.

Stephen acknowledges that there is a long way to go, but this is a positive start.

IMPROVING THE UK'S FINANCIAL REPUTATION

One of Stephen's objectives for UK Finance is to improve the image of the UK banking sector following the financial crisis in 2007–2008. "In terms of reputation and trust, that's a permanent and long-term objective for every participant in the system. Banking, payments and finance is a trust business and trust has been, and is, dented by the banking crisis. I think all of the work we do has to be part of regaining or enhancing the trust that customers have in their banks, their institutions and the sector as a whole," he emphasises.

Leaving the EU will inevitably impact the UK banking sector in various ways, such as forcing relocation of operations, but Stephen doesn't believe Brexit has affected the reputation of the UK banking system. "It's certainly a bump in the road, but it's a political choice that the people of the UK have made," he says. "Of course, it creates significant strategic and operational issues for many of our members. They need certainty in terms of understanding how our relationship with Europe will change, especially those with customers in Europe. There are 77 European Economic Area banks that passport in from licences in continental Europe in the UK. Will they have to relicense themselves?

"In the eyes of many people outside the UK, its reputation as a safe, stable and predictable place to do business may have been damaged. As a sector, we are part of helping those people who previously came to the UK to do business feel that we're still a good place to do business."

The next ten months or so will be a testing time for UK Finance, and it's likely we will hear much more from the finance and banking trade body in the coming year, ahead of Brexit. ●

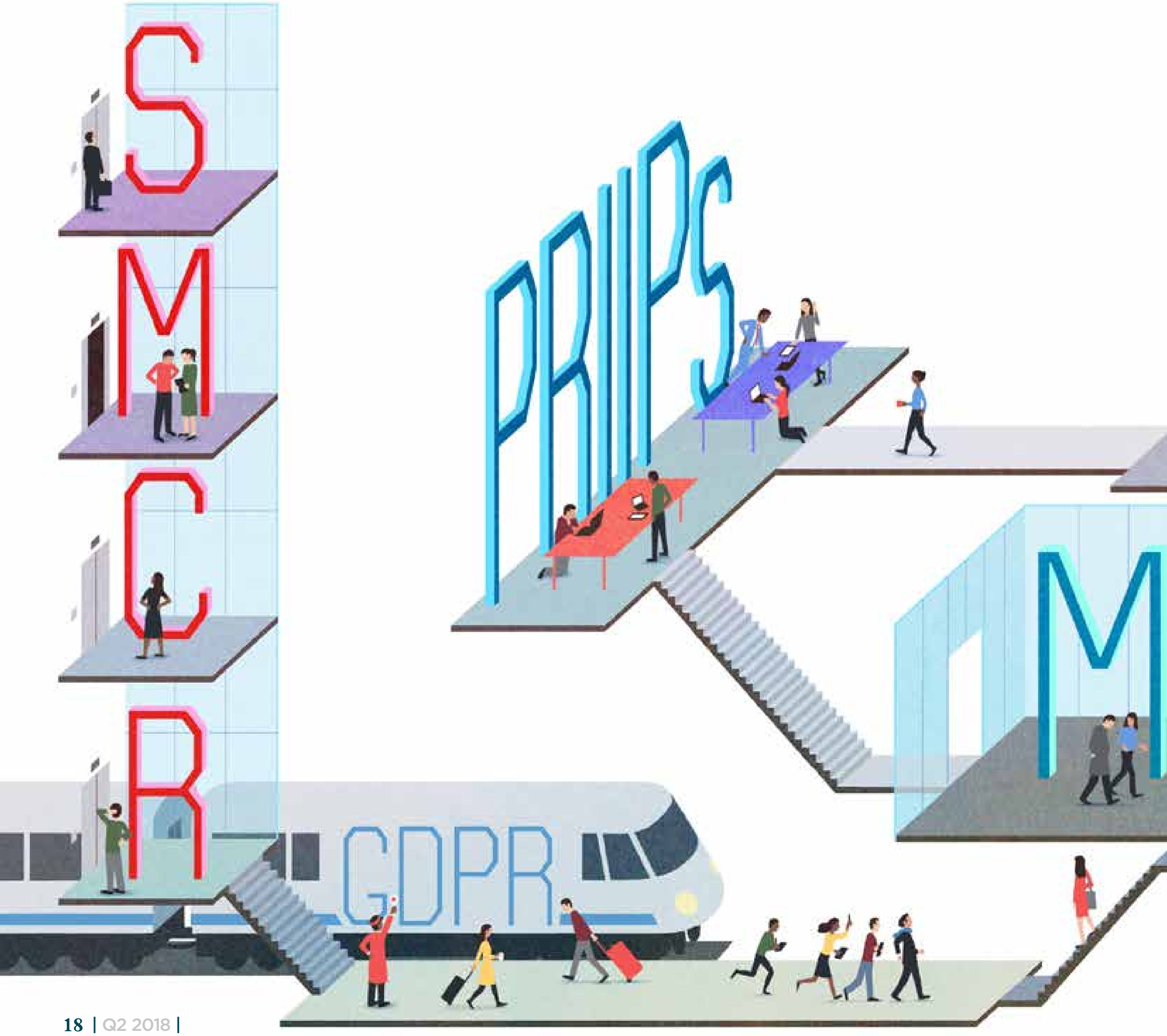
ADVICE FOR FUTURE LEADERS

"There are times when there are demands that work places on you that can be very tough and sometimes you have to stand back and say it's just a job. However, as you get more senior the responsibility that comes with that gets more serious. It's normal to care and wake up in the night thinking about your job, but you've got to stay rounded. Exercise is really helpful in ensuring a healthy balance."

REGULATORY OVERSTRETCH: too much at once?

Since the 2008 financial crisis, regulators around the world have been unleashing new directives, rules and programmes. With many initiatives being rolled out simultaneously, what is the impact of this torrent of new regulation?

NEIL JENSEN MICHAEL KIRKHAM



There seems to be no end to the layers of regulation coming from the EU and the FCA. The high level of activity, coupled with the complexity and specific expertise needed to interpret and then apply the new rules, has made compliance officers a sought-after breed.

"Some companies have changed their compliance consultants because the required experience is not there," says Rory Percival, a former FCA technical expert and consultant.

However, implementing multiple pieces of regulation at the same time isn't just a challenge for compliance staff. A broad range of professionals have responded to an online poll on *The Review* (*cisi.org/reg-poll*) platform asking about the impact of regulatory rollout. Almost half (48%) work in risk and compliance, followed by 19% in wealth management, 10% in operations, with markets, financial planning, fintech, corporate finance and 'other' making up the rest.

An overwhelming majority – 96% – say regulatory rollout has increased their workload over the past year and over a third say regulatory issues take up most of their time. Staff are working hard, across the board.

A senior person who works in operations at a wealth manager, and who agreed to speak to us on condition of anonymity, provided some insight into their firm's workload. Although the past 12 months have been busy, they say that it has been consistently busy for the past five years. "All the regulations, including the Retail Distribution Review (RDR), the Markets in Financial Instruments Directive (MiFID II), Client Assets Sourcebook (CASS) and General Data Protection Regulation (GDPR), have caused a lot of stress, overworked staff and extra hours," they said.

NEW REGULATIONS

One of the most far-reaching pieces of regulation has been MiFID II, an EU law implemented in January 2018 that provides harmonised rules for investment services across its member states. The operations professional says: "MiFID II has put pressure on the whole firm. The first part of MiFID II, transaction reporting, has been the most difficult to roll out."

Another EU initiative, GDPR, rolled out in May 2018, addresses the export of personal data outside the EU. Among other things, GDPR provides new rights for people to access the information companies hold about them, obligations for better data management for businesses and, in the event of non-compliance, a new regime of fines. To help its members understand the complex rules, the CISI has set up a Professional Refresher module on GDPR (*cisi.org/cisipr* – members will need to log in).

Then there's the EU's Packaged Retail Investment and Insurance-based Products (PRIIPs) regulation, which comprises the broad category of financial assets that are regularly provided to consumers in the EU through banks and other financial institutions as an alternative to savings accounts.

PRIIPs, which came into effect in January 2018, aims to help retail investors better understand and compare key features, risks, rewards and costs of different products through short Key Information Documents (KIDs). There have been some concerns about KIDs; in particular, around a requirement to provide five years' worth of performance data.

Product providers and financial advisers argue that this could potentially mislead investors about returns on long and short-term products, which respectively need longer and shorter-term perspectives on performance than five years. The FCA has suggested that providers should offer investors additional explanatory materials to put the performance data into context, but does not say what those materials should cover. Clearly, there are teething problems.

"There is obvious stress in the system, but we haven't reached the peak; there's more to come"

A priority going forward will be the extension of the Senior Managers and Certification Regime (SMCR), the FCA regulation for the UK that promotes greater accountability among individuals. This extension – the initial implementation was in 2016 – includes three main pillars: the Senior Managers Regime, which sets out the senior management functions that apply to firms; the Certification Regime, which requires firms to assess the fitness and propriety of certain employees, who in their role, may pose a risk of harm to the firm and its clients; and Conduct Rules, which relate to professional behaviour rather than the conduct of business. SMCR is to be implemented for insurers in late 2018 and for solo-regulated firms in mid-to-late 2019.

There are many more rules that have helped shape the financial landscape of today: the Capital Requirements Directive IV, which reflects the capital requirements of the Basel II and Basel III rules on capital measurement; PSD2 (the revised Payments Service Directive), an EU directive that will transform some areas of the banking sector; and others related to solvency, money laundering and the FCA's *Asset management market study*.

A SECTOR UNDER STRESS

The Review's poll results show that 92% think the current amount of rollout is more frequent than in 2015. And when asked whether they think the regulatory workload will be reduced in 2018, 82% say 'no'.

With the huge pressures on firms to implement all this regulation, how are they expected to manage? Our interviewee says it's easier for larger firms to deal with, simply because they have more access to resources through bigger budgets.

"If you're a large investment bank, for example, you can pull resources from left, right and centre. There are business analysts and compliance people to help, or brought in to help. I work for a medium-sized business and we haven't got those resources. We tend to use existing staff in the company to help with rollout."

Ian Shipway CFP™ Chartered FCSI, managing director of HC Wealth Management, believes the end is far from near: "There's obvious stress in the system, but we haven't reached the peak; there's much more to come."

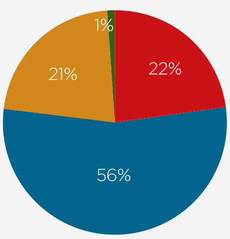
Ian adds that much of the stress comes from clients being confused about why something they see as a simple request for action becomes so difficult to implement. "Things take a long time to get done and usually involve a pile of paperwork the client neither wants nor understands – and in some cases, they have to provide details they have often provided many times before."

Accessibility and clarity of guidance is important, especially in helping organisations to explain the

THE REVIEW POLLED CISI MEMBERS ON REGULATORY OVERSTRETCH – HERE'S WHAT YOU TOLD US

Will you spend more or less on compliance and risk in 2018?

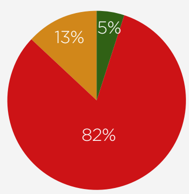
- Much more
- More
- The same
- Less
- Much less



Snapshot of poll results on 3 May 2018

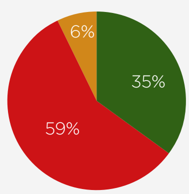
Do you think the regulatory workload will be reduced in 2018?

- Yes
- No
- Maybe



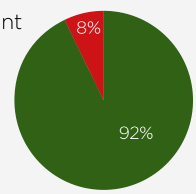
How much impact has regulatory rollout made to your working life?

- It takes up most of my time
- Medium impact
- Low impact



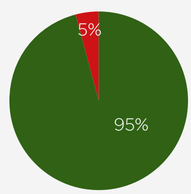
Do you consider the amount of rollout to be more frequent than in 2015?

- Yes
- No



Has regulatory rollout increased your workload in the past 12 months?

- Yes
- No



implications of new regulations to clients, and particularly those who don't always see the full value of all the rules being formulated by the regulators and question the cost and the amount of additional information asked of them.

LOGISTICAL CHALLENGES

The workload resulting from GDPR implementation has been significant, ranging from information audits, documentation of the data being compiled and held and how it is shared and used, proof of compliance, and the appointment of data protection officers. But this is just one of many regulations firms are implementing at the moment. Our interviewee says their firm has moved someone out of their role to focus solely on implementing GDPR.

Dominic Crabb of London Capital says: "The simultaneous rollout does allow you to concentrate fully on your compliance operations, although there's no denying it is a challenge to have multiple projects running. System upgrades and more automation obviously play their part in getting through this."

Firms across the financial sector have little choice but to accommodate the cost implications of new regulation. This includes the hiring of additional support and compliance staff as well as training, implementing new technology and changes to systems. *The Review*'s online poll shows that 97% expect to spend either the same or more on rollout in 2018.

MiFID II, in particular, has tested the ability of the financial system to adapt to new rulings. "This was ambitious in its scale and designed to improve protection for investors," says Graeme Pollok of G&M Compliance Services. "However, the fund management sector, which is impacted most by MiFID II, is less regulated than, for example, banks, which have their own supervisors at regulators. Therefore, it has been something of a major commitment for the sector."

Firms across the sector have little choice but to accommodate the cost of new regulations

MiFID II requires fund managers to communicate costs and fees upfront and provide details of how clients will pay (see page 26 for more details). The directive has built on past versions, and involves the strengthening of front office accountability and more granular reporting, much of it in real time. The scope of assets that firms have to report on is also far broader, moving from just equities to include shares, bonds and other instruments. MiFID II also 'unbundles' the cost of brokerage research and defines the amount that can be transferred to investors.

At the back end of 2017, Smith & Williamson, the financial and professional services firm, said that 73% of polled advisers felt there was not enough clarity on the regulation around the directive.

A NEW NORMAL

With so much regulation bringing more restrictions, as well as costs, can businesses, particularly small and medium-sized enterprises (SMEs), continue to be efficient and effective?

"The same rules apply to larger and smaller firms but where the rules relate to governance, systems and controls, there tends to be recognition and explicit reference to arrangements being appropriate to the size of the firm," says Rory. "However, the conduct of business rules tend to require firms of all sizes to meet the same standards. Hence, this is a real challenge for smaller firms."

As a result, SMEs either attach themselves to a network or use the services of a compliance support company.

In February 2018, the Federation of Small Businesses said that a third of small companies were not ready for GDPR. Non-compliant firms are looking at potential fines of up to €20m or 4% of annual turnover.

"The FCA understands that the new regulations, MiFID II for example, come with a lot of commitment and work. But they want to see companies making serious attempts to fulfil the requirements in accordance with the timeline," says Dominic.

They are certainly trying, but it's not easy. With a third of respondents to our poll saying regulatory issues take up most of their time, and the majority saying their workload has increased, this points to significant stresses in firms across the UK. With all this intense work going on behind the scenes, and our research revealing little expectation that the pressure will dissipate anytime soon, it is probably fair to say that our interviewee sums up the situation neatly by asking: "Who knows what is on the horizon for us next?" ●

INVESTING IN THE FUTURE OF UK ASSET MANAGEMENT

The UK government says that it is committed to supporting the development of a "talent pipeline" for the UK asset management sector. What is it offering, and why?

RICHARD WILLSHER ANDREW BAKER/IKON

The UK is home to the largest asset management sector in Europe and the second largest in the world. According to research from management consultancy Oliver Wyman, British asset managers have a total of £8.1tn of assets under management invested for clients around the world, and, importantly, they generate £5bn–£7bn in tax revenue annually. That's around 1% of the UK's Gross Domestic Product.

In December 2017, HM Treasury published *UK Investment Management Strategy II* (*IMS II*), outlining a government commitment to support the development of a "talent pipeline" for the UK asset management sector – a move welcomed by the CISI. In his forward to *IMS II*, Chancellor of the Exchequer Philip Hammond says: "We aim to strengthen the UK's brand for asset management, enabling firms to respond effectively to the UK's withdrawal from the EU and capitalise upon future trading opportunities."

Strengthening asset management skills sits alongside the strategy's other five objectives (see box, page 24). There are two main educational components: to promote apprenticeships and to establish new asset management centres of excellence.

APPRENTICESHIPS

The apprenticeship element ties back to the government's policy set out in *Apprenticeship funding: apprenticeship funding in England from May 2017*, published in October 2016. *IMS II* aims to attract a range of employees to the sector, including those who "may not have traditionally seen a career in financial services as an option". The measures to be taken are quite specific: "Firms that hire apprentices will need to provide full-time paid employment to the apprentice, as well as purchase apprenticeship training, approved by the Institute for Apprenticeships, to form at least one day a week's training. This training could also allow apprentices to gain a full bachelor's or master's degree." It adds: "The government has simplified the way that apprenticeship training is funded in England, and given employers more control over designing, choosing and paying for apprenticeship training."

"The present system does not provide a unified and holistic approach to skills development"

Some of this is already happening and *IMS II* acknowledges the 'Investment 20/20' initiative undertaken by the asset management sector, which gives school leavers and graduates access to training programmes among 35 partner firms. These include major UK firms such as Aviva, Legal & General and Schroders, as well as overseas employers such as JP Morgan, Investec and Fidelity. The CISI also partners with Investment 20/20, as well as working with most of its partner firms. This partnership is valued by the Institute as an integral part of its vision to give school leavers and graduates the opportunity and route to apprenticeships.

There are many other training providers in the sector. Many businesses upskill their staff through a variety of on-the-job training and continuing professional development. This includes the CISI's globally recognised qualifications that are used by major banks and financial organisations as a benchmark of staff knowledge. The training is provided through the CISI's roster of Accredited Training Partners (ATPs) that deliver training not only in the UK, but to many centres around the world. Training is delivered face-to-face or via distance learning. The Investment Association (IA) provides a selection of short courses across a large range of disciplines, as do other professional bodies, such as accountancy organisations that address skills requirements.

One of the challenges in training investment management staff is the wide range of skills that are applied across the sector. This encompasses expertise in accounting, reporting, legal and compliance, through to understanding markets and particular asset classes, to customer relations and marketing. Developing this huge diversity of capabilities requires the asset management sector to draw in training skills from a wide range of outside firms and practitioners.

Unsurprisingly then, seeking to coordinate and streamline the sector talent pipeline means undertaking a broad, inclusive approach. The *IMS II* acknowledges this and notes that there is room for improvement. Dr Vimal Balasubramaniam, assistant professor of finance at Warwick Business School, reflects on this. "The present system does not provide a unified and holistic approach to skills development for the future of investment management in the UK," he says. "To take the sector to the next level and remain globally competitive, the current ecosystem needs nodal points that pool together resources that focus on knowledge creation (research-intensive units), skills development (teaching centres) and 'upskilling' (career development, providing specialist skills complementing investment management). Human capital investment for the sector is a public good; all firms and stakeholders in the ecosystem will benefit greatly by collaborating and improving the supply of skilled labour, thereby making a qualitative difference to the sector."

CENTRES OF EXCELLENCE

The second plank of the government's strategy is what *IMS II* terms "asset management centres of excellence".

It says that the sector's resources are "spread thinly across many institutions and initiatives," so it aims to "consolidate the majority of existing research spend and concentrate it in a more focused way, [such that] the sector will be able to benefit from economies of scale and have a greater impact on skills."

There are a lot of potential interested parties and sources of funding to be coordinated, including sector participants and academic institutions of various sorts. The CISI, for example, partners with universities to bridge the gap between academia and the workplace by enabling students to achieve professional qualifications alongside their degree programme. It is currently working with 23 universities across the UK (some of the bigger ones being University College London, Newcastle University and ICMA Centre, University of Reading) to help students achieve a competitive edge

UK ASSET MANAGEMENT STRATEGY II – SIX OBJECTIVES

- Enhancing the government, regulator, industry dialogue
- Promoting the UK's competitive and stable tax and regulatory environment
- Strengthening the domestic investment management skills pipeline
- Advancing the development of asset management fintech solutions
- Supporting UK asset managers to be global leaders in innovative investment strategies
- Continuing a coordinated international engagement and trade promotion programme.

within the asset management sector and other financial services specialisms.

It will fall to the sector and the IA, as part of the strategy, "to gather the scattered skills funding and redistribute the money into funding new asset management centres of excellence." Exactly how, is as yet unclear. The government's strategy paper is long on vision and short on detail. For now, *IMS II* does provide a visual summary of its vision (see graphic).

If the government wants the centres of excellence to have a practical impact, it should pay heed to what drives companies to invest in training. In a heavily-regulated sector such as financial services, compulsion is a significant factor. Unless the FCA imposes new, or higher, requirements on investment firms relating to training of staff, and the new centres can help firms to meet those requirements, it seems unlikely that they will have much of an impact on the existing training landscape.

WHAT NEXT?

A component of *IMS II* is the establishment of an Asset Management Taskforce (AMT), currently chaired by the newly appointed Economic Secretary to the Treasury and City Minister, John Glen MP. This comprises senior representatives of firms such as Janus Henderson, Jupiter Asset Management, M&G Investments and Vanguard. The IA is a member, as is the Treasury's director of financial services. The taskforce, which will meet quarterly, is expected to oversee the delivery of *IMS II*'s main objectives.

As yet there have been no announcements of particular, practical measures arising from *IMS II*. A third meeting of the AMT is due to take place in May, while the Treasury says that the centres of excellence will be developed in conjunction with the IA over the next few years, adding that this is still at a very early stage. It urges universities and other organisations that are interested in getting involved to approach the IA directly.

The Asset Management Taskforce is expected to oversee delivery of IMS II's main objectives

With government backing to provide it with a tailwind, the support of the sector's big hitters and representative groups, including the CISI, is in place. The Treasury Secretary told *The Review*: "I want to thank everyone at the CISI for supporting our second investment management strategy and, specifically, our proposal to create Centres of Excellence at UK universities. As one of the leading professional bodies, we want to draw on the Institute's expertise in this area, and I look forward to working with it to unlock the industry's fullest potential."

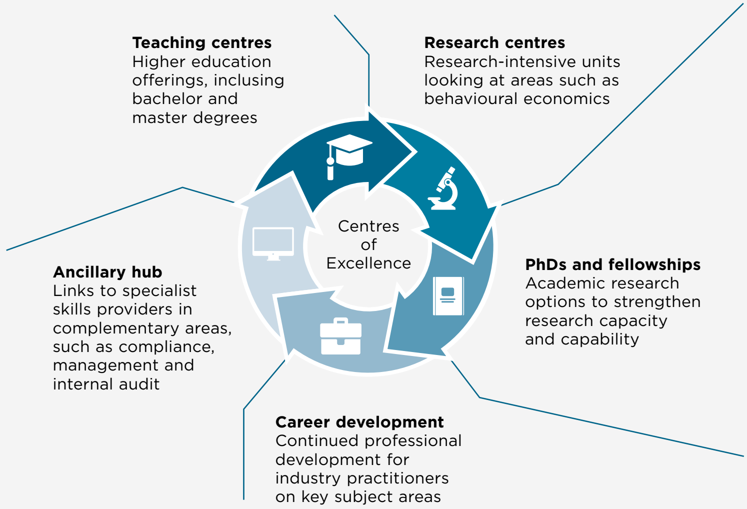
In addition to the IA, the Alternative Investment Management Association (AIMA), which represents a large community of hedge funds and other alternative funds that base themselves in the UK, stresses the need for talent of the right intellectual calibre. It also notes that London attracts this talent by no means only from the UK but also from around the world. In its 2016 document, *Developing alternative investment management in the UK: Brexit and beyond*, AIMA points out that it needs to attract the best candidates from wherever they hail. Its research finds that "non-UK EEA employees represent approximately 20% of the UK alternative investment workforce".

This in turn begs the question of how the issue of attracting talent from overseas will be addressed across the sector. *IMS II* acknowledges this and says: "As the UK leaves the EU, the government's aim is to have an immigration system that supports the economy so that UK industries can continue to attract the brightest and the best with respect to international talent."

So *IMS II* looks to be avoiding the pitfall of becoming inward-looking and drawing only upon homegrown talent. How this will work in practice remains to be seen. And other sectors, including investment management, are also anxiously awaiting news on how the government will square the thorny circle of withdrawing from free movement of labour while continuing to benefit from the EU and global pools of human capital they need to preserve access to.

The current state of play with the *IMS II* initiative is wait and see. The two educational initiatives – apprenticeships and university-connected asset management Centres of Excellence – sound positive and anchored to the real needs of the sector post-Brexit. No significant detail as to how these will work have yet been released, however, and the sector will be waiting expectantly for news from the AMT.

GOVERNMENT VISION FOR HOW ASSET MANAGEMENT CENTRES OF EXCELLENCE WILL WORK



Source: UK Investment Management Strategy II

THE NEW RESEARCH REGIME

MiFID II was finally born on 3 January 2018, bringing in sweeping changes to rules relating to investment research charges. As sector players get used to the new regime, it's becoming apparent that more clarity on the rules is needed

PHIL THORNTON STUART KINLOUGH/IKON

As brokers, analysts, and fund managers trudged to work on Wednesday 3 January, they were aware that the date marked a bright new dawn for financial investment and trading in the form of the Markets in Financial Instruments Directive II (MiFID II).

For investment managers and brokers, one of the most significant features of this giant EU regulation is the obligation to establish a price for investment research and charge for it separately from execution services.

To make the full cost of fund management clear to clients, the regulator, the European Securities and Markets Authority, has ruled that fund managers must account for research fees, and that banks and brokers can no longer wrap up the costs in their execution charges and send research for 'free'. In other words, 'free' research that asset managers receive from brokers is now considered an 'inducement to trade'. Managers that receive advice must assess its value and either pay for it or turn it away.

This reform has forced banks and other research providers to come up with a price for producing research that they had previously seen as a non-profit activity that was useful to support their overall strategy for selling stocks, bonds and commodity products.

With MiFID II still in its infancy, banks are keeping their cards close to their chest and none of those contacted by *The Review* wished to disclose price details. Graham Bentley, managing director of asset management advisory gbi2, said this is because everyone is negotiating separately.

However, leaked details of price listings have shown a range of offers from the blue chip banks from as little as US$10,000 a year to as much as £350,000 (see box).

According to Vicky Sanders, co-founder of RSRCHXchange, an aggregator and marketplace for institutional research, four main models for charging have begun to emerge:

- Platform-only: written research or platform access fee only; agreed upfront
- Rate card: platform fee agreed upfront; incremental advisory services rate card agreed in advance; total payment determined by usage
- Variable advisory model: large fee for full service agreed upfront; small 'top-up' proportion to be determined by votes by individual managers at the end of the quarter/period with the variable share often being 10%

TYPICAL FEES CHARGED FOR RESEARCH BY BLUE CHIP BANKS

Compelling brokers to put a price on something that was free is one of the most dramatic impacts of the MiFID II rules. Banks and brokers are not keen to reveal their prices while they work out what they can charge. So far, clues as to prices for the blue chip banks have come from reports in news websites such as *Bloomberg News* and *Citywire*.

Research provider	Price (per annum)	Research service
Bank of America	Up to US$80,000 (per user)	Full package of services
UBS Group	US$40,000	Basic equity research
Barclays	£30,000–£350,000	Read-only European research/full access to analyst research
JP Morgan Chase	US$10,000	Read-only access to online analyst portal
Bernstein Research	US$150,000	Equity reports

- Vote model: nominal fee paid upfront; majority of payment determined by vote at the end of the period where asset managers vote for the research that they found most valuable when making investment decisions.

RESEARCH BUDGETS CUT

One thing is clear: most fund managers plan to absorb the cost of research inside their profit and loss account rather than pass it on to clients. A survey in September 2017 of 400 of the largest European fund managers by the CFA Institute finds 85% plan to absorb the costs with just 15% expecting to charge clients.

The obligation to account for these charges has led fund managers to cut research budgets. According to Greenwich Associates, a US-based financial consultancy, US$1.35bn was used by European equity fund managers to acquire equity research in 2017. Its survey of 39 European managers shows they have slimmed those budgets for 2018 by 20%, equivalent to a cut of US$300m.

Most fund managers plan to absorb the cost of research inside their profit and loss account

The availability of large quantities of free research sent out by banks and brokers meant fund managers could choose what to read — or whether to read it. According to Quinlan & Associates, banks sent out 40,000 reports a week in 2017, of which fund managers opened just one in 20 and only read 1%.

Chris Turnbull, co-founder of Electronic Research Interchange (ERIC), a marketplace for research for regulated investment managers, said early signs pointed to sharp falls in fees.

"One of the main factors that came to light in the last-minute build up [to 3 January] was the tumbling price of access to research for fund managers on a read-only basis," he said. "The longer they waited, the more the banks needed to get clients, therefore prices seemed to tumble." An article for *The Review* in September 2017 – 'MiFID II and research: what are firms doing now?' – finds many funds leaving decisions until the last moment.

'PEPPERCORN' FEES

Chris identifies a two-tier market with smaller research providers charging "peppercorn" fees for basic research products but holding on to higher prices for a premium product that includes bespoke reports and meetings with analysts. "It seems that some smaller brokers just want to have clients on board so they can speak to them on corporate deals," he says.

MiFID II is likely to create a price list for different types of access above the basic access to read-only research. For example, banks may offer fund managers briefings by a bank's, say, Asian economist, but will then set different prices for a face-to-face meeting in London, a conference call, or more specifically commissioned research on a stock or a sector.

Banks and brokers that come lower down the tables may struggle to attract customers

There is also the issue of what counts as research. The European Commission says it must include content that in one way or another informs an investment decision. Non-substantive summaries written without any valuable analysis can be considered "minor, non-monetary benefits" – but that is likely to be generic coverage that adds little value.

Large banks with universal coverage across sectors and regions should continue to find clients, especially if they are at the top of the rankings tables. However, banks and brokers that come lower down the tables may struggle to attract customers, says Vicky at RSRCHXchange.

Graham at gbi2 says large and mid-cap budgets are being slashed as funds use fewer external providers and more proprietary software and screening tools. However, he says specialist equities researchers will win out. "Knowing what few others know will be their unique selling point," he says.

Given that MiFID II has created a price for research that did not explicitly exist before, it may not be until later in the year that some fund managers see how much their premium research contracts are costing them.

"We will see some of these issues come to a head where people thought they were paying £10,000 but they actually receive a bill for £100,000 and whether they feel they were over-serviced or under-serviced."

One response could be an increasing trend towards boosting in-house research. Some funds already have substantial in-house teams (see box). And according to ERIC's *European Asset Management Survey*, 38% of buy-side firms are considering expanding their internal research teams. Specialist fund managers will need to buy in specific areas of research where there is not sufficient expertise in-house, says Vicky – for instance, an emerging market fund manager covering South Africa. "There has to be some return from having that person in-house."

However, Chris points out that traditionally a lot of research work has been done in-house with the assistance of written products from other providers, and he doesn't think this will escalate. "There does not seem to be that pressure when investors can get access to research for lower prices," he says.

Budgets are being slashed as funds use more proprietary software and screening tools

His major concern is that the low prices being charged for basic research are creating a danger that neither asset managers nor research providers are abiding by the essence of what MiFID II is trying to achieve. "The last thing we want is for an asset manager to be accused of being induced by paying too little for research," he says. "There is a need for clarity and the only person who can bring that clarity is the regulator." ●

FUND MANAGERS DOING THEIR OWN RESEARCH

The Review contacted around 70 fund managers to ask whether they had brought research activities in-house rather than pay brokers. The vast majority declined to answer but the trend from the four who did respond is to focus on in-house research.

Allianz Global said: "We will not be sharing details of our research contracts post-MiFID II, though we already have our own very large in-house global research team."

Columbia Threadneedle said: "As an active manager, our investment process uses in-depth internal research supplemented with specialist research acquired from third party research providers."

Virgin Money said it did not buy in any external research.

And **Brewin Dolphin** said: "We have our own very strong in-house research team. If they require any external research, they will pay for it at their own cost."

WHICH WAY TO GROW?

Whether you run your business as a lifestyle practice or a growing enterprise will depend upon the type of work-life balance you want

TIM COOPER ISTOCK

As the founder of an advisory firm, one of the biggest questions you'll have to answer is: How big do you want your business to be? Would you rather work in your business or on it? The former, a lifestyle business, involves fewer risks, less stressful management activity and gives you more time to see clients, while also affording you a more flexible lifestyle. The latter involves growing your firm into an enterprise to increase its long-term value. This should make it more sustainable and resilient, allow more risk-taking and increase long-term profits. With good management, it could even run without you.

There are, of course, commonalities between both models. FP Advance is a boutique consulting firm that specialises in working with growing and aspiring financial planning businesses. Founder Brett Davidson helps clients to achieve their goals through better business management skills.

"To be a small lifestyle practitioner, you need to run your firm like a business anyway, albeit with different goals," he says. "Otherwise, there will be no lifestyle."

Lifestyle businesses need to hire decent people and outsource suppliers, too. Outsourcing isn't an easy fix for a small business, but when done properly, it passes difficult issues like recruitment to the outsourced firm.

That's where the similarities end, though. In a lifestyle practice, the owner is at the centre and everything is tailored towards helping them achieve their chosen lifestyle, whether that be only working with clients and outsourcing administration tasks or only working a few days a week. In an enterprise, the business is at the centre and decisions are made according to the best interests of the business, not the owner.

GROWING AN ENTERPRISE

Michelle Hoskin is founder and director of Standards International, a consultancy that supports the professional and personal development of financial adviser business owners. She says building an enterprise requires huge energy levels. "That massive input from your professional and personal life can come at a cost. Often, when people realise that, they won't allocate the time and effort.

"They can't do it taking Mondays and Fridays off. You cannot build a growth business with half a leader." The cost could be literal in terms of pay cuts taken during times of hardship or when investing for growth via business development, brand building or recruitment. In other instances, the cost comes in the form of demands on your time.

Gordon Wilson CFP™ Chartered MCSI is managing director of Edinburgh-based Carbon Financial Partners, which launched in 2011 with 24 staff when the directors bought it out from a larger group. The firm has now grown to a team of 40. Gordon says that, as an owner, you are never far from the business, but he and his co-founding directors wanted to build a firm that could operate without them. This would allow them some freedom, such as being able to take holidays without any interruption to client service.

To achieve this, Carbon recruited support staff and planners as it grew its client bank. In the early days, that was mostly through connections. Gordon says organic growth is easier because buying businesses is difficult in financial planning. "Culturally there aren't many that would fit," he explains. "We have found much more success recruiting and training graduates than parachuting in experienced people. The key is to recruit two or three graduates a year. Some become financial planners, others go into operations or paraplanning."

Other enterprises do choose to grow through acquisition, however. Until three years ago, US-based Straight Path Wealth Management in Michigan was a lifestyle practice. Acquiring two businesses jump-started its journey towards a scalable, growth-oriented firm.

Founder Matthew Boersen CFP® says the advice landscape was changing due to improvements in technology, such as sophisticated platforms and client portals. The software wasn't cheap and it was difficult for a small, independent lifestyle practice to offer it to clients, hence the decision to scale up through acquisitions.

There are certain things that every enterprise must focus on to be successful

"Our clients have seen tremendous benefits from the shift, even in a short period," says Matthew. "Buying an accounting practice with a small financial services arm has broadened the skillset to include tax professionals, which makes the financial planning more in-depth and more valuable. It also helps us identify and focus on what our clients value most, which includes retirement planning, tax planning and generally more in-depth planning, rather than plain asset management."

Whether you choose to grow organically or through acquisition, there are certain things that every enterprise must focus on to be successful, including operational efficiency and building a strong brand and reputation.

Carbon has established its brand through sponsoring events. Its target market is senior executives and business owners and they tend to like rugby and golf, so the firm sponsors charitable events around those. Also, the firm has built a strong reputation by emphasising values, ethics and community work. "If you get a reputation for always doing the right thing and delivering good service, you will get referrals," Gordon says. About 80% of Carbon's new business now comes from client recommendations.

Consistency has also been an important factor in Carbon's growth. Everyone follows the same central processes, pricing and proposition, working as a team, not in silos. To support that consistency, work goes through a central client services team and paraplanners. And from the start, the firm has had an operations director who is an equal shareholder. That frees the 'rainmakers' to concentrate on winning business and delivering advice, says Gordon.

THE RECRUITMENT CHALLENGE

Finding people who can win new clients can be tough, says Gordon. "Not many people are hunters – some recent research showed perhaps only one in ten financial planners are. They are hard to find as people like that are often established or have set up on their own. But if you have some who are good at finding business and others good at looking after it, that works."

Finding talented paraplanners can also be a problem. Many good paraplanners are millennials, who often don't stay long in jobs.

FP Advance's Brett says retention is one of the biggest concerns that growing businesses have, and it often stops them from investing in things like staff training. But Joni Youngwirth, managing principal of practice management at Commonwealth Financial Network in Massachusetts, US, says implementation of formal training structures is a major reason why large firms tend to keep growing. Formal training needs to set clear goals, develop a curriculum, and measure performance to confirm learning outcomes.

This structured approach is more likely to help retain staff. But at a more fundamental level, you should let people find what they love and are good at, challenge and stretch them and have a decent social purpose behind your business, Joni says. Even mobile millennials will stay in a good financial planning practice like that.

Recruiting support staff such as paraplanners is the right strategy when you're planning for growth. Brett believes an adviser should be able to make £600,000 revenue with two to three great support staff. You can add another partner and a practice manager who will help structure your support team in a way that suits the firm. Some firms prefer working in pods of advisers, paraplanners and administrators; others use a central pool of support. Both approaches can work, but to achieve scale using the pod structure, good communication is essential.

Brett also recommends tracking management information metrics, such as productivity ratios. If productivity is low, you must fix that before hiring more people. Poor productivity could be for many reasons, including the wrong staff or over-engineered financial planning processes. Despite the recruitment challenges, when you get it right, the satisfaction gained from helping others to start and develop their careers can be

immensely rewarding. "People have more opportunities to develop in a larger organisation and we help them in any way we can," Gordon says. "I have seen people come in from graduation and grow to become CERTIFIED FINANCIAL PLANNER™ professionals."

BUILDING A PRACTICE

The management responsibility involved in growing an enterprise isn't for everyone. Warren Shute CFP™ Chartered FCSI, director of Wiltshire-based Lexington Wealth Management, initially grew his firm by recruiting financial advisers. However, managing them took him away from client-facing work – his favourite part of the job – so he returned to being a sole adviser.

Today, he outsources compliance, paraplanning, investment reports, and some secretarial and marketing consultancy. "Using outside expertise adds value because they work with other firms and bring best practice," he says. "They are always available and it works brilliantly."

Warren works with clients for two and a half days a week, has Wednesday afternoon off, and dedicates Thursday and Friday to financial education activities, such as blog writing, and marketing.

"There is less value in the business because it is just me, but with technology and outsourcing, a small firm can punch above its weight and compete happily with larger firms," says Warren.

However, a practice doesn't have to be a sole adviser. Louise Norman CFP™ APP Chartered MCSI joined Bagshot-based HC Wealth Management in 2010 and is a director and one of seven financial planners. They are supported by five back-office staff, including one paraplanner. The back-office team oversees administrative tasks and the planners deal with client relationships.

Louise likes the client exposure you get within a practice environment. "All the directors had experience of working for a larger firm and felt it was too prescriptive and didn't account fully for the individual needs of clients," she says. "A smaller practice means directors can still meet clients, and have the flexibility to offer a more personalised approach, which our clients value."

Louise also feels it is easier to maintain control over the company in a smaller practice. One challenge in her role is striking a balance between managing her client relationships and overseeing the operations of the business. To help manage the time that each takes, Louise splits her working week so that certain days are allocated to client work and others to projects and running the business.

Another challenge is the time it takes to keep abreast of regulations. "There is so much going on but a smaller organisation has limited resources," she says. "We work with compliance consultants, then have to review all the materials ourselves. But smaller businesses can be just as profitable – in fact, it can be easier to identify efficiencies."

In 2016, HC Wealth Management reviewed and restructured its proposition. "We refined some of the documentation and client review process," says Louise. "We also looked at individual tasks to make sure they were aligned with people's skills.

"We make sure everyone understands why they do what they do and we encourage them to think about whether there is a better way of doing it. We keep roles as broad as possible, so that the support team has variety, otherwise people can get bored. We also have a fairly flat structure, which helps people to stay engaged."

The restructure enabled HC to release some capacity within the team and to free up time by passing on unnecessary tasks.

This sort of efficiency is what Mitch Anthony, US-based president of Advisor Insights and co-founder of Return on Life, helps advisers to implement. He believes a practice allows an adviser to choose who to work with, how and at what pace, but you need systems and processes that allow you to focus on what you do best and pay others to do the rest.

The most effective way for practices to achieve efficiency, however, is to reduce client numbers and raise services levels. Mitch says the most fulfilled practice owners provide in-depth services to 100–150 clients.

"Letting money drive every decision compromises quality of life," he adds. "Move life to the centre, make money secondary and you have an attractive value proposition."

To make a conscious decision about whether to go for a lifestyle practice or an enterprise, ask yourself the following questions: is it the hands-on aspect or would you prefer to build up an enterprise with a good team and then take a step back? How many days a week do you want to be in the office, and how much do you need to earn to achieve this? Will the business be able to run without you when you retire, or if you decide to pass it on? These are crucial questions you must ask at the beginning of the business process. So, look ahead.

JOBS ON THE MOVE

The global map of where financial services jobs are located is changing. While the critical mass of offshore operations is still in India and the Philippines, they are under threat from challenger locations, changing business models and automation

ANDREW STRANGE ALEX WEAVER & GREAT APES

FROM THE UK, WHO'S MOVING WHERE, AND WHY?

Who? IT infrastructure, legal, paralegal, post trade, settlement, reconciliation and other administrative staff; junior accountants
Where? Remaining offshore

Who? Regulatory staff
Where? Offshore and nearshore
Why? To manage the cost of regulation

Who? Roles requiring data access
Where? To Poland
Why? GDPR

Who? IT staff involved in agile development
Where? Onshore and nearshore

Who? Decision-makers, such as the global heads of investment banking and operations
Where? Offshore

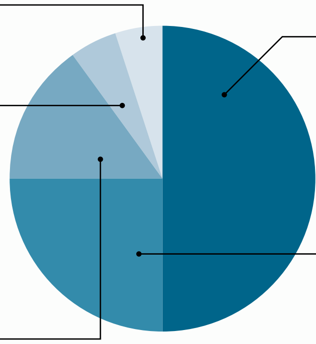
INDIA

Favoured by UK financial services firms, India has more jobs than any other country in banking and financial services (BFS), business process outsourcing (BPO), and the biggest proportion of the work is in sector-specific processes for banking and capital markets.

RBS has bases in Chennai, Bangalore, Mumbai, Delhi and Gurgaon working in functions from technology to risk, payments, transformation and operations.

HSBC global service centres in Bangalore, Chennai, Delhi, Hyderabad, Kolkata, Mumbai and Vizag provide operations services, IT and technical support to the group.

Breakdown of areas BFS BPO workers in India are employed in:[1]



<5% human resources

5%–10% finance and accounting

10%–15% procurement

50%–60% sector specific processes (such as post-trade settlement and reconciliation)

25%–30% contact centres

200,000–500,000 full-time equivalents (FTEs) work in BFS BPO (excluding IT) in India[1] for outsourcers from countries including the UK and the US.

US$280
average monthly salary for BPO call centre worker, including those working for financial services firms[9]

US$64.1bn
foreign direct investment inflows from the financial services sector (banking, insurance, business, outsourcing, R&D, courier, technology testing analysis) since 2000[3]

THE PHILIPPINES

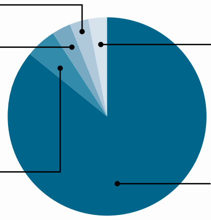
The Philippines leads the world in contact centre outsourcing and is favoured by American institutions because of its cultural ties and English spoken with a US accent.

JP Morgan global services centre in Manila offers operational, research, IT and training support.

ANZ Global Technology, Services & Operations is responsible for the bank's global shared services and has a base in Manila.

US$200–US$250 monthly salary for entry level IT and BP outsourcing staff[4]

Breakdown of areas BFS BPO workers in the Philippines are employed in[1]



<5% HR

<5% procurement

5%–10% sector specific processes

<5% finance and administration

85%– 90% contact centres

100,000–300,000 FTEs work in BFS BPO (excluding IT) in the country[1]

POLAND

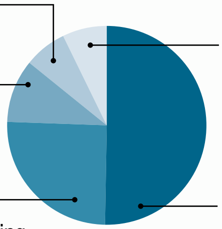
The key nearshore centre in Europe, Poland is often chosen by European financial institutions because it is in the same time zone, has cultural similarities and several European languages are often spoken.

800: Goldman Sachs expects to hire a further 200 people at its Warsaw base, taking the total to 800. They will be in technology, operations, risk management, treasury and human resources.

4,500+: Credit Suisse has more than 4,500 employees in Warsaw and Wroclaw, providing support for the global organisation across many banking processes, such as risk management.

€810–€1,160 is the likely salary of a junior analyst in the banking sector in Kraków[5]

Breakdown of areas BFS BPO workers in Poland are employed in[1]



5%– 10% HR

10%–15% sector specific processes

25%–30% procurement outsourcing

5%–10% finance and administration

50% contact centres

10,000–50,000 people work in BFS BPO in Poland (excluding IT)[1]

OUTSOURCING IN NUMBERS

US$100bn–US$150bn: The global market size of IT outsourcing and business process outsourcing in the BFS sector[1*]

70%–80%: IT outsourcing accounts for the majority of BFS outsourcing[1*]

US$4.9bn of outsourcing contracts were signed by banking and financial services companies between Q4 2016 and Q3 2017[2]

SUPPORT FOR MATURE MARKETS

2,700: South and Central America provide nearshore locations for the US. The Citi Service Center in Costa Rica has 2,700 employees and is recruiting in everything from technology and accounting to audit, risk management, compliance and human resources.

1,500: Some Eastern European countries like Hungary, Ukraine and Bulgaria are among the locations offering financial services. The Citi Service Center in Budapest has more than 1,500 employees and 25 separate functions[6] ranging from human resources to cyber security.

THREATS TO OFFSHORE JOBS

59% of UK financial services firms have increased onshoring in the past two years, while only 4% have decreased it[7]

1.1 million low-skilled outsourcing jobs are at risk across all sectors, including financial services, in the US, India, the Philippines and Poland alone[8]

Sources

1. Everest Group Research | 2. KPMG Global IT BPO Outsourcing Deals Analysis 3Q17 | 3. Invest India 'IT and BPM' | 4. Kittelson Carpo Consulting | 5. Association of Business Service Leaders | 6. Budapest Citi Service Center | 7. Robert Half, 'Financial services brings offshored jobs back to the UK' | 8. AT Kearney Global Services Location Index | 9. Indeed | ****Excluding global in-house centres***

ARE P2P LOANS A GOOD INVESTMENT FOR ISA HOLDERS?

Growth in P2P lending shows no sign of slowing. The innovative finance ISA might provide a further boost. What are the pros and cons for an investment portfolio?

PAUL BRYANT ISTOCK

In his March 2014 Budget speech, then Chancellor of the Exchequer George Osborne announced the government's intention to allow peer-to-peer loans (P2P) to qualify as individual savings account (ISA) investments. P2P lending was a small but fast-growing market at the time, with only £600m of loans being made in 2013, while almost £60bn was invested into cash and stocks and shares ISAs that year.

The announcement was recognition of the potential for P2P and of its important post-financial crisis role. There was clearly demand for an efficient matchmaking service between credit-starved individual and small business borrowers, and return-starved savers and investors.

Fast-forward four years and P2P lending is certainly delivering on its growth potential. In 2017, according to AltFi Data, new loan originations reached £5.3bn, almost nine times more than in 2013, and are forecast to reach £7.5bn in 2018.

But it took until April 2016 for the Innovative Finance ISA (IFISA) to come into operation. This provides a mechanism for qualifying platforms to offer P2P investors the added benefit of a tax efficient wrapper. But platforms did not automatically qualify to offer it. They first had to obtain full authorisation from the FCA, having previously operated under interim permissions granted by the Office of Fair Trading.

Authorisation proved to be a slow process and put a handbrake on IFISA investments. Only £17m was invested in the tax year ending April 2017. None of the 'big four' platforms (Funding Circle, Zopa, RateSetter and MarketInvoice) – between them commanding more than 60% market share – were fully authorised by that time and fewer than ten of the smaller platforms (all issuing less than £50m of loans per annum at the time) had live IFISA products.

With a spate of regulatory approvals in the second half of 2017 and early 2018, this regulatory handbrake has now largely been released. Of the 80 to 90 platforms in operation, 63 were fully authorised by 22 February 2018, with more than 40 of those registered with HMRC as IFISA managers.

P2P might now be poised to capture a much larger slice of the ISA pie.

THE P2P LENDING LANDSCAPE IN 2018

The sector has attracted over 100 new entrants since the financial crisis and is still growing rapidly. In 2017, new loan originations were nearly 40% above 2016.

Platforms tend to specialise in certain types of loans. Funding Circle, the largest platform of new loans, (£1.26bn in 2017) provides loans to smaller businesses. Zopa, the second largest (£985m in new loans in 2017) but oldest platform, operating since 2005, provides consumer loans. Others offer invoice financing, property development loans and buy-to-let residential or commercial mortgages.

A more recent development is the emergence of 'aggregators', such as Goji, which offers investments across a number of platforms – the P2P equivalent of a fund-of-funds.

The larger platforms in particular rely heavily on technology to source borrowers, lenders and to automate parts of their operations. But algorithms have not taken over.

Borrowers are also sourced through introducers such as loan brokers. Funding Circle still has human account managers and credit assessment teams. Credit committees are common, particularly for higher value business or property loans.

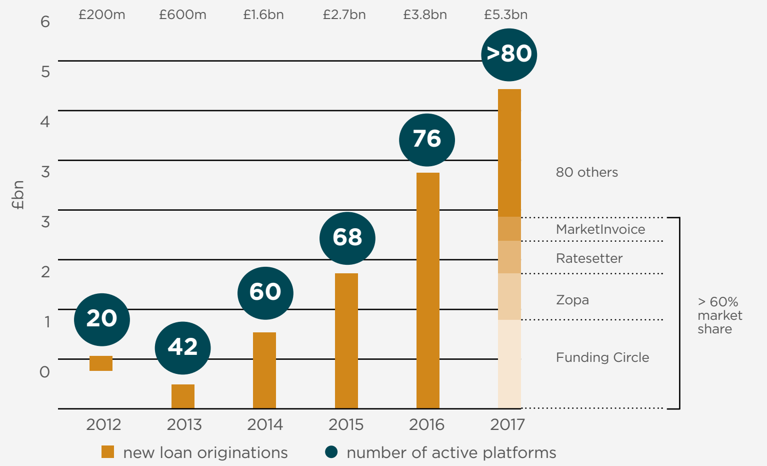
Retail investors are sourced mostly through platform websites but increasingly through financial advisers as well. And contrary to the name of the sector, many platforms also source lending capital from institutional investors.

Attracting investors appears to be easier than attracting quality borrowers, especially in the consumer loan segment. Zopa being closed to new investors for much of 2017 and into 2018 is evidence of this. In 2017, CEO Jaidev Janardana said that this was due to the high volume of investor demand, particularly after the introduction of the IFISA, and Zopa not being prepared to relax credit standards on the borrowing side to boost loan availability.

WEIGHING UP THE INVESTMENT PROPOSITION

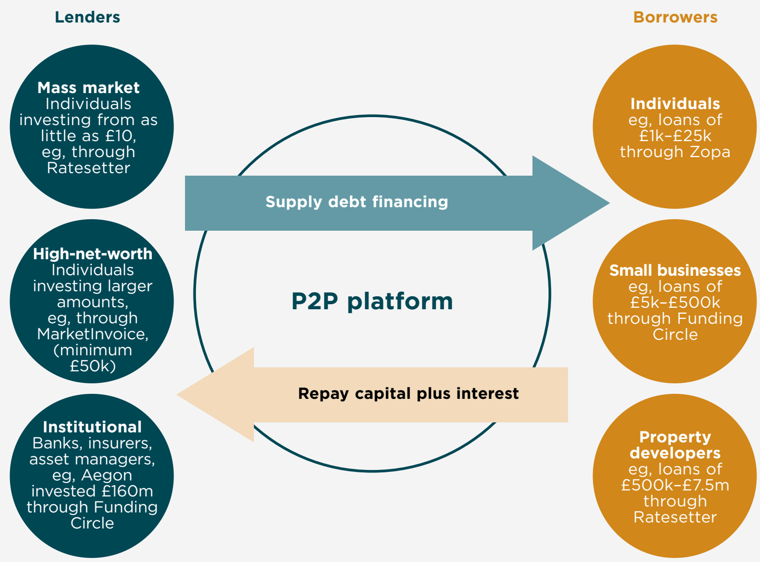
The main attractions of investing in P2P lending have been the higher rates of return when compared to cash (albeit with additional risks such as foregoing

RAPID GROWTH IN P2P LENDING VOLUMES AND COMPETITORS



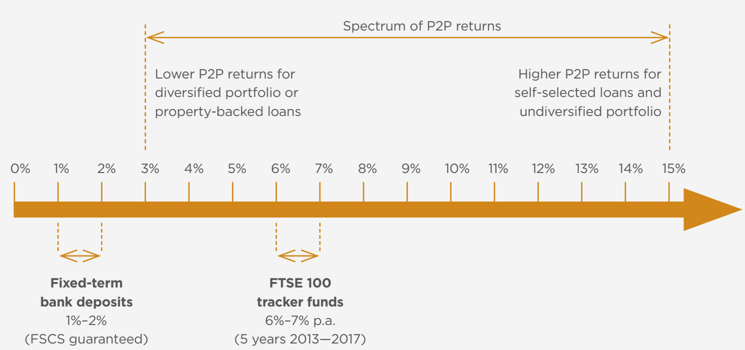
Source: Canbry Research – February 2018 analysis, Nesta, ALTFI, P2P Finance Association

P2P PLATFORMS SERVICE A RANGE OF LENDERS AND BORROWERS



Source: Canbry Research, company websites (February 2018)

P2P LENDING EXPECTED RETURNS VERSUS CASH AND EQUITIES



Source: Canbry Research; P2P platform, bank and investment platform websites (February 2018)

Financial Services Compensation Scheme protection); and that returns are in the main uncorrelated to equities or bonds, making it a valuable tool to increase portfolio diversification. Now, with the recent introduction of the IFISA, the additional benefit of tax-free returns becomes available.

But the diversity of P2P products makes it impossible to compare the sector as a whole to other asset classes. Comparisons need to be made at individual platform and product level.

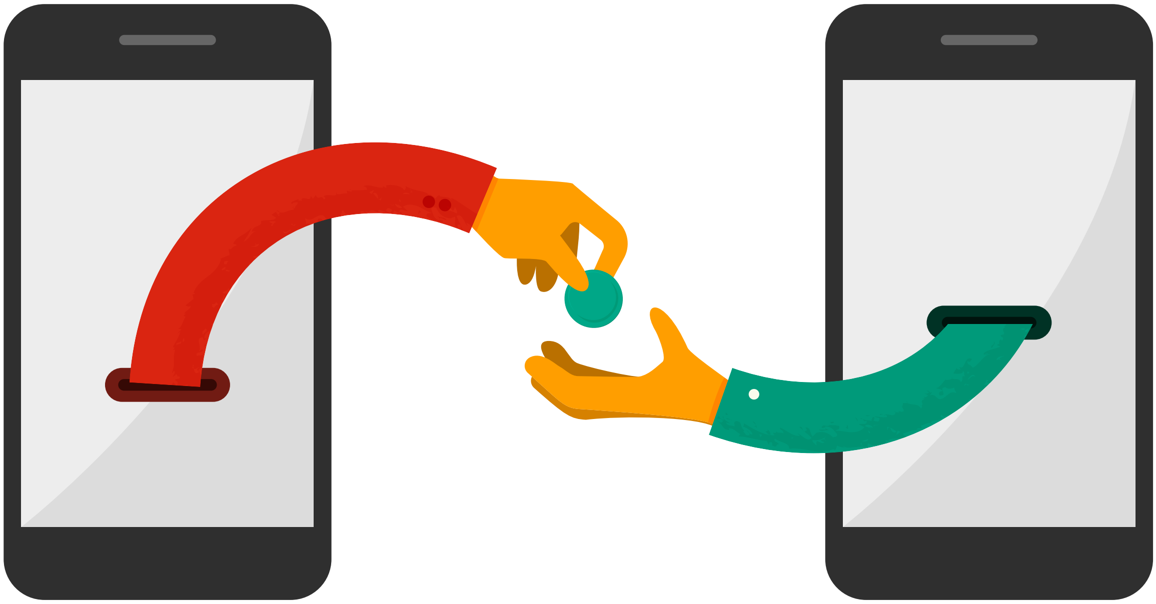
Investment options can range from a diversified portfolio of property-backed loans offering a 4% return (for example, through Octopus Choice) to self-selecting individual consumer loans that return 15% (such as through FundingSecure).

Many platforms do not charge explicit fees to investors (see table). They typically charge borrowers an up-front loan origination fee plus an ongoing loan servicing fee and also benefit from the interest rate spread between borrowing and lending.

LARGEST 10 P2P PLATFORMS OFFERING INVESTMENT THROUGH INNOVATIVE FINANCE ISA

Platform	Loan products	Launch date	Value of loans to date	Equity investors	Number of lenders	Minimum investment	Average return[2]	Bad debt rate[3]	Charges to investors[4]	Diversification/ risk reduction
Funding Circle[1]	Business: £5k–£500k	2010	£3.1bn	Venture capital investors, led by Accel Partners	78,000	£1,000	6.4%	2.1%	1% annual fee on o/s loans	Automated tool spreads investment across hundreds of loans
Zopa[1]	Personal: £1k–£25k	2005	£3.1bn	Venture capital investors, led by Wadhawan Global Capital (India) and Northzone	76,000	£1,000 (not currently open to new investors)	5.2%	3%	No direct fees	Automated diversification — no more than 1% of investment to each loan
RateSetter	Personal: £500–£35k Business: £25k–£750k Property: up to £7.5m	2010	£2.3bn	Woodford Investment Management, Artemis	61,000	£10	4.8%	3.6%	No direct fees	Automated diversification plus provision fund[5]
Assetz Capital	Business and property: £100k–£5m	2013	£434m	Private investors	25,000	£1	3.75%–6.25% (higher with self-select loans)	1.1%	No direct fees	Automated diversification, with an option to manually select loans; plus provision fund[5]
ThinCats	Business: £100k–£5m	2011	£275m	ESF Capital	N/A	£1,000	7%–8%	5.75%	1% reduction in interest rate	Up to investor — loans are self-selected
Funding Secure	Personal (backed by personal assets, such as jewellery, property, cars): £500–£100k	2013	£220m	Private investors	3,500	£25	13.4%	7%	No direct fees	Up to investor — loans are self-selected
Folk2Folk	Business: £50k–£5m	2013	£198m	Private investors	N/A	£20,000	5.5%–6.5%	N/A	1% of loan value	Up to investor — loans are self-selected
Octopus Choice	Property backed: £200k–£3m (current loan book)	2016	£170m	Octopus Group	N/A	£10	4.2%	N/A	No direct fees	Automatically invested in every loan (minimum target of 10); Octopus invest own capital; 5% of every loan
Landbay	Buy-to-let mortgages: £50k–£1m	2014	£94m	Private investors	N/A	£100	4.2%	0.1%	No direct fees	Automated diversification
Lending Works	Personal loans: £1k–£25k	2014	£92m	Private investors	3,800	£10	5%	2.6%	No direct fees	Automated diversification plus provision fund[5]

[1] IFISA currently only available to existing investors
[2] Average annual return, after fees and bad debts, but before tax — since 2010 or since inception if after 2010
[3] Average of 2014, 15 and 16 — incorporating estimated bad debt rates for years that have not yet fully matured, includes recoveries
[4] Most platforms charge bulk of fees to borrowers — eg, a loan origination fee plus a loan servicing fee and/or part of the interest rate spread between borrowing and lending
[5] Funded from the interest rate spread, covers bad debts, but is not a guarantee



Liquidity also varies greatly between platforms. It is dependent upon how the underlying P2P loans are structured and not the fact that investment is made through an ISA wrapper.

Typically, a P2P investment is not an investment into a formal fund. It is money deposited with a platform that is then used to lend directly to borrowers. On some platforms, investors can choose loans themselves while on others, the platform automatically spreads the investment across a portfolio of loans.

Once a loan is made, investors will not have access to any outstanding loan balance, but they will have access to their interest and capital repayments as borrowers repay. These repayments can be withdrawn or reinvested immediately into new loans to compound returns. So withdrawing the full value of a P2P investment will take as long as the duration of the longest loan.

A disadvantage for investors is that P2P investments are not covered by the FSCS

An exception to this is that some platforms offer a secondary market for loans, where investors can sell their outstanding loans to other investors and withdraw their full investment. This can attract a fee – Zopa charges 1%; Funding Circle does not charge – and is also dependent on a willing buyer being available. A sale is not guaranteed.

Some platforms also offer higher returns for not withdrawing funds for a fixed term. RateSetter currently pays 2.7% for its 'rolling portfolio' where investors can withdraw interest and capital repayments as they are received. But if an investor commits to not withdraw funds for a year, RateSetter pays 3.9%.

A disadvantage for investors is that P2P investments – whether held in an ISA wrapper or not – are not covered by the Financial Services Compensation Scheme (FSCS). So, unlike a cash ISA with a bank that enjoys an £85,000 'government guarantee', the capital invested into an IFISA is at risk.

The primary risk is borrowers defaulting on loan repayments. Diversifying investments across many loans and choosing platforms with rigorous underwriting processes can reduce this. Funding Circle and Zopa are examples of platforms with products that automatically spread investments across a minimum of 100 loans.

The other risk is losses due to the platform itself failing. But regulation has been structured to minimise losses in the event of this happening. Deposits not yet lent out have to be held in a segregated bank account, complying with FCA's *Client Asset Sourcebook* rules. And platforms also need 'resolution plans' that spell out how loan repayments will be collected and passed on to investors after a failure.

CREDIBILITY IS BUILDING, BUT QUESTIONS REMAIN

Some platforms have now built multi-year track records of stable returns. Most have also navigated a rigorous regulatory approval process.

But the resilience of returns has not been tested through a severe economic downturn or recession. And even though some have high-profile backers – for example, Woodford Investment Management is an equity investor in RateSetter – doubts remain about platforms' ability to run profitably. The latest financial statements of the vast majority of platforms, including the largest showed losses, some heavy.

The sector has taken major strides to become a mainstream asset class, but the job is not done.

David Gibson CFP™ Chartered MCSI, director at Gibson Financial Planning in Northern Ireland, has achieved a good work-life balance that benefits both himself and his clients, who are at or near retirement

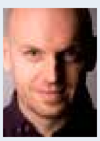
LOOKING AFTER A SMALL NUMBER OF CLIENTS WELL

When did you become an accredited firm? What has happened since?

In 2013. It was the obvious next step after achieving CERTIFIED FINANCIAL PLANNER™ certification. The fact that it was a relatively small number of firms overall who had achieved the accreditation really appealed as it sets us apart and truly demonstrates a commitment to the financial planning process.

What has accredited firm status brought to your firm and why should others seek to become accredited?

I often wondered how our firm's processes stacked up against much larger and notable firms of financial planners. The decision to go for it was based mainly on a desire to see how we compared and where we could improve, and the process was successful in highlighting those areas. Putting myself out there for potential criticism and assessment isn't something I relish but I am never comfortable standing still and always try to improve by making small, incremental steps where possible. For me, becoming accredited was as much about getting confirmation we were up there with the best as it was about gaining a market differentiator.



David Gibson CFP™ Chartered MCSI

David graduated from Queen's University with a law degree and shortly after joined the family firm, W.J. Gibson & Co in 2001. He set up Gibson Financial Planning in 2010.

As a CFP professional, he is committed to the highest standards of financial planning and has a strong desire to constantly improve, adapt and embrace change.

He chairs the steering group of a local charity, which was set up to provide support for adults who have experienced trauma and need support to work through their situation.

What sort of business is it and what services does it offer? What's your USP?

We are clear that our target market is for clients at or near retirement. Our clients will generally be 55+. My dad, who started the firm, naturally had clients his own age, and when I began to take financial planning seriously, I realised our client bank was of a certain age, so I tailored our services for them. I find that retired people are a perfect match for us – they are looking for a safe pair of hands, don't want the hassle of looking after their own affairs and value what we do for them. I was determined from the outset to strike a good work-life balance and retired people can come in to the office during working hours, which helps!

CFP™ certification truly demonstrates a commitment to the financial planning process

How did you get into financial planning?

Like many, I fell into it. When I graduated from university with a law degree, the plan was to work in a clothes shop for six months and travel for the next six – I had decided not to pursue law because the thought of spending the rest of my days conveyancing or dealing with company law didn't appeal. After six months at the clothes shop, my dad offered me a job. I sat in on meetings with my dad and the other advisers, receiving on-the-job training while also completing a certificate in financial planning. I qualified within a year and started off advising on mortgages but never enjoyed it. In 2010 my wife and I took a trip to Nepal with the expectation that we'd both change direction/jobs/location. The opposite happened and we realised what we had back home. At that point I began to take the lead at the firm and my dad began to ease out of the business. I took a hard look at how we did things, what we did and what I wanted to do. We were always looking for new clients, and I realised that capacity might be an issue, and that my preference would be to look after a smaller number of clients well. Simply telling them how their investments had performed over

The Gibson Financial Planning team:

Top row, left to right: David Gibson, director; Abraham Okusanya, technical research analyst; and Karthica Underwood, paraplanner

Bottom row, left to right: Derek Doey, financial planner; and Kate Porter, office manager.

the past year wasn't going to cut it, so the holistic financial planning approach using cashflow modelling seemed like the best way forward. We rebranded the firm, I achieved my CFP certification and gradually introduced financial planning to our clients. Now that's the core of what I do.

What's the best thing about being at a financial planning firm?

This might sound clichéd but I genuinely get a sense of fulfilment at work and a lot of that comes from seeing the positive impact we can have on a client's life. For sure there are times I want to bang my head on the desk and there are not so good days, but I'm lucky that I do enjoy my work.

I've adopted as much technology as I can and delegate and outsource where possible

What do you like about the CISI?

It's still early days, but I do get the sense that the importance of true financial planning has sunk in and that this is a professional and large organisation with the power to make a really positive difference to our profession.

What does a typical day look like?

I have a four and a six-year-old at home and almost without fail my clients tell me to make the most of them at this age as you'll never get that time back if work is your main focus. I try to take this on board. I'm usually in the office for 8am – I'm fortunate to live three miles away so I waste very little time commuting. I find that it's a very productive hour when the phone doesn't ring and no one else is there! I try to incorporate a mindfulness session in my daily routine and usually slot it in this hour too. I'm addicted to cycling and compete in time trials, and, as such, I train six days a week. I am being coached and I have a training plan to follow each week. I fit this training into my schedule – usually late morning or over lunch or late afternoon. The majority – 90% – of our revenue comes from existing clients so most meetings are about ensuring that they are on track and keeping up to date with their circumstances and plans.

What are your key tips for other planners?

I've adopted as much technology as I can in the business, and delegate and outsource where possible. This frees up loads of time and keeps stress to a minimum. Figure out what part of your job you love and what you don't like. Offload what you hate doing or change how you operate. ●

CAREFREE CARE FUNDING

Martin Ruskin CFP™ Chartered MCSI helps his client receive the care she needs without having to sacrifice her family home to pay for it

MARTIN RUSKIN VERONICA GRECH/IKON

THE BRIEF

Brenda, an 83-year-old widow who had lost her husband some five years ago, had suffered a stroke, been discharged from hospital and moved into a local nursing home, which her son had helped to choose.

Brenda's financial resources were sufficient to make her ineligible for local authority help to fund the cost of her care, which was around £30,000 per year. She was proud of her financial independence and didn't wish to live off state handouts or have the quality of her care dictated to her. However, she was concerned that her life savings would be eroded and that she might have to spend all of it on care.

Her attorney (a partner in a local firm of solicitors) approached Paradigm Norton for advice on how best to support her care fee funding and placed particular emphasis on Brenda's wish to retain the family home of more than 30 years, as it had always been earmarked for her only son.

Dealing with later life issues, such as funding for care, has become increasingly commonplace and, having worked alongside solicitors for many years, we've experienced an increasing demand for our professional advice and guidance when they are acting in the role of attorney or deputy to ensure that they are able to make sound choices when it comes to the financial implications of care funding for their clients.

Working with Brenda's attorney, we began to assess her financial position. We ascertained that she would not be eligible for continuing healthcare payments and she would therefore need to fund most of her care costs, which would be in the region of £2,500 per month. Her ongoing legal costs were expected to be a further £2,500 per annum.

We asked her attorney to complete a long-term care questionnaire, which is similar to a client fact find, and identified that Brenda had cash savings of £60,000, her home was worth £350,000 and she had a discretionary managed portfolio through her stockbroker worth £350,000, plus other ad-hoc investments worth £50,000. Her regular secure income amounted to around £20,000, meaning that there was an immediate identifiable shortfall of around £12,500 per annum.

The investment portfolio was moved to a more diversified and lower cost arrangement

We prepared for her attorney a care fee funding report to highlight the various ways of funding for care and included, using agreed assumptions on cash and investment returns, care fee inflation, and other factors, the long-term impact should funding be from: cash; cash and investment; cash and specialist annuity and a combination of all three. While the priority was to ensure that the care fees were fully funded, we also took into consideration Brenda's wish for the family home to not, if possible, be sold.

To aid assessing any investment option, the attorney also completed a risk profile questionnaire. From this, we established that a moderate approach to risk was deemed appropriate.

Once our analysis was completed and the report issued to the attorney, we had a meeting to discuss the options outlined and their potential impact on Brenda's short, medium and long-term cashflow. We highlighted that the investment portfolio was heavily invested in equities and predominately UK-orientated (and therefore not in keeping with our view on what constituted a moderate portfolio) and that the total charges being applied were high.

Brenda has peace of mind that her care costs will be covered throughout her lifetime

The outcome of these discussions led to specific recommendations being made, which included:

- Retaining a high level of cash (£40,000) for personal expenditure and emergencies.
- An Immediate Care Plan (ICP – an annuity that pays for long-term care) purchased for £100,000 to fund the shortfall in care fees, with payment directly to the nursing home (which meant that the annuity was tax-free).
- The investment portfolio was moved to a more diversified and lower cost arrangement with the principle objective of providing inflation protection.
- The family home was retained and looked after and occupied by her eldest granddaughter.

The ICP provided a tax-free income of £12,500 per annum, payable monthly, directly to the care home. A short guaranteed period was included and inflation protection of 5% per annum purchased. We used a common application form which enabled us to apply to several specialist ICP providers at once, and, following underwriting and terms being issued, we could then assess the best rates in the marketplace for Brenda's specific requirements. While mitigating a potential charge to inheritance tax (IHT) was not a priority, the annuity purchase meant that £100,000 was immediately taken out of her estate for IHT purposes.

For Brenda and her attorney, the result of our planning being centred on her needs, fears and financial requirements means that she has complete peace of mind that her care costs will be covered throughout her lifetime; her capital should last longer than her; and the family home doesn't need to be sold.

We were able to ensure that her assets were optimised to provide access to capital throughout her lifetime within a tax efficient, low-cost portfolio, thereby minimising charges and potential tax liabilities and that her family, rather than the state, would be the primary beneficiaries of her estate.

MARTIN RUSKIN CFP™ CHARTERED MCSI

Martin works at multi-award winning Paradigm Norton Financial Planning, based in the Torquay office. He is a director of a successful joint venture with a regional firm of solicitors and is also currently chair of the CISI Financial Planning Forum. Martin has been involved in the financial services profession for more than 25 years.

Martin is passionate about the positive impact that financial planning can have in people's lives, while also believing that money matters, but life matters more.

Hear more from Martin Ruskin at our Paraplanner Conference 2018, where he will be talking about 'Working relationships with financial planners – overcoming differences of opinion'. Find out more at *cisi.org/paraconf*

WHAT HAPPENED NEXT

As with any planning, it needs to be revisited each year to ensure that it remains fit for purpose. As such, an annual review and planning meeting is held with the attorney to ensure that Brenda's financial needs and ongoing wishes are met.

The attorney knows that the comprehensive approach of both our initial work and continuing advice ensures that they are meeting their legal obligations and this provides peace of mind for them also.

Important documents are missing a witness signature. Holly, not the appointed witness, decides to sign them herself rather than disturb the witness at a time of grief. How should her manager respond?

ISTOCK

A SIGN OF THE TIMES?

Holly works for a small firm of wealth managers, where she has been employed for several years. She supports Alex, an experienced manager in servicing clients' needs. Alex thinks highly of Holly, whom she regards as possessing all the requirements for becoming a manager before too long.

Alex and the firm have helped their important clients, the Harris family, arrange their assets to reduce the impact of inheritance tax, including the setting up of various forms of trust arrangements. Regrettably, Mr Harris was diagnosed with cancer and although the initial prognosis was that he should live for several years, it soon became apparent that this was unlikely. Consequently, all his tax arrangements were reviewed, and Mr Harris was required to sign several documents. Alex asked Holly to ensure that this was achieved with as little disturbance of the Harris family as possible. The documents required not only the signature of all the trustees, but also that the signatures be witnessed, so it was a time-consuming process.

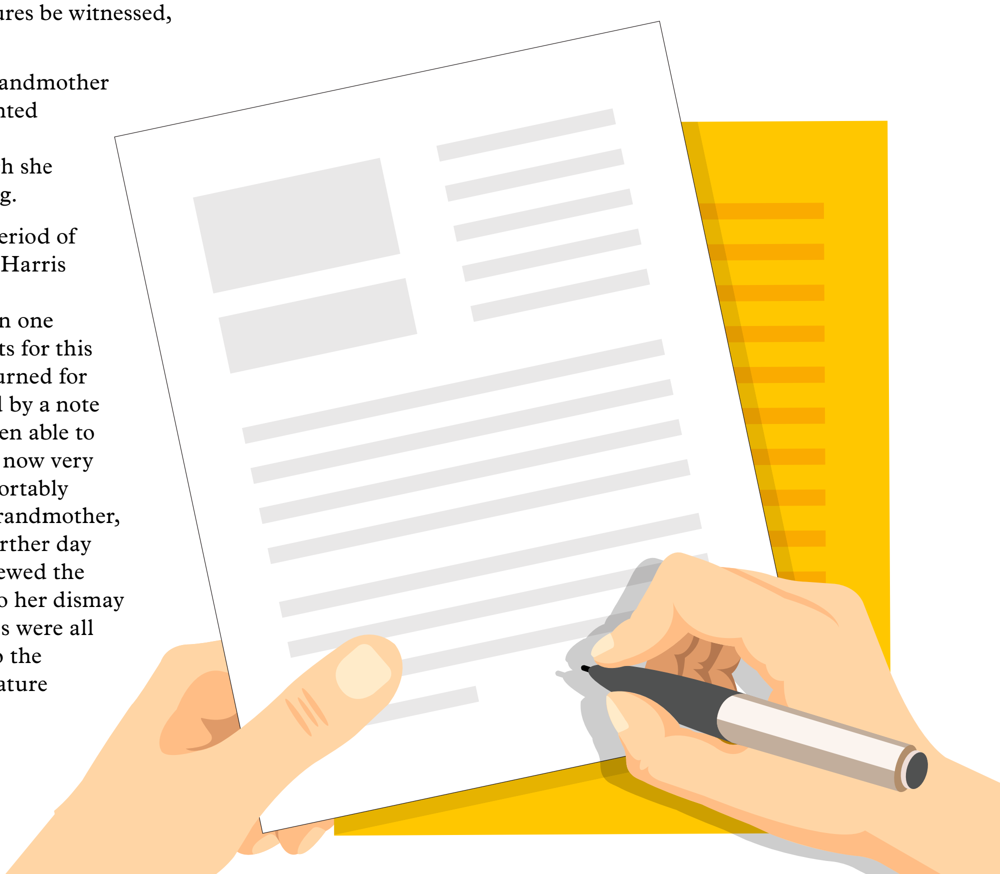
Meanwhile, Holly learnt that her grandmother was also seriously ill. Holly was granted time off to go on what subsequently turned out to be her final visit, which she understandably found very upsetting.

On returning to work after a brief period of grievance leave, Holly reviewed the Harris family documents and found that Mr Harris's signature was missing in one place, so she returned the documents for this to be completed. They were not returned for several days, and were accompanied by a note suggesting that, although he had been able to sign the documents, Mr Harris was now very close to death. Holly, being uncomfortably reminded of the recent loss of her grandmother, put the documents to one side. A further day passed before Holly once again reviewed the documentation, when she realised to her dismay that although Mr Harris's signatures were all complete, one of the other parties to the arrangement had not had their signature witnessed as required.

Imagining the situation in the Harris family household, Holly wondered what she should do. She could not send the documents back at this time but, on the other hand, Mr Harris might die before they were fully complete and effective. Alex was on leave and not due to return to the office for another week, so Holly was unable to discuss the situation with her.

Holly realised, to her dismay, one of the other parties had not had their signature witnessed

Holly could see that the witness completed the rest of the form correctly and inserted their signature at other necessary points throughout. She therefore believed that the trustee's signature was witnessed properly, and the omission of the witness's signature on this page was an 'honest mistake'. She decided that as all



the parties to the documents were known to her, at least to the extent that their signatures appear frequently on Harris family documents, she would sign her own name in the blank witness signature space and, in doing so, effectively act as a witness in this case. After all, she rationalised to herself, it was only the confirmation of the trustee's signature and what alternative did she have? She could not afford to delay matters, and had been given strict instructions to not upset Mr Harris or his family.

Over the next few days, Holly wrestled with her conscience and decided that when Alex returned to the office, she would tell her what she had done and accept the consequences. Alex returned and met with Holly for a review of what had happened in her absence. Holly told her about the situation with Mr Harris, the difficulties that she had encountered in obtaining all the necessary signatures and reassured Alex that she had resolved them all, just in time, as sadly Mr Harris had passed away the previous day. Alex thanked her for what she had done, but then Holly, unable to contain herself any longer, explained that there had been a missing witness signature, and that she had inserted her own signature to confirm the authenticity of the original.

HOW SHOULD ALEX RESPOND TO HOLLY'S ACTIONS?

1. Holly should be fired for gross misconduct. She was not a witness to the trustee's signature, and has therefore fraudulently inserted her own name in the documents.
2. Alex should acknowledge that Holly was left in a tough position and did what she thought was right in the circumstances. However, she did make some serious mistakes, so should be required to undertake further training, and must have all her work strictly supervised for a set time.
3. Holly clearly knows that her actions are wrong, and Alex trusts that she would not behave in this manner under normal circumstances. Furthermore, Alex realises that her own actions, including telling Holly to ensure the paperwork was completed with minimal disruption to the Harris family, and leaving her without supervision during a critical time, contributed to the issue arising. Therefore, she should not take any further action at this time.
4. Holly should face disciplinary action, but the sanction should be short of dismissal, considering Alex's responsibility in the situation arising as well as the exceptional circumstances presented by this case. ●

WHAT WOULD YOU ADVISE?

Visit *cisi.org/signofthetimes* to share your views. The survey results and CISI's opinion will appear in the Q3 print edition of *The Review.*

GOLD DIGGER: THE VERDICT

This 'Grey matters', published in the Q1 2018 print edition of *The Review*, raises a tricky matter for a financial adviser, Karlie, who finds herself worried that one of her client's personal relationships may damage their financial security. Walking a balance between personal and professional relationships with clients often presents difficult dilemmas for professionals, and this is reflected in the variety of responses received. A selection of these will be published at *cisi.org/gold-diggerverdict*

This dilemma was suggested by a CISI member – for which we offer our thanks. Should you wish to suggest dilemmas, please contact us at *principles@cisi.org*.

Options offered and results are as follows:

A. Things change, and Karlie's concern is an overreaction. Jan is happy, and still has ample funds in her name. It would not be appropriate for Karlie to take any action at this stage. (5%)

B. She should tell Jan that she is not prepared to give piecemeal advice, and that unless her access to the pension policy is reinstated she will have to stand down as a point of principle. (6%)

C. She should insist on meeting with Jan alone when she has returned from holiday, and set out her concerns, including how marriage to Paul might affect the wishes she set out when she initially appointed Karlie as her adviser. (59%)

D. Karlie should have realised that Jan's brain haemorrhage made her a vulnerable client all along. It is clear that Paul is now controlling her and, as Jan has no close family, in order to safeguard her interests Karlie should report her concerns to the care authorities. (31%)

Most of the comments speak about the duty of care Karlie owes to Jan, but opinions differ about what form that should take. The most popular option is that Karlie speak to Jan alone (option C), which also gives Karlie the opportunity to establish whether her worries that Jan is a vulnerable client are founded.

However, 31% of respondents say the information they have to hand is enough to identify Jan as a vulnerable client (option B), and that immediate steps should be taken.

The signs that Jan is (and has been) a vulnerable client are compelling – she previously suffered a significant health problem, is widowed, recently appeared confused and forgetful, and is now making choices which seem incompatible with her goals. While waiting for a face-to-face discussion with Jan is an appealing option, Jan and Paul are meant to be away for several weeks, and the situation may escalate during that time. They may even get married.

For this reason, it is recommended that steps are taken now to safeguard Jan's interests. The care authorities and/or Jan's remaining family should be informed of the situation, and Karlie should consider consulting with a compliance professional. Option D is the CISI's preferred option.

WHAT NEXT?

Graham Bishop, European financial affairs adviser, outlines some of the practical realities facing the financial services sector over the summer

GRAHAM BISHOP ISTOCK

Whatever happens with Brexit, one of the EU's top priorities is the completion of 'banking union' to ensure that EU taxpayers never again foot a mega-bill to bail out banks. Banking union as an aim was launched in 2012 in the heat of the euro crisis. It was seen then as a vital step to saving the single currency, which was threatened by a negative feedback loop between sovereign debt in weaker, 'peripheral' countries and their domestic banks. Now, it stands for the European project itself.

DECISIONS BY EUROPEAN COUNCIL OF HEADS OF STATE/GOVERNMENT

- 29 March 2017: Notification under Article 50 of UK's intention to withdraw from the EU
- 15 December 2017: Agreement that "sufficient progress" had been made in the first phase so enabling discussions on the second phase of the withdrawal; the transition period and the framework for the future relationship
- 23 March 2018: Update on progress; EU27 adopted guidelines on the relationship with the UK after Brexit. There will be a simple political declaration accompanying the withdrawal agreement
- 28/29 June 2018: [Update on progress – hopefully agreeing the withdrawal and the transition arrangement, so leaving only the `future relationship' framework]
- 18/19 October 2018: [Planned completion of the withdrawal agreement/future relationship]
- 00.01 30 March 2019: EU Treaties cease to apply to UK, so UK has 'third country' status
- 31 December 2020: Transitional arrangements cease

The importance of the eurozone banking system is clear: its total balance sheet is more than 250% of eurozone GDP, whereas public debt is now less than 90%. Before the financial crash, public debt used to be "undesirably high" at just 65% of GDP. It hit 95% as taxpayers supported 'their' banks.

What has already been achieved more widely and can the eurozone make banking union a reality? The eurozone already has a single supervisory mechanism, and a single resolution board. It is also giving more power to Euro area regulators with an enhanced role for bodies such as the Eurogroup of finance ministers. Talk of a euro area finance minister suggests this part of the integration process has some way to run, but there is determination to get there. Banking union, with a European deposit insurance fund, is probably the final prize.

Anyone who thinks that it will be easy for the EU to grant the UK a bespoke deal on financial services needs to understand what the EU27 thinks is at stake. After all, the great financial crash had its European headquarters in the City of London and has resulted in a restructuring of the EU's economic governance rules. The crisis forced the whole thrust of financial regulation within the EU to move on from "mutual recognition" to a single regulator, such as the Single Supervisory Mechanism for the banking system.

Over the summer, it is likely that the outline of a 'political agreement' on the future relationship between the UK and the EU will emerge. But it is unlikely there will be much detail as that will only be negotiated when the UK is a 'third country' during the transition period – when it will be a supplicant rather than a key player in the rule making. For a business's strategic analysis, the transition deal is of little significance – the future trade deal is the key and the EU's guidelines are instructive as, so far, the UK has achieved no significant changes during the negotiation on guidelines for the earlier phases.

GUIDELINES – WITHDRAWAL, TRANSITION, FUTURE

The 23 March European Council (Art 50) agreed a seven-page negotiating mandate for the future EU/UK relations (distinct from the transitional arrangements). Several paragraphs of the guidelines are exceptionally relevant for the future of the City's prosperity and are set out in the box on the right. There is scant trace of any suggestion of mutual recognition.

'CANADA PLUS PLUS PLUS' – WHAT IS IN CETA?

So we come back to the EU27 talk about Canada's 'comprehensive and economic trade agreement' (CETA) deal as the only plausible template.

What could this actually mean for financial services? Chapter 13 of the CETA document is about financial services and runs to just 14 pages – with 13.16 perhaps the most difficult article for the UK as it is entitled 'prudential carve-out' and provides that "a party may, for prudential reasons, prohibit a particular financial service or activity". That short sentence opens the way for the EU27 to protect itself against another financial crisis by requiring any provider of services into the EU to comply not only with EU rules, but also the necessary enforcement process provided by the European Court of Justice. That is exactly the meaning of the Guidelines.

Banking union as an aim was launched in 2012 in the heat of the euro crisis

Once the EU27 has completed its banking union, it is difficult to see an offer of reshaping it just to meet the wishes of British exceptionalism. UK wishful thinking about 'Canada plus plus plus' may collide with firm and oft-repeated EU27 statements about "no cherry-picking".

In any case, 'Canada plus plus plus' is vulnerable to a bigger problem, The UK Trade Policy Observatory argues the EU is likely to reject a bespoke 'Canada' trade deal for the UK for a simple reason. "The MFN clause means that any CETA+ commitments made by the EU in an existing or future trade agreement with a third country (eg, the UK after Brexit) must be extended to Canada in the relevant dimensions." (See box below.)

EQUIVALENCE

As ECON Rapporteur, MEP Brian Hayes recently published a draft European Parliament report on the EU's relationship with third countries for financial services. He argues that the "time is right to completely reform our equivalence rules, particularly in light of Brexit" and call for a stand-alone financial services agreement between the EU and the UK.

His analysis is strong: if the City is "realistically planning to rely on equivalence as the platform for post-Brexit single market access for the City of London, then we will have serious problems for financial services cooperation between the UK and the rest of the EU. It is a very limited form of access". While his report does not deal with the Most Favoured Nation problem, the EU27 Guidelines implicitly do: access for financial services will be entirely on EU terms. ●

THE EUROPEAN COUNCIL ON FUTURE EU/UK RELATIONS

7. Para 3 "The European Council further reiterates that the Union will preserve its autonomy as regards its decision-making, which excludes participation of the United Kingdom as a third country in the Union Institutions and participation in the decision-making of the Union bodies, offices and agencies. The role of the Court of Justice of the European Union will also be fully respected."

8 (v): "trade in services, with the aim of allowing market access to provide services under host state rules, including as regards right of establishment for providers, to an extent consistent with the fact that the UK will become a third country and the Union and the UK will no longer share a common regulatory, supervisory, enforcement and judiciary framework"

12. "the future relationship will only deliver in a mutually satisfactory way if it includes robust guarantees which ensure a level playing field. The aim should be to prevent unfair competitive advantage that the UK could enjoy through undercutting … This will require a combination of substantive rules aligned with EU and international standards, adequate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement mechanisms. Any future framework should safeguard financial stability in the Union and respect its regulatory and supervisory regime and standards and their application."

FROM THE MOUTH OF THE WTO

Most-favoured-nation (MFN): treating other people equally: "Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members".

Source: WTO website

About the author

Graham Bishop is an expert on European affairs. His commentaries have covered the bond and currency markets of Europe and he has authored Citigroup research on issues surrounding monetary union. As adviser on European financial affairs at Citigroup in London, he reported to the co-CEOs in Europe. Full details on Graham and his services are available at *grahambishop.com*, and he can be seen live on CISI TV once a month in 'Brussels for Brunch'.

HAVING A LAUGH

What do you call a Portuguese data analyst who performs stand-up comedy as a hobby in Scotland?

LORA BENSON

Luis signed up for a stand-up comedy course during the Edinburgh Fringe Festival

Love it or hate it, the *Eurovision Song Contest* allows the winning country an opportunity to host the following year's contest and showcase its homeland. This year was Portugal's turn in the spotlight, following its winning entry in 2017.

Originally from Portugal, Luis Alcada ACSI, a data analyst at Alliance Trust Savings in Dundee and a stand-up comedian in his spare time, has enjoyed the opportunity to answer questions about the country that are not football related.

"In Portugal, most local art is seen as very 'uncool', so hopefully the *Eurovision Song Contest* will change that. I'd love to appear in a *Eurovision Comedy Contest* if that's ever created!"

Luis graduated from Dundee University in 2010, having studied accountancy and finance. He gained an internship as a fund accountant at BNP Paribas immediately after graduation, so decided to stay in Scotland, eventually settling at Alliance Trust Savings.

Luis signed up for a stand-up course during the Edinburgh Fringe Festival a couple of years ago and has been hooked ever since. "It's the perfect hobby if you like adrenaline but are in terrible physical shape, like me. A lot of my work is stripping down processes to essentials, so I've carried that approach into my creative outlet."

"I'd love to appear in a Eurovision Comedy Contest if that's ever created!"

His first experience of performing was dire: "As part of my stand-up course I did a five-minute set at a club in Edinburgh. I did mostly observational humour about UK culture. It was a disaster, but I got enough laughs to encourage me to try again."

His second show was at an open mic night. "It was a dingy, gothic pub. I completely 'died on stage'. The next morning I was at a comedy showcase where they asked if there were any comedians in the audience. I lifted my hand and found myself performing my third set. It went down brilliantly."

Coping with negative feedback is all part of the deal. "If you can't work it out, you can always be thankful that at least you suffered your public humiliation right next to a fully stocked bar."

Luis writes down any funny ideas as they occur. "I like to exaggerate my experiences [of Portugal] and portray a dark, crime-infested and underdeveloped country. I also like bigger issues like religion and philosophy, but I'm still working my way up to them."

Luis loves the Icebreaker Comedy club in Dundee: "I'm there often so a lot of them already know me, which is half the battle."

He also enjoys competing to hone his skill. "The Monkey Barrel Club in Edinburgh does weekly competitions. They attract professional acts that have been doing it for over ten years. I still haven't managed to win but I'm hopeful for next time!"

His hobby has made him more comfortable about having difficult or awkward conversations in his day job: "Once you train yourself to address these things head on, they become easier. The downside is that it makes censoring yourself before you speak much harder."

Luis once opened for Andrew O'Neill when he toured Scotland. "He was incredibly supportive and he gave me a lot of tips about the craft." Luis also performed with Phill Jupitus at The Stand. "He was nice, but like a lot of comedians he came across as shy and quiet in person."

Luis says there are two attributes a person needs to become successful in stand-up comedy: "First, self-awareness. You can be as shy, awkward or offensive as you want, provided the audience realises you're aware of it and that you're comfortable and confident about it. But it's amazing how quickly an audience is lost if they're distracted by anything unusual – an accent, physical features or even room temperature – and the speaker doesn't address it.

"Second, persistence. I'm constantly shocked by how many comedians are absolutely brilliant on stage but are unknown outside the stand-up community." ●

Contact *jane.playdon@cisi.org* if you have a hobby you think will interest other CISI members. You will receive a £25 voucher if we publish your story.

Dialogue of the deaf

Asset managers are failing to make the case for investments over cash

ANDREW DAVIS JOHANNA WARD

Anyone who has sat in a lecture hall, especially after lunch, knows the risk of nodding off. And if they happen to have wandered into the wrong lecture, only to encounter particle physics when they were expecting Spanish literature of the Golden Age, the chances of emerging with any worthwhile insight are even lower, whether or not they manage to keep their eyes open. It sounds like the stuff of comedy, but something similar happens frequently in the personal finance market, as the asset management sector reprises its sermon to the nation's savers on the dangers of the cash ISA.

As you might expect of any lecture delivered by the asset management sector, the message is an artful combination of rational argument and special pleading. The crux is that over the past few years, interest rates have frequently been lower than the rate of inflation, meaning that price rises outstrip the return savers can earn from interest income.

People do not always have a good grip on inflation and its effects

The purchasing power of cash, therefore, goes backwards. Swiss Bank UBS recently published figures showing that over the past five years, during one of the lowest-returning periods in history for cash, the British public put more than 70% of their ISA subscriptions into cash ISAs: £239bn against £101bn that went into stocks and shares ISAs.

Over those same five years, the bank said, the MSCI World Index made four times the return available from the best cash ISAs. If the nation's cash ISAs had performed as well as an MSCI World Index tracker, they would now be worth an extra £2,132 each on average, or £46bn more in total.

It's a striking way to make a well-worn point but the evidence overwhelmingly suggests that the public will once again ignore the lecture from the asset management sector and continue to prefer cash. And so this dialogue of the deaf goes on.

CASH ERODES WEALTH

Strictly speaking, of course, the asset managers are right: negative real returns on cash erode wealth. But there are numerous factors that prevent people from heeding their warnings: they can't see the problem, they don't trust the lecturer and the argument being put to them is flawed because it is theoretical and so fails to take account of their circumstances.

First, consider the problem of perception. Inflation is obvious in some contexts – rising food, fuel and clothing prices, for example – and much more difficult to read in others. Despite the widely-shared belief that house prices have risen strongly since the financial crisis, for example, recent research by the BBC and the Open Data Institute finds that after adjusting for inflation, they have actually fallen in 58% of council wards across the UK. People do not always have a good grip on inflation and its effects, and many will struggle to discern the relatively subtle, long-term threat to their savings from rising prices.

It is too soon to start writing obituaries for the cash ISA

Equally, most people don't trust financial markets or those who work in them, which makes it unlikely they will take much notice of asset managers encouraging them to put their trusted cash savings into what they might well view as a risky punt.

Then there are the practical problems with the case against cash. Of course, if people had invested in the MSCI Index instead of cash they would have made higher returns. But the two are far from interchangeable. They would only have made four times as much if they had stayed invested throughout – what if they'd needed to dip into their savings, as recent figures show they do? Cash is flexible, investments less so. People understand this and to gloss over the difference is unhelpful. The real question is how I work out how much cash I need to hold, given my circumstances. Banks, it should be noted, who need my deposits to fund their profit-making activities, have no incentive to help me arrive at the answer.

INTEREST RATES CLIMB

Now that interest rates look set to climb, I cannot see the public starting to pay more attention to the asset managers' lectures. Quite the opposite, in fact. The sector's case gets weaker as real-terms savings rates become less negative because the penalty people pay for holding on to their comfort blanket of cash decreases.

The amount going into cash ISAs has declined, partly because the savings tax allowance has made them unnecessary for most people – at 1% interest rates, you need more than £100,000 in a cash ISA to get any benefit as a basic-rate taxpayer. However, it doesn't take many rate rises from here to make cash ISAs worth considering once again. Equally, if markets become more volatile as they adjust to rising interest rates, this is likely to make people even more inclined to put their trust in cash and steer well clear of stock markets. All this suggests to me it is too soon to start writing obituaries for the cash ISA. It might not be due a full-blown renaissance, but I suspect there's life in the old dog yet.

REGULATORY UPDATE

CHRISTOPHER BOND, CHARTERED MCSI, EDITOR

FROM THE EDITOR

The world threatened to stop when the updated Markets in Financial Instruments Directive (MiFID II) started in January 2018. Thanks to massive preparations by firms and flexibility from the FCA, it didn't. But much remains to be done on detailed implementation. And now there is a new challenge – the General Data Protection Regulation (GDPR), which started 25 May. A simple change on the surface but very time consuming in the detail. These two events have obscured a raft of other regulatory changes which this section describes for senior managers to confirm what their compliance departments should be doing.

Christopher Bond, Chartered MCSI

bondchristopher@btconnect.com

CHANGES FOR ALL FIRMS

EU GENERAL DATA PROTECTION REGULATION IMPLEMENTATION DATE 25 MAY 2018

The next 'elephant' after MiFID II. It affects both wholesale firms (anti-money laundering (AML) individual information and staff lists) and retail (customer and staff) data. Some impacts – using data for marketing, including adviser lead lists, without specific consent are now illegal; the difficulty in identifying all individual data held on a firm's different servers and employees' computers; deciding whether you and your outsource providers are a 'controller' or 'processor'; putting in place data processing governance, risk assessment, policies and procedures, eg, so that breaches can be notified to the regulator within 72 hours, training, systems tools and templates, and monitoring all of this. Firms with branches and overseas head offices or outsource providers have complications. The FCA has indicated a thematic review of cyber protection by firms ("One of the things that is coming very fast on our to do list is resilience and cyber risk and appropriate protection of data"). Comments were for insurance but likely to be applied to the retail investment sector in future. The Facebook data furore and the search of Cambridge Analytica's offices by the Information Commissioners' Office are indicative here.

MIFID

It is clear that many firms and the regulator continue to struggle with implementation. Problem areas include: regulatory reporting; best execution; the portfolio 10% value drop rule (which platforms, stockbrokers and model portfolio managers firms are interpreting differently); the historic figure of past performance used in Key Information Documents; how to disclose fees and charges to retail and institutional clients (again different practices) and what is 'research', eg, trade ideas; how the inducements rules apply to 'minor non-monetary benefits' and whether if managers absorb research costs, they will increase fees to clients. The FCA is also struggling with transaction reporting (increased from 20 million to 30 to 35 million reports daily).

There is a change of tone on forbearance for late firms - Andrew Bailey, CEO of the FCA, said: "To be clear, it is not our intention to offer forbearance; we expect firms to comply with their obligations. But we thought it important to confirm that we would not use our enforcement powers in a disproportionate manner". There is no sign yet of any follow up thematic review though research costs are the most likely area for one.

BREXIT

The conditional agreement on a transitional period is likely to encourage some firms from implementing their contingency plans. The Bank of England has issued guidance that 'passporting' will continue during it. However, the European Central Bank (ECB) says that this depends upon the Brexit final agreement (where there is disagreement on whether access should depend on the EU's judgement on continuing equivalence (EU), or permanent unless rules diverge (UK). This leaves firms in a dilemma, particularly since the ECB has said that new licence applications for EU entities by UK firms must be made by June this year. A key issue for asset management is whether some EU countries, particularly France and Germany, will take a strong position on refusing EU entities' ability to delegate investment management to UK firms (the Investment Association estimates that the UK manages £2.6tn of non-UK assets, including £900bn from Ireland and Luxembourg).The French AMF said: "When we give authorisation to new managers, we need to be sure that there are enough people to control the delegation"). There are similar wonders about 'back-to-back' trades between EU and UK entities, UK insurance companies writing policies for EU entities, and for all firms, concerns about bringing in EU nationals to the UK. Donald Tusk, European Council President, has said that a Canada-style free trade agreement is not consistent with mutual recognition of financial services.

FINTECH

The trend towards this is becoming irreversible with the UK government, regulator and large and small financial firms joining in. Some examples:

- The FCA is taking its regulatory 'sandbox' global – and separately has signed a 'bridge' agreement with Australia for mutual recognition of fintech standards.
- Big high street banks such as Barclays and RBS are offering incubators to fintech firms to provide future services to it.
- They (and others) are promoting robo advice.
- 'Real' robo advisers are 'marching in' using artificial intelligence.
- Financial advisers are using machine learning to analyse large amounts of data to provide investment advice to clients.
- Wholesale firms are driven towards fintech, particularly in executing trades (to meet new 'best execution' requirements), transaction reporting within milliseconds and recording electronic trades.
- Even regulators are using it in their investigations of firms' marketing materials (machine learning is "five times better" than random searches for finding "language that merits referral to enforcement"– US SEC).
- Most importantly of all, big tech is partnering with big banks to provide bank accounts to users (eg, Amazon and JPMorgan), and stock exchanges and clearing houses grow increasingly concerned that big tech will provide infrastructure to firms (eg, using blockchain to settle trades). A fascinating parallel discussion is taking place on how big tech should be taxed. The EU, including the UK, is considering a tax based on revenues rather than profits; the US (where big tech is based) is resisting this.

REGULATION OF CRYPTOCURRENCIES

The regulators disagree on whether these (such as bitcoin) should be regulated. The Japanese Financial Services Authority has done so. This has contributed to a market boom in it and others such as XEM, but it has been blamed for failing to supervise two large crypto platforms/custodians (MountGox and Coincheck) which have collapsed through fraud. Regulators are aware of investor demand and are caught between allowing this and the risk of fraud and their use for the dark web. The European Banking Authority is cautious about regulating them, preferring to ban banks from supporting them. Mark Carney says they need to be "isolated, regulated or integrated" into regulation. "The time has come to hold the crypto-asset ecosystem to the same standards as the rest of the financial system. Being part of the financial system carries enormous privileges, but with them great responsibilities". However, global regulators have decided to take no action for now. The FCA has also warned against fraudsters encouraging individuals buying cryptos. The Bank for International Settlements is concerned that its relationship with mainstream finance (eg, listing on the CME Exchange or opening accounts with banks such as Barclays) will cause systemic risk. The jury is out on whether they should continue without regulation, heavily regulated, for links with conventional finance prohibited or simply banned. The UK Treasury has announced the establishment of a 'task force' to "harness the benefits of this technology while guarding against the risks it poses" (perhaps a prelude to regulation). Investment managers are also having to understand how they work, and to consider whether they are becoming a mainstream investment. Bitcoin has halved in value from approximately £15,000 to £7,500 recently.

FINANCIAL OMBUDSMAN SERVICE

Here are some figures showing its growth and why its funding is likely to change. Ten years ago the FOS had 350 staff and handled 20,000 cases. Today there are 4,000 staff handling 500,000 cases. Much of this is from Payment Protection Insurance (PPI) claims, but there is an important shift in its use. In the past it was the ultimate resort for unsettled claims; now it is the first port of call for

both firms (through rejecting claims) and unhappy clients. After PPI claims finish, this shift will remain. The good news is that complaints against advisers fell 16% in H2 2017 (816 against 966 in H1 2017). Of these new complaints, 34% were upheld against 43% in the previous six months. However, a landmark judgment held a network responsible for the fraudulent activities of its appointed representative.

FIRMS' CULTURE

Andrew Bailey has again focused on the culture of regulated firms as a current priority, but the FCA has learnt its influence on firms' culture is only partial: "The question is not whether to focus on the individual or the broader organisational system. It is about examining the influences surrounding the individual, be it peers, managers, leaders, incentives, goals etc, and how aligned these factors are". Interestingly, Barclays Audit Committee has "observed that the issues arising from unsatisfactory audits indicated that there was still work to do in embedding the required level of control consciousness across the group and ensuring that control exceptions were highlighted clearly in management reporting". The latest Banking Standards Board survey of bank employees finds that 27% would still not speak out about a colleagues' bad behaviour – for fear of trouble and futility of resulting action.

DISCRIMINATION

The media storm resulting from the publication of gender pay gap figures continues. There is a significant gap between the average bonus of men and women in finance. In some cases, eg, Goldman Sachs in the UK, it is as much as 67%, although only 36% on salaries. Goldman Sachs said: "Comparison of the average pay of all men at the firm compared with the average pay of all women at the firm, reflects our current reality that there are more men than women in senior positions in our organisation" – this leaves the question of why, and also whether women get paid less than men in the same role. (Interestingly, HMRC figures show that the gap between investment income for women compared with men increased 150% between 2011/12 and 2015/16 from £9.6bn to £24 bn – one suggestion for this is that men get paid more earlier and without interruption). Andrew Bailey has thrown his weight behind this movement and has said that diversity in financial services firms can help improve culture, prevent 'groupthink' and poor customer outcomes.

BANK REGULATION

There is an important international debate on whether the bank regulation (both prudential capital and limits on their trading risks) introduced in the post-crisis reforms should be maintained or rolled back. The rollback movement is strongest in the US, on the grounds that banks hold the key to economic growth – the rollback being achieved mainly through Trump appointing reform-friendly leaders to regulators rather than law change (although there is a draft law before Congress that would remove mid-sized banks from Federal Reserve oversight). Non-US regulators are likely to follow the US, given the size of their banks and to avoid giving them competitive advantages, and the EU has in any event diluted the global prudential standards to suit, eg, on exceptional treatment for non-performing loans (think Italy). Mark Carney frets that reducing prudential capital will increase systemic risk in systemically important banks. The ring fencing of large retail banks in the UK is proceeding with much work, cost and glitches (Barclays has court approval for its ring fencing plans). One consequence of prudential capital requirements and banks' reduction in lending is the rise of direct lending to business and individuals by non-banks, such as asset managers, hedge funds, private equity and loan/deposit matching platforms – increasingly to sub investment grade borrowers on covenant-lite terms. (Internationally, shadow banking grew to approximately US$45tn in 2017 – 13% of total global financial assets.) Loan amounts have increased too – up to £300m for a single loan. The European Securities and Markets Authority (ESMA) recommended non-bank lenders be regulated as banks, but the EU Commission decided against it.

ASSET MANAGEMENT

The revolution in asset management is close, according to the CEO of Jupiter Asset Management, Edward Bonham Carter. "Is it a slow inert industry that has arguably been buoyed up by high profits? Yes. Is it an industry that is going to look very different in ten years' time? Yes, with or without regulators." He cites fintech and machine learning

and a "substantial reduction" in headcount. This could lead to large reductions in management fees, where Fidelity is leading the way. There are more radical fee ideas – for example, Mercer proposes a new relationship between manager and client under which the manager would guarantee a rate of return, and keep any outperformance. Japan's Government Pension Investment Fund agrees: "Without excess returns, their fee must be equal to that of passive managers with the same amount of asset size." On a commercial level, big UK platforms and advice firm consolidators (such as AFH) are beginning to flex their negotiating power to reduce fund management fees. Morgan Stanley has recently warned that the asset management sector had missed the opportunity of the bull market to restructure its cost base – it sees a 20% saving from automation, and a 10% reduction from outsourcing some operations. Peter Hargreaves has criticised the difficulties in starting new funds – "This is because if they [the adviser] buy it, they have to show that they have ticked all the boxes, and one of those boxes is track record. So, unless a fund manager has worked at a very big firm, and the track record has their name on it, they can't do it".

PRIVATE WEALTH ADVISERS

- Key Information Documents (KIDs) continue to be contentious, particularly their projection of future returns, which can run into thousands of per cent, based upon the past five years and what is a 'complex' product (regulator review at the end of this year). Firms adjusting to handing out KIDs before investment can be made; continuing confusion over 10% portfolio drop rule – who is responsible for warning the client if there is a discretionary fund manager (DFM) and adviser and platform involved?
- Legal uncertainty of self-invested personal pension (SIPP) providers' responsibility where client or adviser has invested in unregulated investments through unregulated introducers (possible under regulation).
- A lot of work preparing for GDPR.
- Many firms still not MiFID II compliant, eg, on disclosure of all costs and charges, providing venue execution information to clients (FCA priority); and in notifying clients of changes to terms and conditions. There is also an interesting report on firm supervision and enforcement from the FCA which states its expectation that firms will take the initiative in taking remedial action in compensating investors without waiting for a FCA investigation – "If firms and individuals fully account for any harm caused, including putting it right where there are reasonable grounds to do so, we will consider this when applying sanctions". Conversely, failure to take action or cooperate with the regulator may lead to a heavier penalty.

PENSIONS

The FCA is under great political pressure to slow down the rate of transfers from occupational pension schemes. So boundaries on what is "suitable" advice are constantly shifting – dangerous for firms. There has been lots of enforcement action in this space – more than 20 advisory firms on pensions have been restricted or banned. PI premiums for some pension transfer advisory firms have increased dramatically. An FCA survey suggests that 48% of individuals with advisers do not know what fees they are paying, and (unsurprisingly) 73% of those without advisers – is transparency the solution to financial illiteracy? As importantly, the rate of pension drawdown is reducing where advisers are involved – but the number of drawdowns without their involvement is increasing. (Many pension providers now insist upon adviser involvement on transfers, but not so many on withdrawals). The FCA's latest policy statement for advisers retains the presumption that transfers are unsuitable unless shown otherwise, requires deep knowledge of the investor and describes what the "appropriate pension transfer analysis" should look like.

The following articles provide analysis of key global developments across the asset management sector

ARJUNA SITTAMPALAM, CHARTERED MCSI, EDITOR

REVIEW OF INVESTMENT MANAGEMENT

ALARM BELLS FOR PRIVATE BANKING[1]

Private banking is no longer generally acceptable and might be in its death throes, as argued in the prestigious *Euromoney* magazine. This thesis is supported by developments in Switzerland, which had been known as the centre of global private banking.

Many non-Swiss private banks have abandoned their private banking activities in Switzerland, focusing instead on wealthy clients in various locations, particularly in emerging regions such as Asia. The two largest Swiss banks, UBS and Credit Suisse, have ceased to use the term 'private banking' and have relabelled their services to the rich as 'wealth management'. Other leading Swiss players Julius Baer, Lombard Odier, Pictet and Vontobel have done the same.

HISTORY AND CURRENT DISREPUTE

Private banking has a venerable history, having started in Europe centuries ago as a service to the continent's aristocrats to safeguard their money against revolution. Secrecy was the watchword. More recently, however, private banking has been associated with illegal money and tax evasion, enabled by a rigorous approach to secrecy with even authorities not having access to client details.

This important service of tax minimisation has unsurprisingly now come into disrepute, partly under pressure from governments to end secrecy. Between 2009 and 2017, various Swiss banks and the private banking arms of international banks have had to pay over US$6bn to the US and French governments as a result of tax investigations.

Shareholders, accordingly, have started to dislike the private banking label and become less interested in tax avoidance. Internationally, wealth management, distinct from private banking in several ways, has become the norm with secrecy much less important. This sector has been growing fast in recent years and consequently, banks with wealth management divisions are rated higher by investors than those without.

NEW PREFERENCES BY WEALTHY

Wealth management itself is undergoing a sea change in what it stands for, possibly spelling the death knell for traditional private banking. In recent years, digitisation has come to the fore and become a central topic in the sector, not just among executives, but also between institutions and their clients.

An even bigger upheaval in client preferences is expected to gather force. It is now no longer sufficient to focus on risk and return, the traditional two-dimensional approach to asset management. A third important variable, the social impact of an investment, has come into the picture, a concept that is light years away from what old-style private bankers identified with.

Increasingly, investors don't want just good returns. They are also keen on their investments having a positive social impact. Tax optimisation is becoming less of a priority. This new preference is being adopted by some of the wealthiest in the world. Many billionaires are now getting worried about inequality and a potential backlash. Wealth management CEOs have now no choice. They have to reinvent their businesses to take account of social and environmental factors in their investment thinking.

However, some traditional private bankers are not convinced. Reportedly, Yves Mirabaud, president of the Geneva Financial Centre and senior managing partner of Mirabaud Group, feels that banks have no duty to consider as illegal activities those that may be just immoral.

MILLENNIALS

Much of the drive for products and services in responsible investing comes from the younger generation, a critical target of wealth managers. According to Shullman Research Centre data, millennials (aged 20-38) comprise 23% of the world's millionaires. They are set to inherit about US$30tn from the baby boomers' generation.

A private banking study by HSBC of entrepreneurs finds a big difference between those in their 20s and 50s, with 24% of the former group giving priority to a positive community effect in their investments compared with only 13% of the latter group.

INVESTMENT RETURNS

Maximilian Martin, global head of philanthropy at Lombard Odier, stated that impact investment did not produce lower returns in general and often had better performance than the mainstream.

UBS, reporting on 2,200 peer-reviewed academic studies, pointed out that 90% of them find positive/neutral correlation between sustainability and financial performance. These results support Harvard Business School research that concludes that companies focusing on sustainability as well as growth achieve less waste, more diversity and greater satisfaction, retention and productivity among employees. The overall effect is better performance.

PROBLEMS AND OBSTACLES

Progress to date across the sector is slow in adopting the new approach of impact investment. It is expected that widespread implementation will take time.

Until recently, digital was seen as the big story. Many advisers in the sector are now struggling with the mission approach of the younger generation. While many in top management are adopting the mission, the same is not true of the actual advisers and relationship managers lower down. In general, they are uncomfortable with sustainability. They neither understand nor believe that their banks can offer solutions and therefore, often avoid mentioning the topic so as not to look stupid.

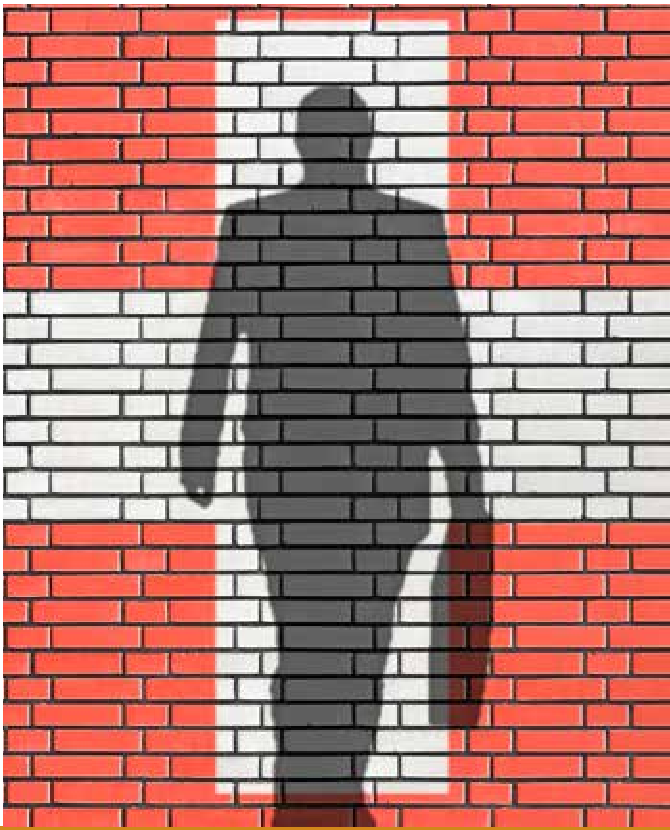
In a recent study on sustainable finance by the Centre for Sustainable Finance and Private Wealth, wealth managers have been telling younger clients that they are not ready to serve them yet, but are investing in training for this purpose, according to Paetzold.

Impact investment consultant and author Julia Balandina Jaquier says that advisers not only ignore, but actively dissuade clients from these investments. So, she states that private banks need better talent and processes with more training and new incentive structures.

CURRENT EFFORTS

Lisa Shalett, head of Morgan Stanley's wealth management investment resources and investment and portfolio strategy, says that the bank is combining the two big trends of digitisation and sustainability. They are creating desktop tools and looking at artificial intelligence to provide advisers with what they need to know.

Globalance Bank (US$750m assets under management) is a Swiss firm founded by CEO Reto Ringger with a mission to advise clients on investments and portfolios with positive social impacts. Globalance's mission is very clear and only attracts employees aligned with this.



MEASUREMENTS

Impact investment lacks a generally agreed measurement system. Globalance has introduced a new service, Globalance Footprint, that informs clients about the social impact of their portfolio on a scale from positive to negative.

Currently, the introduction of an adequate measurement system has a long way to go. The big problem starts with definition as to what is responsible or sustainable. Stuart Parkinson, CIO of HSBC Private Banking, points out that currently it is difficult to rate a holding on a responsibility scale that is generally accepted. Another big problem is that different clients vary in what they are passionate about in terms of social impact and so require different portfolios.

EDITOR'S COMMENT

Private banking is not yet dead, still enjoying the patronage of many clients, but no longer has the same cachet. Wealth management is the name of the game with impact investment increasingly important.

However, it is too early to assert that sustainability will become a core aspect of the portfolios of the rich. The lack of standardisation will curtail growth. This needs urgent attention, sustainable investments being critical for fund management's future let alone that of the planet.

1. 'The death of private banking … and how wealth management can have a brighter future', Helen Avery, *Euromoney*, February 2018.

IMPACT INVESTMENT – LEADING PLAYERS PUSHING AHEAD

EDITOR'S INTRODUCTION

In private banking and wealth management, impact investment represents mainly hopes and promises as yet, but a few leading financial institutions have already been taking concrete action in this field in a committed way, though some of the vehicles are being criticised.

IMPACT INVESTMENT BECOMES CREDIT SUISSE'S CORE STRATEGY

In a move provoking widespread surprise, impact investment has been labelled as strategically important by Credit Suisse's CEO Tidjane Thiam, underlined by his appointing Marisa Drew, formerly a top investment banker in the firm, as the head of the new global impact finance and advisory division.[2]

Her job straddles all other functions of the bank, including institutional asset management, financial markets and affluent private customers. This is made clear by her reporting directly to Thiam himself. Drew expressed excitement as to what the bank has already done in this field. These activities include microfinance, student loans, green property endeavours and other environmental projects.

Drew says that the timing is right as various sectors of asset management, pensions, mutual funds, private equity and wealth management are crying out for more impact investment. Her ambition is to come up with innovative solutions capable of being scaled up in these various areas, including creating new capital market instruments for this purpose.

A particular technique that she is enthusiastic about is creating instruments with different levels of risk in the same project. For instance, money that is donated could take the highest risk and different tiers of risk could cater for the needs of different types of investors.

She also highlights the success of social bonds, an example of which is a program for the homeless in Denver. She believes that it is not difficult to scale up similar solutions as such deals are already in Credit Suisse's fabric. Finding partners is the key.

PROMINENT LIFE INSURER'S SERIOUS COMMITMENT TO IMPACT INVESTMENT

Pacific Life in the US, a Fortune 500 company and the eighth largest in total life insurance sales, is another group that has demonstrated serious intentions in impact investing by actively supporting a subsidiary: Swell Investing.

Adrian Griggs, chief operating officer of Pacific Life, said that the next generation wants to have positive impact in all their activities in line with their values, explaining his company's excitement about Swell.[3]

Swell was founded as investment adviser by its CEO David Fanger to focus entirely on impact investing. Though still tiny, managing just US$13m, it is expected to do very well, given Pacific's backing.

Swell provides investors with a choice of six different themes: clean water; healthy living; disease eradication; zero waste; green tech and renewable energy. Fanger emphasises that return is not being sacrificed through the impact approach. All six portfolios either equalled or exceeded index benchmarks from May to December 2017. Some of its attractions include low fees at 0.75% per annum, half of that charged by others, and a tiny minimum investment of US$50.

TOP PLAYERS' IMPACT EFFORTS CRITICISED

Several prestigious financial institutions promote investment vehicles under the label 'sustainable' or 'environmental, social and governance' (ESG). *Forbes* magazine attacks the real nature of these vehicles and hints that they are the products of marketing efforts.

American Century is a case in point. A fund was launched by it in 2004 under the name Fundamental Equity, investing mainly in big companies. In 2016, after frequent underperformance, it was renamed as Sustainable Equity Fund, apparently in response to investor demand. Accordingly, its portfolio was restructured using data from MSCI's sustainable-investment research arm and Sustainalytics. However, other stocks widely suspect in terms of ESG such as ConocoPhillips, Marathon Petroleum and Philip Morris are still being backed.[4] The fund firm defends the Philip Morris choice by referring to its ecigarettes.

Similar comments are made about BlackRock and Vanguard using liberal definitions of what qualifies as ESG. BlackRock's MSCI KLD 400 Social ETF is invested in McDonald's, ConocoPhillips and Occidental Petroleum, though McDonald's is described as having ongoing labour disputes.

Vanguard's SRI European Stock Fund includes British American Tobacco and Royal Dutch Shell as its top holdings. Mark Fitzgerald, Vanguard's head of equity products in Europe, justifies this by saying that they use screening criteria such as respect for human rights.

Yale professor and sustainability expert Daniel Esty ascribes the problems partly to flawed data and lack of standardisation.

EDITOR'S COMMENT

Credit Suisse and Pacific Life are clearly enthusiastic, but this is not enough. A serious take-off of the impact sector depends on clearly agreed concepts of what it stands for. This is the big hurdle Maris Drew has to overcome. At the end of the day, Credit Suisse is a profit making corporate and the impact on the bottom line is what will ultimately motivate the CEO. It is not surprising that the big companies operate a diluted version of ESG vehicles, as they have to cater for a wide class of clients.

2. 'Credit Suisse gives impact investing its Drew', Helen Avery, *Euromoney*, December 2017.

3. 'Middle Mensch', Zack O'Malley Greenburg, *Forbes*, 26.12.2017.

4. 'Portfolio placebos', Jeff Kauflin, *Forbes*, 26.12.2017.

EXCESSIVE BLOATING OF UNICORNS[5]

Many unicorns (start-ups with valuations over US$1bn) are excessively valued, distorting investment selection to the potential detriment of mutual fund holders. This is the conclusion of academic work that points out that in a large percentage of cases, the value of these unicorns is inflated by even 100% or more, thus disqualifying them from the label 'unicorn'.

The study *Squaring venture capital valuations with reality* by academics Professor Ilya Strebulaev of Standard University and Assistant Professor Will Gornall of the University of British Columbia, identifies serious flaws in the valuation process that give rise to optimistic assumptions by fund companies, venture capitalists, journalists and those within the unicorns. In some cases, even the calculations are wrong.

The study pinpoints the basic flaw in the widely used valuation process. The practice is to base the value of the entire unicorn on the price that was achieved in its most recent round of financing.

In this process, fund groups are not taking into account differential terms granted to multiple share classes. Because these terms vary a lot, they have a serious impact on the overall estimated value.

In carrying out the study, the academics examined the terms granted to each share class and assigned a proper weight to unissued stock options. There are other sources of distortion. A new issue of preferred stock can include guarantees not available to those who invested earlier. Similarly, new shares might have rights that provide them with priority, if a liquidation occurs. The newcomers can also be promised additional shares, should a sale take place.

These features which seriously impact valuations are ignored in the practice of valuing the company in terms of the price paid, often the highest, in the latest financing. Almost all mutual fund companies value these venture-capital backed start-ups at the same price, thus massively exaggerating the worth of the unicorns.

In an example of incorrect pricing, Square, the international payments company, in its last financing prior to its initial public offering in November 2015, issued Series E preferred shares at US$16 per share. At the time, Square's valuation was estimated at US$6bn in the media, though according to the academics, the correct value was not much more than a third of this figure, at US$2.2bn. Subsequently, the price achieved at the flotation was only US$3bn.

Professor Mercer Bullard at the University of Mississippi School of Law described the situation as a serious problem. He pointed out that inflating the value of these holdings can be a hidden way of increasing fees that are based on assets under management.

Kathleen Smith, co-founder of Renaissance Capital, an investment firm, suggests that such wrong figures raise questions about the overall accuracy of fund prices which are applied to investors when they buy and sell. If they do so at the wrong price, then there is a potential problem.

EDITOR'S COMMENT

Some of these unicorns are in a growth mode, so any excessive valuation now might be neutralised by enhanced company revenues and profits that later justify the currently inflated figures.

But not all unicorns can be assumed to grow. In any case, if new investors are drawn into a mutual fund at the wrong price, they can get seriously disappointed if their hope for return fails to be achieved.

This issue needs to be investigated in depth, and if necessary, regulators need to act.

5. 'The unicorn mirage', Richard Teitelbaum, *Institutional Investor*, December 2017/January 2018.

GENDER DIVERSITY AND PERFORMANCE[6]

Several highly publicised instances of sexual harassment in start-ups have given birth to allegations of more widespread bad behaviour in Silicon Valley. The lack of gender diversity is considered to contribute to this situation, with only 7% being female in the venture capital (VC) sector. However, apart from the curbing of sexual misbehaviour, another compelling reason for a much better male/female balance is that it enhances business performance.

The VC firm Aspect Ventures represents a real-life example of how better gender diversity in Silicon Valley might achieve results. It goes against the norm by having a 50/50 split between males and females, rare in Silicon Valley. The firm was founded in 2014 by Theresia Gouw and Jennifer Fonstad who had worked at firms such as Accel and DFJ, early stage companies. Gouw and Fonstad gave practical expression to their deeply held belief that diversity both within their company and companies in their portfolios will produce better results. They benefited from relationship networks that were different from those of the traditional VC firms.

Aspect Ventures has chocked up many significant successes. These include Cato Networks and Exabeam which are cyber security start-ups, Vida Health in health technology and The Muse, a source of online career access. ForeScout, a security start-up, was floated in the autumn of 2017, valued at US$800m.

The individuals and institutions that fund Silicon Valley financially are now beginning to accept that gender diversity pays. Not only do the investors realise that sexual harassment claims can contribute to destroying value, as in the case of Uber and Binary Capital, but also they are becoming convinced of the business case for diversity.

Two high-profile investors in Aspect are strengthening the drive for more gender diversity. Melinda Gates, co-chair of the Bill & Melinda Gates Foundation, is one of them. Her opinion is that the venture and start-up ecosystem is still a boys' club – excluding, disadvantaging and mistreating talented women who want to contribute to it. She asserts that the data points out that these practices are harmful to business and society at large.

The second high-profile investor is the networking giant Cisco Systems, which invests directly in start-ups and other funds. Janey Hoe, vice president of Cisco Investments, stated that the in the current fiscal year, they incorporated diversity for the first time in their investment planning.

It is felt that the impetus behind gender diversity, while strong, has not yet achieved the critical mass needed to make the VC sector change their spots. Melinda Gates is extremely keen on pushing for change by saying that she wants to back people best placed to support the future path-breaking ideas, rather than those successful in the past.

EDITOR'S COMMENT

The movement towards gender diversity has not been a mainstream pursuit for a long time. It looks like changing now, but a large company, in respect to gender diversity, is like a huge super tanker which cannot be turned around quickly. Changing proportions is not easy if the existing work force is mainly male-orientated, as overnight it is neither sensible nor practicable to replace large numbers of men with equally qualified women.

6. 'Can these VCs fix tech's bro problem?', Michal Lev-Ram, *Fortune*, 01.02.2018.

ESOTERIC ETFs BETTING ON POLITICAL PARTIES

Innovatory exchange-traded funds (ETFs) effectively betting on the success of political parties have been introduced recently. ETF provider EventShares has come up with three: Republican Policies ETF, Democratic Policies ETF and European Union Breakup ETF.[7] Another political ETF, the Point Bridge GOP Stock Tracker ETF, was established by the group Point Bridge.

The Republican Policies ETF emphasises holdings in defence, border protection, deregulation, infrastructure, US energy independence and tax reform. Examples of exposures are Cheniere Energy, a US natural gas transporter which might benefit from less regulation and the betting of the fall (shorting) of Kansas City Southern that derives half of its revenues from Mexico.

The Democratic Policies ETF focuses on health care, environment and reform of education and finance, and holds Molina Healthcare while short-selling Goldman Sachs. The Point Bridge GOP Stock Tracker ETF goes further. It is unconcerned about the companies' underlying activities. Instead it goes for firms whose employees and lobby groups are highly supportive of Republicans seeking election to the Congress, vice presidency or the presidency. Companies chosen must have donated a minimum of US$25,000 to a Republican candidate in any of the two previous election cycles. The weighting is determined by ranking the firms by the amount of money given to Republicans compared with Democrats.

In the first two weeks this fund received over US$30m. It outperformed another – also issued by EventShares – the US Tax Reform Fund which backs companies expected to benefit from tax cuts and policies helping exporters.

There is much scepticism about these political funds, according to Ben Johnson, director of global ETF research at Morningstar, calling them marketing gimmicks.[8] But there is some limited academic support. One study found that for every US$1 spent on lobbying for tax breaks, companies got US$220 in kickbacks. Furthermore, James Bessen in the *Harvard Business Review* in another study says that lobbyists cause corporate profits to rise.

Ben Phillips, CIO at EventShares, feels that the political effect can last even up to a decade, pointing out that Obamacare is still relevant.

EDITOR'S COMMENT

These political ETFs are new and tiny, but the concept, though not firmly grounded in investment theory nor in any kind of scientific approach, cannot be totally dismissed. The current crop is focused on the US, but political turmoil, uncertainty and populism are likely to increase worldwide, and political bets through funds could catch on.

There are many investments which rest on flimsy fundamentals, but sentiment can make them highly popular. Note, for instance, the new craze for initial coin offerings.

7. 'An exchange traded fund to make America great again', David Stevenson, *FTfm*, 18.09.2017.

8. 'ETFs now with political opinions', Carolina Wilson, Pat Regnier and Dimitra Kessenides, *Bloomberg Businessweek*, 25.12.2017.

GIANT START-UP REVOLUTIONISING OFFICE STRUCTURES

Despite worldwide negativity surrounding the US, its dynamism is alive and kicking, as epitomised by WeWork.[9] Promising to radically change the office experience everywhere, at US$20bn, this group is the most valued American start-up behind Uber and Airbnb. This recent valuation was set by the infusion of capital from SoftBank, a group which has rapidly acquired a name for backing tech start-ups worldwide.

Masayoshi Son, Japan's wealthiest man and one of the world's great investors according to *Forbes* magazine, took just 12 minutes at a meeting with Adam Neumann, the co-founder and CEO of WeWork, to agree to invest.

WeWork started life as an intermediary, renting space on a hold-sell basis and then letting out individual desks to entrepreneurs who found it cheaper than setting up full offices. Flexible leases, good design and services such as internet, reception, post-room, cleaning, free coffee and beer are part of the offer. What WeWork provides is not just space, but an entire office culture.

Having started with one space in 2010 in New York City, it has now three times the number compared with end-2015 in 52 cities worldwide in more than 160 locations. The range of office types it offers has expanded. The space rented by many of its 150,000 members extends from just using a desk in a common area to a 50-person office.

About US$1.3bn of revenue with operating margins of 30% is expected for 2017. However, Neumann is proud that it is not revenue that defines the company, but its energy and spirituality which commands a premium.

Even prior to SoftBank's arrival, other leading firms such as Benchmark, Fidelity, Goldman Sachs and JPMorgan had invested in WeWork, recognising its disruptive model. According to Benchmark, WeWork creates a vibrant and fun environment and fills it with excited people to energise the work experience. Jamie Dimon, CEO of JPMorgan, refers to WeWork as a way of life. He points out that it has built a hybrid of a technology group and a hospitality operator, very different from anything else in real estate.

But WeWork is not just a servicing start-up. These large companies recognise that it can radically change how everybody can experience an office. In the past two years it has acquired clients including GM, GE, Samsung, Salesforce, Bank of America and Bacardi.[10] Big companies now generate 30% of sales.

WeWork now utilises advanced technology and logistics to optimise its new locations to make maximum use of every inch of space. 3D scanners and virtual reality models are used to design each floor. Technology is also involved in arriving at the right balance of shared space and conference rooms. Increased tech efficiency and economies of scale has reduced the cost of adding a new desk by 45% to US$8,600.

EDITOR'S COMMENT

WeWork is a boon to start-ups everywhere. It is relevant to asset management, the dynamism of which is under threat from the burden of regulation and other changes. The

access to WeWork culture and ability to rent space on a flexible basis could be a small improvement in the other direction, encouraging more entrepreneurial fund managers.

9. 'The erosion of listed equity markets to worsen' *Investment Management Review*, January 2016.

10. 'The way we work', Steven Bertoni, *Forbes*, 24.10.2017.

US CORPORATE CASH RETURNS HOME – MARKET REPERCUSSIONS

Tax reform introduced by the Trump administration has encouraged some of the gigantic trove of US corporate cash held overseas to return home, triggering much speculation as to how financial markets might be affected.

The Tax Cuts and Jobs Act became law in December, cutting the US corporation tax rate from 35% to 21% and levying a one off reduced tax rate of 15.5% held on cash outside the US.[11]

Many of the largest companies are taking advantage of the lower tax rate applicable for a temporary period to repatriate their cash piles. Two questions arise. What will be the effect on the US economy and financial markets from the deployment of this cash in the US? The firms could invest in their businesses, spend it on share buybacks or just continue to hold it as cash within the US.

Currently, much of the overseas cash is invested in global bond markets. The second question concerns how the fixed income sector might be affected by the exit of these funds.

As the Trump administration would hope, if a large proportion is actually invested by the companies in their business activities, a significant boost to the US stock market could occur. On the other hand, if the money is used to repurchase shares, then it is a potential positive for stock markets.[12]

The biggest source of speculation is what might happen to bonds. A substantial proportion of the total US cash pile estimated by Citi at over US$2tn is held in global markets. The 30 leading US companies have US$800bn in fixed income investments, according to a *Financial Times* analysis of recent filings with the Securities and Exchange Commission.[13] Some of the largest groups are effectively becoming professional investment managers running portfolios with a highly sophisticated approach. The 30 large companies have invested more than US$400bn in US corporate bonds, nearly 5% of the total outstanding.[14] So, the fear is that the withdrawal of these investments might unsettle the fixed income markets.

Already many of the largest companies have announced repatriation of their overseas cash and the payment of the tax at the low rate. This tax payment even at the lower rate has made a significant impact on many of the companies which have reported losses.

Companies reporting losses, because of this tax, include Citi (US$18bn quarterly loss) after paying US$22bn in repatriation taxes.[15] Goldman Sachs announced a loss of US$2bn. American Express experienced its first quarterly loss in over 25 years, because of this tax law, amounting to US$1.2bn after paying US$2.6bn in repatriation taxes. In spite of the short-term pain, the companies, in general, are positive about the long-term impact of the tax reform, as widely reflected in the lift of the US stock market on the introduction of the law.

EDITOR'S COMMENT

Any cash brought back by companies and invested in their businesses could boost the economy, but this cash having been left overseas all these years has not been a primary cause of non-investment in underlying businesses. Many of the companies concerned would have had no difficulty in raising the money domestically to fund worthwhile investment opportunities. Possible reasons are a lack of attractive long-term investment opportunities or CEOs' short-termism arising from a faulty incentive structure.

Any buybacks might, in theory, boost the US stock market, but the latter is suffering from other big uncertainties, such as the prospects for global trade tariffs and valuation levels already considered high. So, it is dubious whether there will be a marked effect on stock levels.

In the bond market the impact could be more significant. But the big corporates do not need to liquidate their bond holdings immediately. All they need to do is to transfer the bonds from their overseas subsidiaries to their operating companies back home. They are already acting like sophisticated professional portfolio managers with these holdings and it is more than likely that any impact on the bond markets on this account will be minor.

Moreover, tax avoidance has not been the reason for holding bonds. The main motivation has been the extremely low rates available in short-term money markets. The risk of rising rates and inflation could be a bigger factor in the fortunes of global bonds which could influence the corporates to liquidate their holdings. But this has little to do with repatriation.

Overall, the cash coming back home is unlikely per se to have a serious impact compared with the influence of global macroeconomic uncertainties.

11. 'Last byte - cash back', Brian O'Keefe, *Fortune*, 01.03.2018.

12. 'Trump's tax plan could bring $250 billion into the US – here are the companies set to benefit most', Joe Ciolli, uk.businessinsider.com, 20.12.2017.

13. 'US blue-chips pump excess dollars into debt', Eric Platt, Nicole Bullock and Alexandra Scaggs, *Financial Times*, 13.09.2017.

14. 'Debt collectors', Eric Platt, Alexandra Scaggs and Nicole Bullock, *Financial Times*, 16.09.2017.

15. 'Apple leads these companies with massive overseas cash repatriation tax bills', Lisa Marie Segarra, fortune.com, 18.01.2018.

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REVIEW OF FINANCIAL MARKETS
RESEARCH INTO WEALTH MANAGEMENT, CAPITAL MARKETS AND BANKING ISSUE 17 Q2 2018

INSIDE THIS ISSUE

Opportunity, and its travelling companion uncertainty, abound in this issue. We bring you crime, in the form of unexplained wealth; the future of banking; the investment opportunities in sustainability; the concomitant swing towards 'green finance'; and the rewards of virtue – the growing evidence that 'good' businesses perform better as investments than 'bad' ones.

But how to keep track of all of this, and how does the young financial professional in particular cope with volatility and uncertainty at work? In a stirring new programme on CISI TV on 'Smashing through "the long maybe"', Dr Robert Barnes, Chartered FCSI, a director at London Stock Exchange and former CISI director, paints a graphic picture of the new knowledge and skill sets that will be needed in tomorrow's very different world. At the CISI/CSFI – Centre for the Study of Financial Innovation – Mansion House City Debate in March 2018, the motion that 'Fintech would save the City' was knocked down overwhelmingly (by three to one) by the notion that a new generation of properly-trained and constantly up-to-speed people would do the trick.

As we explained in the previous *Review of Financial Markets*, we are working to that end with the Open University (UK) and the University of Regensburg (Germany) in a collaborative research project to examine how professionals in the finance sector deal with volatility at work. Insights from this research will be used to develop training interventions for better professional development as the study progresses. Full details of the survey and the opportunity to participate can be found at *cisi.org/futureproof*, available to access directly in the online edition of *The Review*.

The Open University

The changing world of professional learning

The world of learning and continuing professional development is changing beyond recognition. Daniel Broby, Chartered FCSI, an investment manager by profession who now lectures at the University of Strathclyde in Glasgow, has launched the first Masters in Fintech in the UK, and as part of that has been working with colleagues at Strathclyde and the University of Glasgow on how the new and emerging world of fintech is changing financial education.

In a recent paper titled *On the educational curriculum in finance and technology*, Karkkainen, Panos, Broby, and Bracciali identify how recent technological developments such as big data, cloud computing, artificial intelligence, blockchain, cryptocurrencies, peer-to-peer lending, crowdfunding, and robo-advising are changing the educational curriculum. They argue that while traditional computer programs and other technology have been around for a while, the new fintech sector is enabling transformation of the financial services sector, and the way finance is taught has to change. They propose an updated educational curriculum that balances knowledge and understanding of finance and technology. They point out that a curriculum that provides a skill portfolio in the two core components and complements them with applied knowledge can support the enabling forces which will render fintech as a true opportunity for the financial service sector and for society as a whole. Their paper is a scholarly inquiry into the educational curriculum in finance and technology, reviewing skills shortages, as identified by firms and experts, and examines the state-of-the art educational processes embedded in some of the first educational programmes in fintech.

A Strathclyde PhD graduate, Allison Littlejohn, now professor of learning technology and academic director of digital innovation at the Open University (and co-director of the study referred to above) delves further into the theme of *Reconceptualising learning in the digital age* in a book to be published by Springer in summer 2018. With co-author Nina Hood, a research fellow at the Faculty of Education, University of Auckland, she probes the world of 'massive open online courses' (MOOCs) and open learning within a broader educational, economic and social context. This study raises questions regarding whether MOOCs effectively address demands to open up access to education by triggering a new education order, or merely represent "reactionary and unimaginative responses" to those demands. The book's subtitle is *The [un]democratising potential of MOOCs*. It offers a fresh perspective on how we conceptualise learners and learning, teachers and teaching, accreditation and quality, and how these dimensions fit within the emerging landscape of new forms of open learning.

University of Strathclyde

The contradictions in MOOCs

MOOCs, say the authors, are often viewed as synonymous with innovation and openness. In the financial world, they are sometimes seen as a panacea for the education and CPD needs of those working in routine functions – such as securities operations. Littlejohn and Hood open their work by "interrogating" the wide-ranging uses and interpretations of the terms massive, open, and course and how these terms are represented in different types of MOOCs.

"We then identify contradictions associated with MOOC excitement. Despite the initial agenda of MOOCs to open up access to education, it is seen that they tend to attract people with university education. Rather than offering scaffolds that support people who are not able to act as autonomous learners, MOOCs often are designed to be used by people who are already able to learn. Like traditional education systems, MOOCs usually require learners to conform to expected norms, rather than freeing learners to chart their own pathways. These norms sustain the traditional hierarchy between the expert teacher and novice learner. A particularly troubling feature of MOOCs is that, as supports are becoming automated and technology-based, this power structure is becoming less visible, since it is embedded within the algorithms and analytics that underpin MOOCs."

MOOCs have become an industry in their own right, say the authors. Organisations have been founded to offer MOOCs to millions of learners worldwide. ClassCentral (*class-central.com*), a website aggregating data and information on MOOCs, listed 30 MOOC providers in 2017. These providers partner with over 700 universities around the world to offer MOOCs. It is estimated that around 58 million students had signed up for at least one MOOC by the end of 2016. We will be assessing some of the practical implications of this for future learning in the next *Review*.

The rise of sustainable investment

A conspicuous trend recently has been rapidly-growing interest in and attendance at events on responsible or sustainable investment. Seats are taken quickly at any events the CISI runs on this; rooms are packed with a growing number of noticeably younger members, from bigger institutions, than at other wealth management-related events.

Our annual event on Islamic finance in November 2017 in CISI's offices focused on links between this specialist branch of finance and more general issues around sustainable funding and social infrastructure. Led by Dr Hatim El Tahir, a director of Deloitte and Middle East leader of the firm's Islamic Finance Knowledge Centre, this event has spawned an excellent new report on *Scalable and sustainable funding sources for social infrastructure.* Stella Cox CBE, managing director DDCap Group and head of the CityUK Islamic Finance Advisory Group, was one of the leaders of this project and writes with authority on pages 66–67 on creating financial systems that are more responsive to the real economy.

Eat your greens

On the same theme on pages 68–69, Mike Wardle of Z/Yen introduces the firm's latest index – the Global Green Finance Index (GGFI) – produced by Z/Yen with its Brussels-based partners Finance Watch and sponsored by the MAVA Foundation.

Benoît Lallemand, Secretary General of Finance Watch, set out the context for the index at the Brussels launch in March 2018, and its aims of providing insight on what makes a financial centre green or not; promoting a race to the top in green finance; and spreading best practice in green finance and green financial centres. Guest speaker Sarah Goddard, Secretary General of the Association of Mutual Insurers and Insurance Cooperatives Europe, spoke of the long experience of the insurance market in considering and building data on the impact of climate change. She noted that it is only recently that the insurance industry has been invited to play a fuller part in discussions around green finance. Professor Michael Mainelli, Chartered FCSI, of Z/Yen focused on the results of GGFI 1. He reflected that the time is now right to institute the index, with a consistent interest developing in recent years in green finance. The index focuses both on the depth of green finance within the total finance offering in centres; and the quality of the green finance work being undertaken in centres.

The key headlines that Professor Mainelli focused on were:

- Scores were generally closely clustered, which suggests there will be change in the rankings over time.
- Centres which have demonstrated significant leadership on green finance, such as Paris and Luxembourg, achieved high rankings in the index.
- For depth, Western Europe and China performed well.
- For quality, the US did well alongside Western Europe.
- A number of centres were close to receiving a place in the index and we would expect the number of centres featuring in the index to increase as respondents increase.
- There was most interest in sustainable infrastructure finance and green bonds.
- These areas were also seen to have most impact on sustainability.

The report has sparked areas on which further research might focus, including the factors that lead to improvement, the effectiveness of policy, and the views of those with differing levels of involvement in the field. We will follow these closely in future editions of *RoFM*.

BIG DATA AND ESG INVESTING

Ciaran McCale, head of media and communication, Arabesque
Ciaran.McCale@arabesque.com

Machine learning is shaking up the world of finance. What was once the preserve of technology firms, the financial sector – from innovative new fintech firms to the giants of Wall Street – is starting to apply the technique to everything from fraud protection to finding new trading strategies, promising to change the global market landscape forever.

This paradigm shift has coincided with another mega trend that we are currently witnessing across finance, which is the rapidly increasing demand for environmental, social, and governance (ESG) products. Research has shown that more sustainable firms generally outperform their counterparts over the long term, both in terms of stock market as well as accounting performance. Almost three-quarters of investment professionals worldwide (73%), surveyed by the CFA Institute, now take ESG issues into consideration in the investment process. An investor who factored ESG into long-term investment decisions starting in 2008 would have avoided 90% of the US corporate bankruptcies that have taken place within the universe of companies they analysed since then. And companies in the top fifth in terms of ESG ratings in 2005–2010 experienced the lowest (32%) volatility in earnings per share in the subsequent five-year period. By contrast, companies with the worst environmental, social and governance records averaged 92% volatility.

Inspired by the impact that the X-Ray had on medicine in the early 20th century, S-Ray is the latest technology of its kind to capture vast amounts of sustainability information that now exists on companies, and make it relevant and understandable to investors.

Ciaran McCale discusses the work of S-Ray – which systematically combines over 200 ESG metrics with news signals from over 50,000 sources across 15 languages for some 7,500 companies, in a special film on CISI TV. The chart below shows highlights of how the highest 20% of companies, in terms of ESG scores, outperform the lowest 20% by 5.2% annually.

How the top 20% of 'good' companies outgun the market

Unexplained wealth – whose business?

This year's Cambridge University economic crime symposium, the biggest event of its kind in the world, has a special focus on 'unexplained wealth', a key academic research focus in recent years and now an urgent target of legislators round the world. In the UK, for instance, Unexplained Wealth Orders came into force in January 2018, under the Criminal Finances Act 2017, introducing new measures to tackle asset recovery and money laundering in the UK. Research has delivered evidence that the UK has become a safe haven for corrupt individuals and their assets, and until now UK law enforcement has had limited power to seize corrupt property.

Before the new law, little could be done to act on suspicious wealth unless there was a legal conviction in the country of origin. In the words of Transparency International, one of the leading non-university researchers in this field: "In cases where the origin country is in crisis or the individual holds power within a corrupt government, this can take decades to obtain or is unlikely to be achieved at all, producing a mere trickle of results against a torrent of corrupt illicit funds."

Professor Barry Rider, founder of the Symposium, introduces this year's gathering:

The Thirty-Sixth International Symposium on Economic Crime is the most extensive and ambitious programme that we have so far attempted to put together. The overarching theme is how we can better identify and render accountable unexplained and suspicious wealth. As we increasingly realise that the way in which most of us approach suspect wealth and money laundering lacks efficiency and imposes arguably disproportionate burdens and risks on the financial and business system, it appears a partial answer might be in focusing on the identification of unexplained wealth, but then what do we do?

These important and timely issues are pursued in a practical, applied and relevant manner, by those with the benefit of experience from around the world. The symposium, although held in one of the world's leading universities and recognising the significance of intelligent deliberation, is not a talking shop for those with vested interests – official or commercial. We strive to offer a rich and deep analysis of the real issues and, in particular, threats to our institutions and economies presented by economically motivated crime and misconduct. Therefore, well over 600 experts from around the world will share their experience and knowledge with other participants drawn from policy makers, law enforcement, compliance, regulation, business and the professions. The programme is drawn up with the support of several agencies and organisations, and the organising institutions and principal sponsors greatly value this global commitment. In recent years the symposium has attracted well over 1,800 participants from over 95 countries.

In considering how to better discourage and control economic crime, we examine the real threats facing our economies and, in particular, those who look after other people's wealth – not just from criminals and terrorists, but also indirectly as a result of law enforcement and regulatory intervention. We also context these risks and the responses, not only in terms of the law, but also regulation and especially compliance practice. Therefore, in every specialist panel or workshop there is an array of relevant practical experience and expertise.

As in previous symposia, we do not focus on a single issue, no matter how important, but address a wide range of topics concerned with promoting integrity. Just spend a few minutes to look through the 36th Symposium programme – I am confident that you will be impressed by its depth, breadth and relevance. The symposium is not an ordinary conference, it was conceived to fulfil a practical purpose – to promote understanding of the real issues in controlling economically motivated crime and facilitate cooperation and effective action, ideally preventative. Consequently, we make every effort to foster networking and promote meaningful cooperation.

The Cambridge Symposium is not and has never been just a conference. It is organised on a non-profit making basis by some of the world's most respected academic and research institutions with the active involvement and support of numerous governmental and inter-governmental organisations. Those who are concerned to protect and promote the integrity and well-being of their national economy, institution or enterprise – or who are simply concerned to better understand the risks facing business today, cannot afford to miss this very special event.

Professor Barry AK Rider OBE

Founder, executive director and co-chairman of the Cambridge Economic Crime Symposium

Jesus College, Cambridge

The Symposium runs for a full week at the beginning of September 2018 in Jesus College, Cambridge, with many senior delegates from around the world spending much of that week there. Busy UK professionals are welcome to attend for any part of the Symposium and may find the special session on Thursday 6 September conducted under the auspices of the CISI – 'Winning the war against financial crime: best practices and emerging risks' – a particularly useful addition to their CPD armoury.

Members of the CISI are eligible for a 10% discount on attendance at the Symposium, and also a full 50% discount for themselves or any of their students who wish to register for the CISI's two crime-related exams – Combating Financial Crime and Managing Cyber Security – before 1 September 2018.

For full details, please visit the partner events pages on cisi.org

Winning the war against financial crime: best practices and emerging risks

The Symposium will host a special day-long programme on City issues on Thursday 6 September 2018, under the auspices of the CISI, covering six key themes:

- How does good governance and stewardship assist in combating financial crime? Do you really know your client?
- In the cyber age, do we need a new approach to monitoring and controls?
- Should the financial services sector, its regulators and law enforcement work together more?
- Emerging and existing financial crime risks: how do I know if I should be suspicious?
- How do we win against cybercrime and provide for data security?
- Are human beings the weakest link?

These sessions bring together top-level practitioner speakers from Barclays, BNP Paribas, HSBC, the Saudi Arabia Public Investment Fund, Standard Chartered and Willis Towers Watson, amongst others, with enforcement officers and regulators, and accountants and lawyers.

The day will end with a debate on: 'This House accepts that financial institutions should do more to police the financial markets'. Full details as above.

PRESENT AND FUTURE PRINCIPLES OF BANKING: BUSINESS MODEL AND CUSTOMER SERVICE

Moorad Choudhry FCSI, visiting professor, University of Kent
mooradchoudhry@gmail.com

> I have a problem with psychometric testing: it is to my mind a spurious device used by large corporations to ensure that anyone with a semblance of wit or independent thought doesn't get anywhere near securing a job. If the entire country was subjected to psychometric testing and all those who failed it humanely put down, we'd be left with a rump of deathly, grey-faced middle managers.
>
> Rod Liddle, *The Sunday Times*, 18 August 2013

It is surely unarguable to state that before one can achieve a satisfactory result in any endeavour one must first ask what 'satisfactory' looks like. A practitioner of any art, and banking is as much art as science, must first define greatness before attempting to create it. Most of us know what banking is and what a bank does; that isn't the hard part. But what does *good* banking look like? Is a bank that is in a satisfactory state the one that has generated the required rate of return for its shareholders? Or the highest rate of return? Or is it the one that pays its employees the highest salaries? Perhaps it is the one that has the most satisfied customers, or conversely the one with the fewest complaints per 1,000 customers? Or the one with the best relationship with the regulator?

Actually it's none of these. As the author is fond of saying, the first principle of good banking is to have principles. Banks are a cornerstone of modern society, and indeed not-so-modern society. Without a banking service in a community, very little commercial activity would get done and the state of the human condition would be much more underdeveloped than it is now. Practically every aspect of modern life has been assisted at some point of its development by bank funding, or government funding that is reliant on the banks. So while all of the criteria set out in the first paragraph are undoubtedly important, none of them is the most important one.

The boxout below gives an example of a rickshaw puller using a mobile phone: a genuine improvement in quality of life for those previously without access to a landline telephone. Just one of many thousands of symbols one could use to illustrate the good that finance in general and banks in particular can achieve. One could say that it was the mobile phone companies that created the product, and of course one would be right; but the financing for the project, from design and development to implementation, such that a modern-day technological marvel could be accessible to one of the poorest sections of society, came from banks. We can point to any number of similar instances of societal well-being enabled by banks: more people owning their own home, or starting their own business, or being able to save for their retirement or to help put their children through university. Or indeed setting up their own university. The list is a long one.

The purpose of the foregoing is not so that everyone who works in a bank can pat themselves on the back – not at all. Rather, the purpose is to make the point that the key stakeholder of all banks is society itself. Not the shareholder, the customer, or the regulator but the entire community. Of course the three aforementioned are important stakeholders, but a good bank is one that generates good for society. That's pretty much it.

Certainly the customer is very important, although in that respect banks are by no means unique, in fact the contrary. Every corporate institution, excepting certain (but not all) public-sector entities, must ensure it delivers customer satisfaction, otherwise it may find its future well-being rather bleak, if not shortened considerably. Banks have to go one further, however, and work to ensure community satisfaction. They form such an essential part of modern society that any other objective would ultimately be short-sighted. So good banking would be that which had as its objective working towards achieving society's well-being and improvement, as far as it is able to influence actions with such an aim.

In this article we present recommendations on the issues banks should be considering in their daily activity and as part of their longer-term goal. This does, as one might expect, focus on the customer. The relationship with the regulator we consider a given – it is (or should be) merely the starting point for all banks that they have an open, constructive, and transparent working partnership with the regulator. Managing the balance sheet shape and structure is also a given – every bank should be working on ensuring the balance sheet is long-term viable. The issue of marketing, being as it is very important in customer franchise targeting and retention, we consider also a given.

The author wrote this in the preface of his book *The mechanics of securitization*[1]

In 2009 *The Times* newspaper of London carried an interview with Paul Volcker. The former chairman of the Federal Reserve "berated bankers for their failure to acknowledge a problem with personal rewards and questioned their claims for financial innovation." According to *The Times*, Mr Volcker rebuked "senior figures in the financial world for failing to grasp the magnitude of the financial crisis and belittled their suggested reforms." As bankers demanded that new regulation should not stifle innovation, Mr Volcker was quoted as saying, "The biggest innovation in the industry over the past 20 years has been the cash machine."

It's a pity that this impression is now fairly commonplace in business, media, and political circles. One only has to look at the mobile telephone industry, and to be aware that it was financed mainly by recourse to financial engineering techniques that included securitisation, to understand that innovation in finance has often been a force for much good in the world. It is worthy of preservation, and if one were to observe a rickshaw puller on the streets of Dhaka, Bangladesh (average salary US$1 per day) using a cell phone, one would indeed be convinced of this. The technology needed to make the cell phone available to a mass population worldwide required hundreds of billions of dollars in investment, and a fair proportion of these funds were raised via the securitisation markets.

This book is not a general textbook on banking or finance, much less a polemic on the virtues of free markets and capitalism. It is a focused guide aimed at practitioners in structured finance who are involved with originating, structuring, or arranging securitisation transactions. Essentially it has been written to act as a checklist of necessary tasks for commercial banks that are interested in closing a securitisation of assets either off their own balance sheet or on behalf of a third-party bank. These assets might be corporate loans, mortgages, credit card loans, or other more esoteric 'future flow' cash receivables, but the essential principles that must be followed when securitising any asset class are virtually identical, and differ only in detail. These essential principles are covered here. Much securitisation activity in the immediate post-2008 era was of the 'in-house' variety, with an objective of creating tradeable securities that could then be used as collateral when obtaining funding from their central bank.

1.Moorad Choudhry, *The mechanics of securitization: a practical guide to structuring and closing asset-backed security transactions* (John Wiley & Sons, 2013).

Instead we look at the customer and the ideal banking business model that should be in place to ensure the customer is always at the receiving end of good service. We illustrate our recommendations using a hypothetical pitch book of a 'model bank' that has just set itself up for business. We hope that this model bank approach gives a clear picture of the customer ethos that all banks should be aiming towards, where the customer is once again identified and treated as an individual and not a number.

Customer service: the model bank

This is not the place to discuss the failings of banks in the Western world (and by 'failings' we are not referring only to failed banks in the crash. The fines paid out by UK banks for derivatives misselling or LIBOR rigging or a number of other tawdry practices are also a form of failing). In the period since 2008 there has been a considerable literature reviewing the state of financial markets and banks, generally by authors much more august and higher up the 'pecking order' than yours truly. Sector issues of trust, remuneration, the usefulness of innovation, product misselling, and myriad other problems abound in the business media. There is no need to discuss these issues further here, which are covered elsewhere in abundance.

Instead we will present what we consider are the key principles that *should* be integral to a good bank's customer business model. The recommendations are open to argument of course, and a business philosophy that is not genuinely customer-centric might easily suggest a counter to our proposals. That is perfectly fine, and is what makes a market. Rather, the purpose of this section is to state what we consider to be *principles* of banking; as such they should be, if not timeless, at least of validity for a good few years into the future. There is always an alternative approach that one can take. What we recommend here is simply the best approach for truly good banking.

Note that this section is very much a 'high-level' description and suggestion of best practice in customer service in a bank. For a more detailed look and primer on marketing bank products and good customer service practice, please see chapter 2 of the author's book *An introduction to banking*, 2nd edition (John Wiley & Sons, 2018).

Genuine customer service

It is important to avoid platitudes when formalising one's attitude and objectives with regard to customer service. Every bank, indeed every corporate providing a service, will always insist that 'the customer comes first' and that they promise to deliver customer satisfaction. This aim is as old as commerce itself. The key is to take such platitudes and turn them into something genuine, by enshrining a customer-centric ethos into the firm's culture. This is something that is much harder to do, particularly in banking where in all but the very smallest firms there is considerable 'silo mentality' at work and most staff never deal with customers. Combine this with a remuneration structure that rewards volume of business generated over levels of customer satisfaction and it is no wonder that banks, at least in the Western world, were so vilified after the last crash.

In response to the events of 2008, the competition authorities and the regulators made various attempts to reduce the barriers to entry in banking, which have always been high and made higher by the capital and liquidity requirements of Basel III. Whether this made any difference or not is a question worthy of study. That said, large numbers of new entrants did come into the market. However, with only one or two exceptions, such as Metro Bank or Handelsbanken in the UK, which combined traditional branch networks with more-or-less full service product offerings (although with certain types of corporate customers ruled out), most of the new players were niche market competitors. Excluding non-bank firms such as peer-to-peer lenders, licensed banks tended to fall into the 'digital' bank category, with a limited product suite. Taking the UK again as an example, although the approach observed here has also been noted elsewhere in Europe as well as in North America and Southeast Asia, new banks tended to fall into the following categories:

- SME-only branchless banks: examples might include Aldermore and Oak North Bank. The former has subsequently expanded into retail customer business and the latter targeted retail depositors, but the focus of their business was the small corporate.
- Retail-only branchless banks: these are banks such as Tandem, Atom, and Starling banks, which are digital only with customer interface via a smartphone mobile app. The product offering is narrow, based around the current account and overdraft.

Not all new or 'challenger' banks could be said to fit into these obviously narrow categories, but the point we are making is that in essence such niche banks target a limited section of the customer marketplace.[2] This makes it difficult for them to truly 'challenge' the established large players, most of whom have well-regarded digital and mobile offerings as well. Of course, they can certainly offer ideas and approaches that the sector may adopt. Ultimately, some customers will be happy doing all their banking from a smartphone, while some other customers will desire some human interaction for some of their banking. The banking relationship is a lifetime one; all of us require financial services of some kind or another throughout our lives, and our requirements change over time.

In that spirit we would suggest that the modern approach to good banking would encompass all of the following:

- **Genuine customer service:** by this we mean the customer is the focus of the business and the bank has a real relationship with it, irrespective of how important or profitable the individual customer may be. To have a real relationship is to know the customer personally, as a name and not a number, to understand his/her/its banking requirements but in the context of the customer's overall lifestyle, and to provide these requirements in a timely, efficient and error-free manner. This goes beyond the type of computer algorithm understanding of a customer's needs that an online retailer possesses, for example:
- **Name not number**: one cannot emphasise enough how for a bank as opposed to, say, a high street clothes retailer (although that is in no way intended to denigrate the latter), every customer needs to be treated as an individual, and not merely one of many in a mass-market environment. Only through this approach will a bank be able to provide genuine customer service. Banking needs of individual customers develop and grow over time. For example, the financial services requirements of a single 21-year-old salaried worker are different, or at least less onerous, than those of a 55-year-old married self-employed person with children at school. Treating customers as all purchasers of the same tin of baked beans will not enable true understanding to develop and will hinder the provision of good customer service;
- **Omni channel**: some customers, individuals and SMEs alike, are perfectly happy dealing with their bank through digital interfaces only, and have no desire or need to talk to a member of staff either

2.The CFO of one of the new banks told the author once, "We're targeting the 18–35-year age group only". This may or may not be a wise strategy, but it does mean a large section of the potential market will never be your customers.

in person or on the phone (or video link). Some may never step into a bank branch in an entire decade. Still others prefer to deal with a human being for at least some service requirements, such as a mortgage, personal finance loan, or FX exposure hedging requirement. Unless a bank is specifically setting up as a niche provider for a certain group of customers only, it will need to ensure it provides the customer interface infrastructure that all its customers are likely to desire to use *through the entire period of the customer relationship*. This means enabling digital mobile, phone, internet, video, and branch banking, but is also a key reason why the bank branch is unlikely to disappear. To that end:

- Just as many well-known brands do not locate a sales outlet in every high street in the country, banks also do not need to do so. A smaller number of branches is expected over the next 10–20 years, and this is logical: a good yardstick would be to position branches in 'major' population centres only. In the UK there are only 21 towns and cities with a population greater than 250,000.
- The 'model bank' we describe in the next section adopts the following strategy: place a branch in every town with a population of 250,000 or over. For the UK, this would mean just 21 branches for the entire country. This is a far cry from the many hundreds (or even thousands) of branches some UK banks possess at the time of writing this book, and so is an opportunity for a significant cost saving. And the branch would remain what it still is today: an important part of the customer interface and relationship maintenance process;

- **Instant response**: in the digital technology era, there is little justifiable reason for any form of delay in the service process, be this approving a loan, responding to an information request, or correcting an error. Any good bank must place instant response service provision at the top of its priorities, measured in hours rather than days.
- **No more 'computer says no' banking**: the adoption of 'black box' banking relying on models and assumed parameter input has been the significant factor behind the erosion of the relationship with the customer. Computer models are an integral part of the finance sector and will remain so, but an element of judgement call made by a human being is the essential ingredient of genuine good customer service provision. In the UK, banks such as TSB and Handelsbanken are noteworthy for enabling local branch managers an element of autonomy in the loan origination decision. This must surely be the way forward for any bank that takes genuine customer service seriously.

Delivering the above requires the right working culture in the bank. To help inculcate the correct culture, there is one imperative: *employee remuneration should not be linked to customer volume, sales levels, or P&L, but rather customer satisfaction levels*. Anyone who disagrees with this should acquaint themselves again with the stories of each of the bank failures in the UK, Europe, or the US in 2007–2008.

The foregoing presents the basic tenets of a 'good' bank, but in essence only. There is much more required to flesh out these bones, but the above are the key points. Of course, there is much variety in banking and some will prefer an alternative approach, niche or otherwise. Both mainstream banks and new or challenger banks have some things to learn from each other, in reality. But for banking to re-emerge as a long-term sustainable force for good, the mainstream banks are the key players in this great game. An article in *American Banker* entitled 'How far can 'challenger' banks ride fintech charters?'[3] suggests that so-called challenger banks need to do more than simply provide a sleek app if they wish to mount a genuine challenge to the established banks. Its premise was that while such fintech banks may thrive in Europe, the US market is too fragmented in comparison and as such established banks will need to be challenged by a full-service digital service provider rather than a niche provider. But the fintech start-ups in Europe may find a similar obstacle in Europe as well. For instance, it is a moot point how many of the more-than-20 new banks, mainly mobile-only entities, that have been licensed in the UK since 2013 will still be around in 2023 or beyond. Any bank needs to present solid USPs and a reason for a customer to move over to it, and it is in this sphere that so many challenger banks struggle to build critical mass. If a bank cannot present a convincing reason why a customer should change its supplier, it isn't necessarily 'challenging' anybody.

ChoudWest Bank: the model bank and 'concierge banking'[4]

This hypothetical bank presents a business model that is customer-centric and technology savvy. Its credo is in effect to bring 'private banking' to everyone, but by private banking we don't mean asset management and tax planning for wealthy individuals; our definition is of a bank that provides a personal service to each of its customers, retail and corporate, irrespective of their size or income generation potential. Doing this by definition sacrifices an element of profit for the bank. Traditionally, it would also necessitate a large physical branch present and considerable front-office staff numbers, but in the era of fintech this necessity is negated somewhat. In other words, it is by no means inevitable or preordained that, unless one is a high net-worth individual or a large corporate, one has to go without personal service or human contact for one's banking needs. The bank uses the expression 'concierge banking' to encapsulate its service offering. It defines this as follows:

> With Concierge Banking we will make each and every customer feel like they are the most important and valuable customer we have.

The following exhibits set the scene, illustrate the problems with customer service, and how a bank (whether a new start-up or established institution) might look to address the issue. They are self-explanatory. They are designed to be applicable in any jurisdiction, but of course in some countries the problems suggested – and their respective solutions – may not exist, in which case that is already a more satisfactory state of affairs to begin with. Tables 1 and 2 list some current customer issues with their bank in many countries around the world; Figures 1 to 4 describe the model bank's response to them.

3. https://www.americanbanker.com/news/how-far-can-challenger-banks-ride-fintech-charters
4. This section was co-authored with Adam Ginty.

Table 1 Current customer issues

SMEs	Retail customers
• Limited access to unsecured borrowing, and decline in lending • Their bank doesn't understand their business • Often feel that charges are excessive, complex, and unfair • Overdrafts facilities are being withdrawn at short notice • Lending criteria felt to be too onerous • Slow response/turnaround times • No relationship, they are just one of many customers	• Mass market general customer service, not individual focused • Attractive interest rates or bonuses 'disappear' after a short time without notification • Poor customer response: late, inappropriate, inflexible, or conflicting responses • Unusual or onerous contract terms; hidden fees and charges • No genuine service, unable to speak or meet with a human being who is familiar with personal situation

Table 2 Crowded competitive landscape – no single bank meets all customer types' requirements.

Existing banks	'Challenger' banks
Introductory, free business banking with phone-based account management and a range of savings products 1. Business current account and retail savings accounts 2. Full suite of lending, credit, and savings products 3. SME banking focus 4. 18-month free business current account 5. Full product suite 6. SME and retail savers branch and phone	Digital service model, generally serving only a portion of SME and retail savers' banking needs 1. Specialist lender 2. Savings, asset and invoice finance, property lending 3. Telephone, internet, and some limited relationship banking 4. Business lending, property finance, and savings 5. Internet and intermediary based 6. Regional focus

***Figure 1** – Creating a value proposition that delivers concierge banking*

***Figure 2 – Addressing customer issues 1:** Why can't I be treated as more than just a number?*

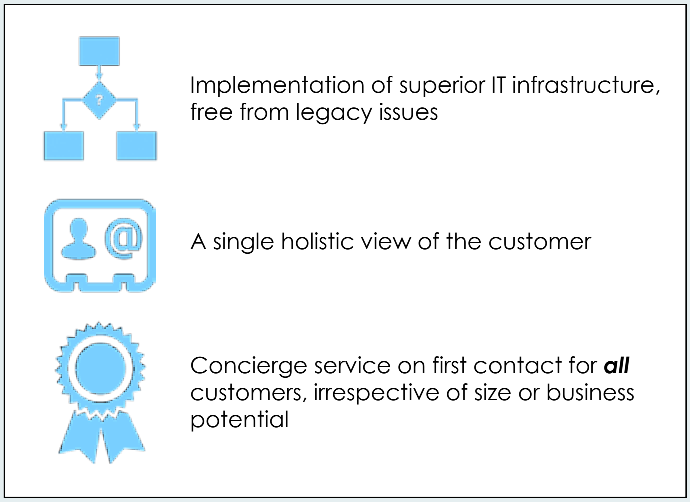


***Figure 3 – Addressing customer issues 2:** Why should I settle for 'computer says no' banking, or busy call centres where my query is simply passed down the conveyor belt?*

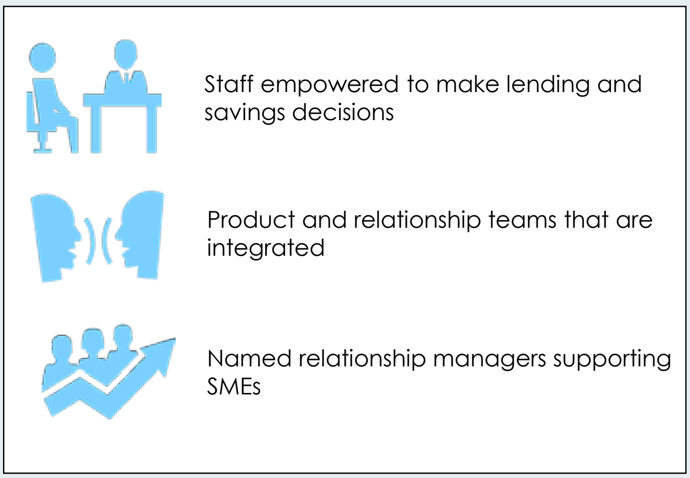


***Figure 4 – Addressing customer issues 3:** Why should I need two years trading history to get a loan, when I've got a great business idea?*

SUSTAINABILITY AND INVESTMENT OPPORTUNITIES

Stella Cox CBE, MD, DDCAP Group

CREATING FINANCIAL SYSTEMS THAT ARE MORE RESPONSIVE TO THE REAL ECONOMY

Islamic financial market practitioners have long argued that forms of Shariah-compliant finance bring impact beyond conventional market alternatives. Their supporting logic is that funds are raised and invested in asset-backed and asset-based transactions through equitable, contractual arrangements that promote partnership and the sharing of profit and loss for the benefit of the wider economy.

Following the global financial crisis, debate about culture and practice within global financial services, as well as their prospective impacts on global social welfare and environment, became a core agenda item for both private and public sectors. Environmental, social and governance (ESG) focused determinants became increasingly numerous, with the social (S) element including crisis and conflict management, community infrastructure services such as healthcare and education, employment and diversity. These determinants resonated further when asset owners, investors and institutions set objectives beyond risk and return to prioritise global social welfare within investment criteria.

The descriptors applied to the various groups and focuses within the responsible investment subset are seemingly ever-evolving, encompassing not just considerations of social impact but those pertaining to the environment (E), including green financing and sustainable investing and also to governance (G). Frequently grouped together, while responsible investment practices incorporate environmental, sustainability and social welfare considerations and therefore have similarities, investors and beneficiaries who also adopt socially responsible investment (SRI) values endeavor to combine financial return with moral or ethical return with the purpose of satisfying measurable social impact objectives.

There is now a growing consensus that the objectives of generating profit and doing well (in whatever form, be it tackling environmental concerns, poverty alleviation, humanitarian crisis management or resourcing healthcare or education) are not mutually exclusive and, in fact, can be achieved in tandem. On 25 September 2015, the General Assembly of the United Nations adopted a set of 17 Sustainable Development Goals (SDGs), with specific targets to be achieved by 2030, as a universal call to action to end poverty, protect the planet and ensure peace and prosperity for all. With an inclusive agenda, the goals are interconnected and provide clear guidelines for adoption, as well as targets for all countries to unite them and address the root causes of poverty. Subsequently, an acceleration of themed funds and investment products targeting socially impacting assets has taken place.

The Islamic capital markets appear to have embraced the trend towards sustainable investing, particularly in South East Asia. Mirroring growing demand for green assets from conventional market investors, there is a similar trend developing in the Shariah-compliant space. This is small to date but undoubtedly growing, in parallel with investments that are made with reference to social considerations. Malaysian sovereign wealth fund, Khazanah Nasional, launched the US$282m Sukuk Ihsan programme in 2015. Ihsan's inaugural issuance became the world's first social impact bond to be rated globally, with issuance proceeds disbursed to improve the accessibility of quality education in Malaysian government schools.

At a supranational level, a noteworthy, global Islamic capital market transaction was the successful US$500m Sukuk issuance in November 2014 by the International Finance Facility for Immunisation (IFFIm). An AA rated obligor, IFFIm raises funds within the international capital markets to accelerate the availability of funds for immunisation programs and health system enhancement by Gavi, the Vaccine Alliance. IFFIm's unique public-private partnership presents a compelling case study for financing with social impact. Government provides 79% of Gavi's funding, with the balance coming from the private sector. Its financial base consists of legally binding grant payments (around US$6.3bn) from its nine sovereign donors, of which the UK is the largest in terms of funding amount and tenor of commitment, while the World Bank is IFFIm's treasury manager. Prior to the 2014 Sukuk, IFFIm had raised some US$5bn equivalent from the conventional capital markets in support of Gavi over an eight-year period. Proceeds of the Sukuk-funded children's immunisation programs in the world's poorest countries. The landmark transaction was the first socially responsible Sukuk. It was the largest Sukuk al-Murabaha in the public markets at the time of issuance, as well as being the largest inaugural Sukuk offering by a supranational.

In May 2016, the United Nations Development Program (UNDP) entered into a Memorandum of Understanding (MoU) with the Islamic Development Bank (IDB) to strengthen their bilateral relationship with the purpose of supporting the effective implementation and achievement of the SDGs. UNDP and IDB's initial MoU was executed as long ago as 1986. Since then, the IDB has extended more than US$240m over a ten-year period for projects relating to agriculture, electricity and housing under the UNDP's Program of Assistance to the Palestinian People. Under the 2016 MoU, concentration will be on upscaling ongoing initiatives and exploring new opportunities.

The Lives and Livelihoods Fund (LLF) is blending a US$500m grant of funding with US$2bn of the IDB's own capital to enable the IDB to accelerate its concessional financing of health, agriculture and basic infrastructure for the IDB's lower income member countries. Major LLF donors include the IDB's own Islamic Solidarity Fund for Development, the Bill & Melinda Gates Foundation, the Qatar Fund for Development, the King Salman Humanitarian Aid and Relief Foundation and the Abu Dhabi Fund for Development. Recently, the IDB, through a statement made at the IMF/World Bank meeting in Washington DC in October 2017, affirmed its intention to extend its Sukuk issuance program in support of financing medium to long-term projects that are principally focused on the SDG objectives.

These are just a few illustrations of the impact that multilateral accords and high-profile public /private sector undertakings can deliver. They are of critical importance. The SDGs will not be achieved without effective social infrastructure for delivery. Sources of conventional, institutional funding do not have sufficient capacity to meet demand and the position is further challenged in emerging economies or those where financial markets remain underdeveloped. Examples of benchmark transactions like IFFIm's have been very limited to date but over the years, financing and investment templates have evolved in response to investment requirements across a diverse set of infrastructure projects in numerous geographies and sectors. They have shown that most asset-backed or asset-based infrastructure is generally eligible for Islamic funding, that sources of Shariah and conventional finance can coexist successfully and that funding can be delivered through public and private sector collaboration. In most instances of private and public sector funding being deployed, multilateral development banks and institutions have been pathfinders, but precedents have been created for commercial lenders to follow.

A changing dynamic in investor demand and stipulation is also now playing its part in shaping the funding of social infrastructure, while diversifying sources of investment and prospectively adding capacity and scale. The scope and extent of that demand is not just apparent within the wholesale markets, either. In the next few years, millennials (those born between 1980 and 2000) will inherit the largest transfer of generational wealth to date and are potentially set to control US$24tn by 2020, according to Deloitte. Millennials tend to be better educated, better informed and socially minded and they are proactive investors in the SRI environment. More affluent Muslim countries have significant millennial populations that are proportionally greater than in non-Muslim countries.

Creating an environment conducive to the financing, creation, implementation and ongoing development success of these innovative, privately owned technology businesses and concepts is, however, a subject of Islamic financial sector debate, as the extent of public sector provision and commitment varies between geographies and start-up businesses are challenged by the lack of access to capital.

Challenge and awards initiatives such as the Ethical Finance Innovation and Challenge Awards (EFICA), sponsored by Abu Dhabi Islamic Bank and Thomson Reuters, which will enter its fifth year in 2018, and the RFI Foundation's Support Disruption for Good Challenge, acknowledge the current disconnection between smaller, impact focused businesses and the unsatisfied requirement to mobilise capital to meet the 2030 targets of the SDGs. These Challenges provide a platform for small and innovative business to present and highlight to a broader audience, giving the opportunity to generate awareness, extend outreach, attract expert mentorship or even raise capital. In 2018, the RFI Support Disruption for Good Challenge will focus on identifying technology companies whose products and services are gaining market traction and whose technology helps the financial sector to increase the scale of its financing and investment in the priority sectors of agriculture, healthcare and development of sustainable cities.

The IDB is also launching a fund which will provide seed capital to innovative start-ups and small and medium-sized enterprises (SMEs), helping them implement development projects related to certain of the SDGs. IDB's Transform Fund, which has a target capital of US$500m, will run in tandem with a new online hub called Engage, designed to connect innovators to each other and assist them in developing their ideas. Both the hub platform and the Transform Fund will focus on projects related to six of the SDGs, being greater food security, healthier lives, inclusive and equitable education, sustainable management of water, access to affordable and clean energy, and sustainable industrialisation across the developing world. The Fund will ensure that innovators, start-ups and SMEs with the best ideas get access to financing for those projects. It will provide up to US$50,000 to US$100,000 for individual projects, as well as funding partnerships between researchers and entrepreneurs that will tackle the world's most pressing development challenges.

Conclusion

There are many principles of Islamic financing and investment that are complementary to impact investing. Both focus on creating financial systems that are more responsive to the real economy and provide a more holistic approach for all stakeholders. Undoubtedly, the stewardship embraced by Islamic financial practitioners promotes social impact and governance but, as a financial sector subsector that has evolved from a commercial banking model within emerging markets, there has been a timeline to ensuring that the sector, its capabilities in terms of both product and technology and the mindset of its stakeholders are suitably developed, aligned and appropriately placed to deliver. Given the enormous global requirement for investment in social infrastructure development to satisfy welfare needs, public sector policy and multilateral accord must provide for delivery of financing and investment solutions to achieve goals and meet objectives. However, the opportunity is there for private sector participation of varying scale. Other subsets of the SRI community are clearly enthusiastic to explore opportunities to collaborate with Shariah-compliant partners and, within the Islamic financial marketplace, we are establishing our own organisations to foster a more evolved understanding of where our respective responsible focuses and values might complement each other. This with the objective of originating practical and compelling financial offerings.

The Deloitte report on 'Scalable and sustainable funding sources for social infrastructure' is available at deloitte.com

GREEN FINANCE – THE PENDULUM SWINGS

Mike Wardle, head of indices, Z/Yen

Mike_Wardle@zyen.com

Z/Yen, the team led by Alderman Professor Michael Mainelli, Chartered FCSI which delivers the Global Financial Centres Index, has turned its attention to global green finance for its latest index. This series will chart the progress of the world's financial centres towards a financial system that delivers sustainable development, and values people and the planet as much as profit. Mike Wardle, who ran the project at Z/Yen, explains the background. For further information, see a special interview with Mike Wardle on CISI TV. [Detailed footnotes are available with links for convenience at cisi.org/rofmq2-18]

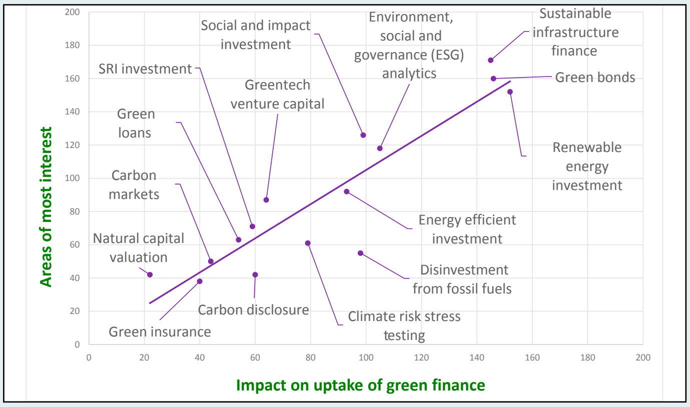


Chart 1: Relationship between areas of impact and interest

As we accelerate through the 21st century, the world is facing a number of significant challenges which will require unprecedented levels of investment in systems and infrastructure if they are to be overcome. The UN recognises the vitally important role of a sustainable financial system, which "serves the long-term needs of a healthy real economy, an economy that provides decent, productive and rewarding livelihoods for all, and ensures that the natural environment on which we all depend remains intact and so able to support the needs of this and future generations."[1]

Why an index?

Measurement is important, and this is reflected in the mantra of business management, 'we value what we measure'. As Mainelli and Harris point out, "environmental sustainability is a tough equation",[2] so the more data we have to work with, the better.

However, as Boyle states, we are often "exact about some of the least interesting things, but silent on wider and increasingly important truths".[3]

Measurement is only a means to an end. The purpose of measurement is to create the data from which information and knowledge emerge. Information and knowledge which can be used as the basis for sound decision-making and policy creation. We hope that this index will provide policymakers, businesses, academics and NGOs with data that can be used to facilitate the development of sustainable financial systems and the greening of financial products and services.

What are we seeking to measure?

The Global Green Finance Index (GGFI) seeks to measure perceptions of the quality and depth of green financial products across the world's financial centres. This leads to three questions:

- What is green finance?
- What is a financial centre?
- How can you measure quality and depth?

What is green finance?

Numerous organisations and institutions have developed their own definitions of green finance. The G20 defines it as the "financing of investments that provide environmental benefits in the broader context of environmentally sustainable development".[4] The OECD considers the term to be "stand-alone, a subset of a broader investment theme or closely related to other investment approaches such as socially responsible investing (SRI); environmental, social and governance (ESG) investing, sustainable, long-term investing or similar concepts."[5] Deutsches Institut für Entwicklungspolitik (DIE) defines it as the financing of public and private green investments (including preparatory and capital costs) in the following areas:

- environmental goods and services (such as water management or protection of biodiversity and landscapes)
- prevention, minimisation and compensation of damages to the environment and to the climate (such as energy efficiency or dams)
- the financing of public policies (including operational costs) that encourage the implementation of environmental and environmental-damage mitigation or adaptation projects and initiatives (for example feed-in tariffs for renewable energies)
- components of the financial system that deal specifically with green investments, such as the Green Climate Fund or financial instruments for green investments (eg, green bonds and structured green funds), including their specific legal, economic and institutional framework conditions.[6]

For the purposes of the Global Green Finance Index (GGFI), green finance refers to any financial instrument or financial services activity – including insurance, equity, bonds, commodity and derivatives trading, analytical or risk management tools – which results in positive change for the environment and society over the long term (sustainability). The most basic 'greenness' criterion of a company or project is that it contributes to reducing the emission of greenhouse gases. Over the past two decades, the rise of new financial instruments, such as green bonds, and environmental markets, such as carbon, forestry, or water services, along with advances in analytical techniques, have increased attention on green finance.

As demonstrated by its prominence in international policy discussions, such as in recent World Economic Forum meetings, green finance is no longer seen as a fringe activity, but a profitable and desirable sector, which drives financial markets, serves society and enhances the status of financial centres that demonstrate expertise.

The transition to a green economy, required if the world is to meet the targets laid down in the Paris Agreement, is a global investment opportunity estimated to be worth tens of trillions of dollars.[7] Vast investment is required for sustainable urbanisation in the face of a growing world population.[8] Financial services, if properly regulated and sized, are

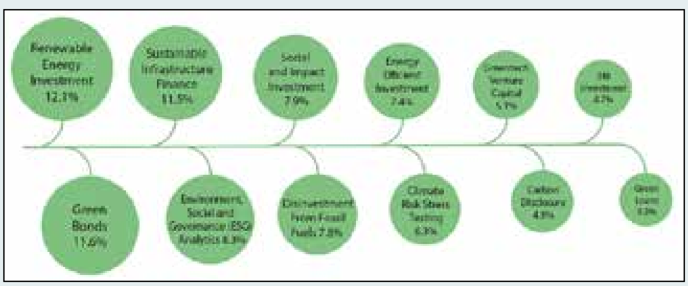


Chart 2: Activities with most impact on sustainability

an essential component of a sustainable economy,[9] which meets the needs of stakeholders, enhances quality of life, protects the environment and addresses global issues such as climate change. However, there is still a long way to go: so far, only 5–10% of bank loans are 'green' [10] (based on data from the few countries where national definitions of green loans are available). Brown finance (finance flows that support carbon-intensive projects or activities) still massively overshadows green: G20 countries alone spent US$72bn annually in public finance on fossil fuel energy production between 2013 and 2015.[11]

Financial systems are failing effectively to reflect pricing signals and risk, as financial systems do not routinely take account of environmental costs or environmental limits. Four out of nine 'planetary boundaries' have been crossed: climate change, loss of biosphere integrity, land-system change, and altered biogeochemical cycles.[12] To help explore these issues, the GGFI gives a measure of how financial centres are responding to this challenge. We hope that enabling centres to compare their performance with their peers will improve policy makers' understanding of the drivers of green growth, and assist them in shaping financial systems to support sustainability goals.

For practical purposes, a financial centre often means a city with a stock exchange. UNEP defines financial centres "as cities with an intense concentration of financial activity involving an interlocking set of financial sectors and transactions." [13]

The approach to measuring quality and depth

Green financial products and services have been traded for over two decades, but until recently, volumes were quite small and trade tended to be primarily restricted to niche and domestic, rather than mainstream international markets. Measuring the quality and depth of green financial products across the world's financial centres presents a significant challenge. This has been recognised by the UN and other international bodies and has formed the focus of a number of initiatives, including UNEP FI's Positive Impact Initiative,[14] UNEP's Financial Centres for Sustainability Initiative,[15] Climate KIC, I4CE and PwC's Benchmark,[16] and UN PRI's Sustainable Stock Exchanges Initiative.[17]

The GGFI is complementary to these initiatives, as it seeks to use advanced statistical techniques to bridge the gaps in existing data by combining quantitative factors with the perceptions of financial services professionals and other experts. Another strength of this approach is that it is future-facing; combining the real-time opinions of practitioners with past performance data. As survey data for the GGFI is gathered on a continual basis and the intention is to publish updates twice a year, the index will be sensitive to real-time changes in the international policy environment and developments in financial services markets.

The survey asks for views on the penetration of green finance in a financial centre's overall financial activities. This reflects that the mix of financing activities, such as the ratio between green and brown financing, is important for sustainability. The survey also asks about the quality of green finance, enabling respondents to rate a financial centre independently from its market volumes. Thus, if a centre adopts weak green labelling standards in a bid to boost volumes, this may show up in the GGFI as a lower quality rating. This approach is designed to encourage a race-to-the top among financial centre policymakers. The GGFI, in combination with the other measurement initiatives listed above, will allow the identification of trends, and potentially enable policymakers to track the impacts of their decisions and identify and fill data gaps.

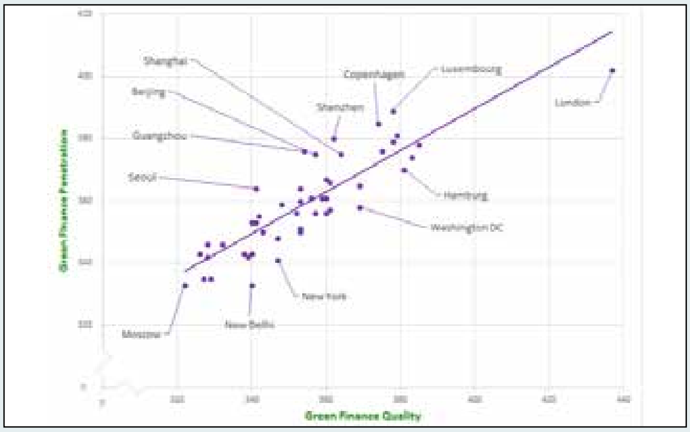


Chart 3: Relationship between penetration and quality

Areas of green finance: impact on sustainability

Alongside the ratings of penetration and quality in the GGFI questionnaire, the project asked additional questions about the development of green finance. These focused on: areas of green finance considered most interesting by respondents; areas of green finance with most impact on sustainability; and factors driving the development of green finance.

We asked respondents to identify the four areas of green finance which they considered had most impact on sustainability. The results are shown in Chart 2 (left). The top areas listed are: renewable energy investment; green bonds; sustainable infrastructure finance; environment, social and governance (ESG) analytics.

Interest, impact and penetration

Chart 3 shows the relationship between ratings of penetration and quality in the index. The ratings are universally low, however, this chart shows the generally close correlation between the assessments of each factor by respondents.

Looking at the areas of green finance respondents identified as interesting and those they considered had most impact, we see a close correlation, as shown in Chart 1. Disinvestment from fossil fuels stands out as further from the trendline, reinforcing that its impact was judged greater than the interest shown in it as a green finance activity.

Key results of initial survey

Western Europe does well, featuring nine of the top ten centres in the quality index and seven of the top ten in the penetration index. 21 of the 47 centres in the index are in Western Europe. London comes top for both measures, closely followed by Amsterdam for quality and Luxembourg for penetration. Only 58 points separate the top five centres for quality and just 21 points for penetration.

San Francisco and Washington come equally in tenth place in the ranking as the top North American centres in the quality index. San Francisco is also the top North American centre in the penetration index. Despite being acknowledged as one of the world's top financial centres, New York is significantly outperformed by other North American centres in the GGFI.

Shanghai and Shenzhen are top in the Asia Pacific region for quality and penetration respectively. Chinese centres all perform well and are closely clustered in terms of ratings.

THE REWARDS OF VIRTUE

As part of the CISI's education programme with BlackRock, one of the world's biggest asset managers, we recently ran a major event for members on some of the key drivers in sustainable investment, one of the hottest topics in wealth management, financial planning, and capital markets in 2018. This note provides some of the chief highlights from this talk. The full version is available on CISI TV.

John McKinley, a director at BlackRock and one of the founders of the firm's Sustainable Investing team, spoke to a packed audience of CISI members, many of them high-flyers from major houses, in mid-April. His full talk is available now on CISI TV, but his key points are summed up in BlackRock's belief that "companies that effectively manage ESG – environment, social, and governance – risks and opportunities perform better over time. BlackRock benefits from one of the biggest and most sophisticated data analytics machines in the world – 'Aladdin', which makes most academics green with envy. Hooking up with the equally prodigious MSCI research has found that companies with strong ESG profiles exhibit the following characteristics:

Stronger cash flows

They are more competitive than their peers because they more efficiently use their resources, and/or have better human capital management as well as better management of long-term business plans. This leads to higher profitability and higher dividends.

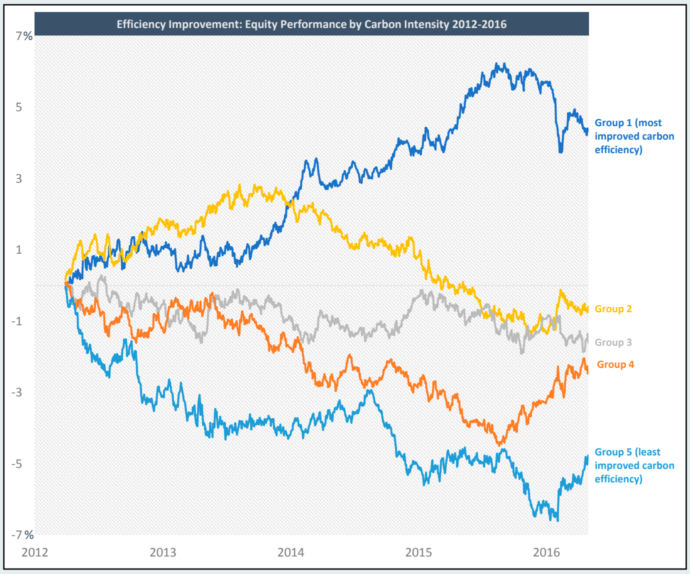
Less idiosyncratic risk

They have better risk control and compliance standards. Better risk control leads to fewer negative incidents and less stock-specific downside or tail risk in the company's stock price.

Higher valuations

They are less vulnerable to systematic market shocks and therefore show lower systematic risk. Lower systematic risk means a lower beta, which translates to lower cost of capital and a higher valuation. Further valuation is increased through the increased size of investor base.

Meanwhile, BlackRock found that companies that reduce their carbon footprint also have stronger equity performance:



MSCI: 'Foundations of ESG Investing, Part 1: How ESG affects equity valuation, risk and performance," 2017. Giese, Guido, Lee, Melas, Nagy, Nishik. Sources: BlackRock Investment Institute, ASSET4 and MSCI, July 2016

Notes: The analysis above calculates the carbon intensity of all MSCI World companies by dividing their annual carbon emissions by annual sales. Companies are ranked and bucketed in five quintiles based on their year-over-year change in carbon intensity. BlackRock then analyse each quintile's stock price performance versus the MSCI World Index. Most improved means the 20% of companies that posted the greatest annual decline in carbon intensity. Data is from March 2012 through April 2016. The example is for illustrative purposes only.

How to incorporate sustainable investing

There is a broad spectrum of ways to incorporate sustainable investing. Investor motivations often fall into one of two categories: 'Avoid' and 'Advance'. Avoid is about eliminating exposures to certain sectors or activities. Advance is about aligning capital with certain behaviours, activities or outcomes. The graphic below, supplied by BlackRock, shows some solutions for avoiding and advancing. Solutions marked with an asterisk are currently in development. (As ever, there is no guarantee that a positive investment outcome will be achieved. The information below is for illustrative purposes only and should not be interpreted as investment advice or recommendation.)

	AVOID	ADVANCE		
	Screened	**ESG**	**Thematic**	**Impact**
Objective	Remove specific companies/ industries associated with objectionable activities	Investing in companies based on aggregate ESG performance	Focus on particular E, S or G issue	Target specific non-financial outcome alongside financial return
Key considerations	Definition of the screen and financial impact of screens	ESG rating system, active risk	Broad or concentrated/ niche exposure	Dedicated reporting on progress towards outcome
BlackRock sustainable investment sample solutions	BLK offers a wide range of services customised solutions in SMAs and screened commingled products. Offerings include: • ***Climate:* ex fossil fuels** • ***Industry:* ex controversial weapons, ex tobacco** • ***Country:* Sudan free** • ***Religious:* Christian, Islamic**	BLK separate ESG strategies across two specific styles • **ESG optimised:** offer a way for clients to maximise the overall increase in the ESG score of their portfolio while closely tracking parent indices. • **ESG best-in-class:** a higher conviction strategy for clients interested in overweighting the highest scoring ESG companies	BLK develops thematic products for clients focused on a specific theme **Environmental focus:** • **Low carbon** • **New energy** • **Electric vehicles*** **Social focus** • **Diversity & inclusion*** • **Human capital***	BLK offers strategies across asset classes that are linked to a tangible impact • Equities: impact **equity** (Systematic Active Equities) • Fixed income: **impact bond** (Systematic Fixed Income), **green bonds** • Private market: **global renewable power**