

JULY 2016

THE Review

CISI.ORG/REVIEW

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

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Economic reforms are spurring growth in India

A taxing issue

Tax havens are in the spotlight once again

Threats from within

How to prevent internal leaks

Inside

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AND JULIAN ROBERTS
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BUSINESS PROBLEM WITH
A CHARITABLE OUTCOME



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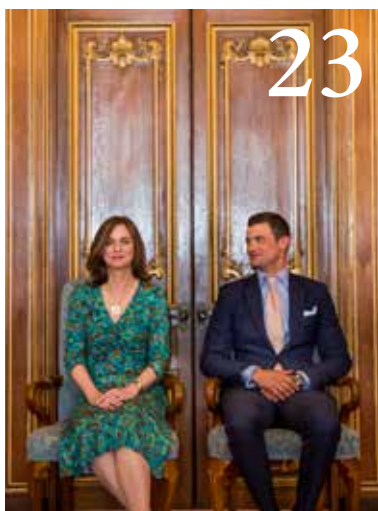
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WE ARE MOVING

The CISI London office is moving this summer

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City view



UK TAX IS A COMPLICATED AFFAIR, PARTICULARLY FOR THOSE WORKING ABROAD. BUT COULD THE WHOLE SYSTEM BE SIMPLIFIED AND MADE FAIRER AT THE SAME TIME?

Fairness is only one of the four components of the Institute's definition of integrity, along with honesty, openness and transparency, yet it is often the key driver whenever the subject of tax is raised.

This is why there is such a huge adverse public reaction whenever there is the revelation that a firm or an individual hasn't paid what is considered to be their fair share of the tax burden, or delight when there is a ruling that makes the wealthy pay more.

The bloggers had a field day in mid-April when the Supreme Court ruled against a group of celebrity investors (including many well-known footballers) that their film scheme (Eclipse 35) was nothing more than a tax avoidance scheme and they are now liable for £635m of tax.

POOR BALANCE

But the UK income tax system isn't fair at the best of times. The top 1% of taxpayers, roughly those who have an income over £150,000, pay almost 30% of the entire income tax burden of £160bn, while the average person pays less than £5,000.

The recent leak of papers from the Panama lawyers, Mossack Fonseca, led to dramatic

headlines about the super-rich sheltering their income, and a highly charged political debate about whether holding investments in a company registered in an offshore jurisdiction was illegal, immoral, sensible and/or common practice.

However, we could greatly simplify the collection of UK tax, and spread the load more fairly, if we moved away from just operating a residence test when determining whether an individual should pay tax.

We could simplify the collection of tax, and spread the load fairly

At present it is residency, rather than citizenship, that determines whether or not an individual is liable to pay tax on their worldwide earnings. This should now be changed so that anyone who is a UK passport holder is also liable to pay tax on their worldwide income in exactly the same way as US citizens are taxed on their worldwide income, irrespective of where they live. Of course, there are double taxation treatments in most countries, so

a citizen who is resident outside the US doesn't pay twice.

The same should apply in the UK.

If an individual wants the benefits and protection from being a British citizen, they will have to pay UK tax. Full stop. It will mean that many UK citizens currently working abroad in low, or zero income tax countries, would need to contribute to the UK Exchequer.

A BETTER WAY

At a stroke, it would remove the arguments over the definition of residency; it will no longer matter if someone is in the UK for 16 days, 90 days or 183 days (all key time periods at present in determining residency). It will avoid the nonsense of midnight flights and sub-optimal planning as individuals, usually highly paid and with a high net worth, take steps to ensure they don't overstay their time in the UK in a tax year.

It will mean that those who seek lower tax havens can still do so, and they can run empires and businesses from anywhere in the world – but if they want the benefits and rights of UK citizenship, then they need to accept their responsibilities to pay their fair dues.

CISI Awards Ceremony celebrates top achievements

In April, the CISI celebrated the achievements of some of its best and brightest members at its Awards Ceremony 2016. The glamorous event, held at the Mansion House in London, recognised the dedication and successes of those who have completed qualifications to the highest

standards this year. Sir Alan Yarrow, Chartered FCSI(Hon), CISI Chairman, said: “Many congratulations to all those who won awards; your success now will help you to achieve your career goals in the future. It is events like this that make you realise just how much the Institute has

influenced the industry’s development, not just in the UK, but around the world.”

We spoke to some of the prize-winners about their accomplishments, starting with Georgia Sherman MCSI, overall winner of the CISI’s highest-level award.

BACK STORY

Georgia Sherman MCSI, Channel Marketing Executive at Quilter Cheviot, won the Institute’s top prize after receiving the highest aggregated mark of the year for the Chartered Wealth Manager Qualification (level 7)



Georgia studied Geography at the University of Cambridge. She enjoyed discovering how different elements can affect the world, and particularly enjoyed the political aspect of the course and seeing what was going on in the world generally. Likening this to her current role, Georgia said: “Investment requires an in-depth knowledge of the macro environment and I think it was this that attracted me to the industry.”

After graduating in 2012, she joined Quilter Cheviot that September as a Trainee Investment Manager. To supplement her knowledge, she began taking CISI qualifications, most recently completing the course for which she was recognised.

She says that it has been a great help to her work in investment. “The Chartered Wealth Manager Qualification opens the door to a career in the wealth management

industry, and the knowledge gained from the qualification can be applied to a plethora of roles. Having not studied economics or finance at university, it improved my understanding of financial markets and provided me with a range of skills that I will continue to use in my current role and in future roles.”

In November 2015, Georgia took on the role of Marketing Executive. “I really wanted to expand my knowledge within the firm and my new role gives me the opportunity to explore other areas within investment management. Being in a marketing role in an investment company, it helps to have an understanding of what the client wants and how our investment managers build and manage portfolios tailored to each client’s individual preferences.”

For those hoping to emulate her success in exams, Georgia says an understanding of

oneself can be as important as knowledge of the subject. “It is important to understand how you learn. No one revises in the same way so my biggest tip would be to use revision techniques that work for you. I revise by writing out extracts from the textbook numerous times, so my biggest challenge was finding the time!”

Outside of professional and academic life, Georgia continues to push herself. She is a keen athlete, playing netball while also finding time to run.

For those considering taking on further study, Georgia says the CISI qualifications should be a first port of call. “I couldn’t recommend these qualifications enough. They provide you with a solid understanding of the wealth management world and they fully prepare you for a role as a wealth manager due to the client-focused nature of the exams, unlike some other exams out there.”



60-SECOND INTERVIEW

Gareth Hodson MCSI, Operations Manager at EFG Harris Allday, received the award for overall winner of the Diploma in Investment Operations (level 6). He also won the award for Global Operations Management (level 6)

Why did you choose to take CISI qualifications?

CISI exams are widely recognised throughout the industry and I have always been determined to expand my knowledge with pertinent qualifications. The Global Operations Management (GOM) paper was the final exam I needed to pass in order to complete the Diploma in Investment Operations qualification.

I enjoyed the fact that this paper took a very high-level view over a broad number of topics and themes. In a working environment, details can always be looked up, whereas this exam makes you think about broad principles, risks and judgments that you may be required to make in senior roles.

How have these qualifications helped you in your current job role and or career?

The process of revising for the GOM paper widened my appreciation of risk and I now genuinely consider it a benefit to operations, rather than the box-ticking exercise it may have previously been thought of.

I was promoted to a managerial role in November 2015. Of course, this wasn't entirely attributable to the completion of the exam, but I firmly believe that having a level 6 postgraduate diploma in a relevant exam has me well placed for my career.

What advice would you give to someone taking the qualification?

You need to be prepared to put the work in. Balancing a demanding full-time role alongside the study required is a skill in itself, and there is a need to be disciplined with time management. Ultimately you have to go through an intense few months but can hopefully relax once the exam is complete.

How did you study for the exams? What tips do you have for others?

Read the textbook very quickly, read it again highlighting key text, look at past papers and attempt them. I also attended a Capital Markets & Derivatives Training course. I cannot overstate how beneficial it is to have a tutor on hand to raise queries with.



There is also a need to go beyond the syllabus and research topical issues that are relevant to the industry in the lead up to the exam.

What is your focus now?

I am now focusing on my new role as Operations Manager. I will continue with CPD and use the professional refreshers on the CISI website alongside attending CISI events. I then aim to achieve Chartered MCSI status before finally hoping to achieve Chartered FCSI status over the required time period.

Would you recommend these qualifications to others?

Without any hesitation. The key is relevance – there is no point gaining a qualification that you cannot use. Candidates are more attractive to present and potential employers having completed high-level papers that differentiate them from their peers.

CISI Awards winners from level 2 to level 7

CISI qualifications offer practitioners the opportunity to achieve core competence and foster strong careers in all areas of financial services. Starting from level 2 and level 3 foundation qualifications, candidates can further their knowledge by following a progressive study pathway at increasingly higher levels. We chatted to winners to get their feedback

LEVEL 2 AWARD

DREW DAVIS, Production Executive at CISI, is one of several winners of the Fundamentals of Financial Services award

Why did you take the qualification?

When I first started work at the CISI, I had little experience of the financial services industry. Now I have a far deeper understanding of the material I work with, and am able to converse with our industry specialists – who provide and update the content of the workbooks – on a better-informed basis.

Would you recommend this qualification to others? If so why?

Of course! Studying for this exam formalised and clarified a lot of areas of which I had previously only had a vague and general understanding. The CISI online revision tools were invaluable in helping me identify my areas of weakness, meaning that I could go back and focus my attention where it was most needed. The result has given me a good, all-round grounding in the financial services industry.

- Find out more about Fundamentals of Financial Services at cisi.org/fundamentals



LEVEL 3 AWARD

LISA FOX, Technical Senior Associate at Fidelity, is a multiple award winner. She is the overall winner of the Investment Operations Certificate (IOC) and one of the Introduction to Investment – The Foundation Qualification winners

Why did you choose to take CISI qualifications?

The IOC exams are a superb introduction to the industry as a whole, and an invaluable tool in learning the key elements.

Would you recommend these qualifications to others? If so why?

The IOC is a great way to achieve a firm grasp on the financial services industry as a whole. For anyone looking to work within the industry, or indeed progress, these exams are a solid starting point. I would highly recommend them. Passing the IOC gave me the confidence I needed to push

myself further and I haven't looked back!

- Find out more about the Investment Operations Certificate at cisi.org/ioc



LEVEL 4 AWARD

STEVEN WYLES ACSI, Head of Audit – Sales & Operations at Santander, is one of two joint winners of Managing Operational Risk in Financial Institutions

Why did you choose to take a CISI qualification?

It is a recognised qualification with a strong reputation, and it provided me with the flexibility to study at home and at my own pace.

Would you recommend this qualification to others? If so why?

Yes. It cements and reaffirms existing knowledge and adds credibility to the work we perform in internal audit.

- Find out more about Managing Operational Risk in Financial Institutions at cisi.org/morfi



LEVEL 5 AWARD

FELICITY HOOPER ACSI, Manager – CGT at Investec Wealth and Investment, winner of Advanced Global Securities Operations

Why did you choose to take a CISI qualification?

To challenge myself and expand my knowledge of the operations aspect of the industry.

Would you recommend this qualification to others? If so why?

Yes, as they provide a step up from the IOC. By studying for my qualification I have improved the depth of my understanding of the industry

as well as the interaction between the team I manage and the wider business. As well as gaining knowledge, the exams test your application of the information learnt. I believe this is very helpful for supervisors and managers or for anyone wishing to further a career in an operations role.

- Find out more about the Advanced Certificate in Global Securities Operations at cisi.org/agso



LEVEL 6 AWARD

JAMES COOPER, Corporate Finance Manager at Lovewell Blake, is a multiple award winner: overall winner of Diploma in Corporate Finance and Corporate Finance Strategy & Advice

Why did you choose to take a CISI qualification?

After transferring to the corporate finance department, I wanted to gain a better understanding of the theory behind corporate finance. The partners at Lovewell Blake were supportive of my undertaking the Diploma via the study route, so that we could promote this to future members of the team.



Would you recommend these qualifications to others? If so why?

I would recommend this qualification to anyone who is already working in corporate finance or is looking to enter into a career in corporate finance. The course syllabus is relevant to my day-to-day role of advising clients on matters such as mergers, acquisitions, disposals, management buy-outs, raising debt and equity finance and business valuations. It has really helped my understanding.

- Find out more about the Diploma in Corporate Finance at cisi.org/dlpcf
- Read James's 60-second interview at cisi.org/james60seconds

LEVEL 7 AWARD

SEBASTIAN TAYLOR, Chartered MCSI, Investment Adviser at Charles Stanley, achieved the highest mark for Applied Wealth Management, which is the final unit of the Chartered Wealth Manager Qualification

Why did you choose to take a CISI qualification?

The CISI level 7 qualification is the benchmark and also the most highly regarded qualification within the investment management industry. In order to manage discretionary money, companies now consider it a prerequisite to be level 7 qualified.

Would you recommend these qualifications to others? If so why?

Yes, as they are essential to having a solid career in the wealth/investment management industry. Investment management is an extremely broad subject, however you will usually specialise in a specific area. By studying for this qualification I was exposed to new areas. Having an understanding of all these other areas, I feel I am better equipped to deal with clients and their

queries. It is very important not to underestimate the exams as they are not easy and if you don't study hard for them, it is unlikely that you will pass.

I also found that working towards these exams focused me and helped me achieve more at work.

- See page 6 for our interview with the overall winner of the Chartered Wealth Manager Qualification



Level 7 - About the Chartered Wealth Manager Qualification

The Chartered Wealth Manager Qualification is the CISI's flagship wealth management qualification, leading to full membership and Chartered Fellowship of the Institute.

It is a postgraduate level specialist qualification, encompassing the breadth of knowledge needed to provide the highest quality service to clients. Comprising three units: Financial Markets, Portfolio Construction Theory

and Applied Wealth Management, it provides a grounding in economics and interpretation of economic statistics, financial statements, investment analysis, portfolio construction and applied wealth management.

Upon achieving the qualification you may be eligible to apply for our Chartered Wealth Manager title.

Find out more at cisi.org/cwm



The Review's quick quiz features questions from CISI *Professional Refresher*, an online learning tool. This consists of more than 70 modules covering topics including anti-money laundering, the UK Bribery Act, information security and data protection. Answers are on page 15.

1. After the UK, which jurisdiction has the highest number of listings on the London Stock Exchange?

- A Guernsey
- B Jersey
- C Isle of Man
- D Bermuda

2. Why would having a valid will be preferable to dying intestate?

- A Because it gives control of the destination of assets
- B Because it always reduces the inheritance tax liability
- C Because it always means the spouse gets everything
- D Because it can be kept up-to-date for free

3. Which of the following is most likely to be regulated advice rather than generic advice?

- A A recommendation to invest in equities rather than bonds
- B A recommendation to invest in a particular geographic region
- C A recommendation to reduce holdings in commodities
- D A recommendation to invest in a money market fund

4. What is the meaning of the term 'insistent client'?

- A A client who insists on taking advice from a particular financial adviser
- B A client who insists on a course of action which is contrary to that recommended by a financial adviser
- C A client who insists on reading all documentation prior to accepting an adviser's recommendation
- D A client who insists on carrying out a course of action without taking advice from an adviser

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 about *Professional Refresher*, visit cisi.org/refresher or contact the CISI on +44 20 7645 0777.

Events preview

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

CONFERENCES

3-5 OCTOBER

FINANCIAL PLANNING ANNUAL CONFERENCE

Celtic Manor, Newport, Wales

The CISI's first Financial Planning Annual Conference will cover a range of technical and soft skill topics delivered by high profile speakers from in and out of the industry.

5-6 DECEMBER

SCOTTISH FINANCIAL PLANNING CONFERENCE

Norton House Hotel & Spa, Ingliston, Edinburgh

The CISI will be hosting a conference for Scottish financial planners and paraplanners which will focus on local policy challenges and skills development.

CPD WORKSHOPS

13 JULY The six steps of financial planning (Birmingham)

17 NOVEMBER Estate planning (London)

ANNUAL DINNERS

08 SEPT Scotland branch Annual Dinner & Awards

06 OCT Bristol & Bath branch Annual Dinner

13 OCT South East branch Annual Dinner

10 NOV East Anglia branch Annual Dinner

18 NOV South Coast branch Annual Dinner

OTHER HIGHLIGHTS INCLUDE

11 July: Divorce and the family business, solutions and marital agreements (Yorkshire)

12 July: From outer stress to inner peace: dealing with stress at work (London)

27 July: Principles of Financial Planning exam workshop (London)

06 September: IFP Forum: Creating a transformational client experience (London)

08 September: Behavioural economics – the FCA, you and your clients (London)

13 September: Introduction to technical analysis for wealth managers (London)

14 September: Supervision and people management in an evolving regulated environment (London)

20 September: Bank of England update (Yorkshire)

27 September: Economic impact of business confidence (Scotland)

28 September: Financial planning – From pensions to communications skills to adding value through tax and more (Northern Home Counties)

20 October: Passing wealth on & What a good client file looks like (Lancashire and Cumbria)

26 October: Global macro and market outlook (London)

IN-HOUSE TRAINING

The CISI delivers in-house training courses for members and non-members, spanning a variety of skill areas. If you have a team that requires training, please contact Alex Xavier (Assistant Director, Member Services) on +44 20 7645 0725 or alex.xavier@cisi.org

- 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, training courses, CPD and social events available to members, visit cisi.org/events

Ask the experts: What are the changes to Market Abuse Regulation?

What are the rules for?

Market Abuse Regulation (MAR) and the Market Abuse Directive (MAD) II are designed to improve confidence in the integrity of European markets, increase investor protection and encourage greater cross-border co-operation. Most of the provisions apply from 3 July 2016.

What is the scope of the new rules?

The remit of MAR has expanded. The scope is extended to include all financial instruments admitted to trading on a multilateral trading facility (MTF) or an organised trading facility (OTF). It also applies to financial instruments where the price or value depends on or has an effect on the price or value of a financial instrument trading on a regulated market (RM), MTF or OTF.

What do the rules say about insider dealing and unlawful disclosure?

The use of inside information to amend or cancel an order is now considered to be insider dealing. Recommending or inducing another person to transact on the basis of inside information amounts to unlawful disclosure of inside information.

And market soundings?

MAR recognises that inside information can be legitimately disclosed to a potential investor in the course of market soundings in order to measure interest in a potential transaction, its size or pricing. However,

MAR adds requirements on firms to establish a framework for persons to make legitimate disclosures of inside information and imposes detailed record-keeping requirements in the course of market soundings.

Insider lists?

These place an obligation on issuers and emission allowance market participants (EAMPs) to draw up and maintain a list of all those persons working for them that have access to inside information.

Most of the provisions apply from 3 July 2016

Manager/directors' transactions?

Persons discharging managerial responsibilities (PDMR) within an issuer and persons closely associated with them, must notify the issuer and the regulator of personal transactions they undertake in the issuer's financial instruments.

Stabilisations and buy-back transactions?

There are some revisions to the existing stabilisation and buy-back regulations. Stabilisations must be carried out for a limited period; relevant information about the stabilisation must be disclosed; and adequate limits regarding price must be respected. For buy-back transactions, full details of the programme must be disclosed prior to the

start of trading; trades must be reported to the relevant competent authority as being part of the programme and subsequently disclosed to the public; and adequate limits regarding price and volume must be respected.

Algorithmic and high-frequency trading?

Some types of abusive algorithmic and high-frequency trading strategies are expressly forbidden. Furthermore, any person(s) involved in design or coding of algorithms that are manipulative or abusive are within scope.

Investment recommendations?

Persons producing or disseminating investment recommendations are required to ensure information is objectively presented, and to disclose any conflicts of interest. Investment recommendations will also include sales notes and re-dissemination of research.

Suspicious Transaction and Order Reports (STORs)?

Investment professionals' obligation to report suspicious transactions is extended to cover suspicious orders as well. Trading venues are also caught by the obligation to submit STORs.



Rebecca Deane, Senior Manager, Business Risk Services, Grant Thornton

Membership Privileges



10% off on all attraction tickets

Looking for a fun day out or an excursion in the UK or further abroad? Treat yourself and the family to an experience to remember at a wide range of local and international attractions. From The London Bridge Experience, to Universal Studios in Hollywood and Big Bus Tours in multiple cities, there is something for everyone.

With a one-stop shop all under one roof, there's no easier way to book your tickets, even at the last minute. You can book your

attractions tickets online and by phone with our dedicated booking service. You will receive your tickets instantly via email, plus there are no credit card or booking fees.

To benefit, log in to *MyCISI*, click on Membership Privileges and View your Membership Privileges, which will take you to the shopping portal. Search for 'attraction tickets' for a comprehensive list of offers. Simply book online and your discount will be automatically applied.

Terms and conditions apply. See website for further details.

The Review: Insight and analysis for financial services professionals



In 2017, the Institute proudly enters its 25th year since it evolved from the London Stock Exchange, and I write this message to you, having just been involved

in a discussion about how we'll mark this milestone with our members. It's when celebrating milestones like this that time is taken to reflect on changes, developments and achievements over the years, and for the Institute, there certainly have been many of them.

Our merger with the Institute of Financial Planning (IFP) in November 2015 heralded a new chapter. Many traditional wealth management firms are now growing their financial planning capability, and we see financial planning as a growth area, particularly in light of the numerous and far-reaching UK pension reforms, which have accelerated the need for individuals to obtain proper financial planning and advice. We are delighted that we are now the UK arm and membership body for the global CFP™ designation and we welcome the financial planning community to the CISI.



While clearing up in anticipation for the move to our new office in the 'Walkie Talkie' building (yet another exciting new chapter!) we found the proofs for the first ever edition

of the *Securities & Investment Review*, published in July 1992. It is fitting that

now in July 2016, we are introducing your updated membership magazine: *The Review* – providing insight and analysis for financial services professionals. Along with a change in title, we've increased the scope and subsequently the size of the publication, which now includes 12 pages of financial planning content, to complement the capital markets, regulation, risk, compliance, wealth, securities, investment and economic comment already included. We are now a larger membership body and it is important that the magazine offers topical CPD opportunities for all CISI members.

Our new financial planning content starts with the next two pages, featuring Q&As with Campbell Edgar Chartered FCSI, CISI's Head of Financial Planning, and Jacqueline Lockie CFP™ Chartered FCSI, CISI's Deputy Head of Financial Planning. It continues with a feature on risk profiling, which highlights the intersectionality between wealth managers and financial planners (pp. 16–19), followed by two new regular sections, 'Case study' and 'My business', starting from page 54.

To complement the changes to the hard copy publication, we're also increasing the amount of online weekly content at cisi.org/review. If you are not already an online reader, I encourage you to take a look – and don't forget, the CPD hours gained from reading online are automatically added to your CPD record.

I would like to thank the members of our Editorial Panel who meet with us every six weeks to provide guidance and support on the content included in publication. It is very important to us that the magazine is, and continues to be, a magazine for our members and that the insight and topics discussed each quarter, and online, keep you informed.

Simon Culhane, Chartered FCSI
Chief Executive

CISI Corporate Members – June 2016

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iShares www.ishares.com/UK

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Prestwood Software

www.prestwood-group.co.uk

Seven Investment Management

www.7im.co.uk

Standard Life www.standardlife.co.uk

TIME Investments

www.time-investments.com

Transact www.transact-online.co.uk

Vanguard www.vanguard.co.uk

CISI AGM 2016

This year's Annual General Meeting will be held on Thursday 6 October. The venue and time will be confirmed in the September edition of *The Review*.

A Member (MCSI) or Fellow (FCSI) of the Institute may be nominated for elected vacancies on the Board. Board members retiring by rotation may stand for re-election and the Board itself may also sponsor candidates for any vacancies arising. Nominees will be invited to meet with members of the Board Nomination Committee before going forward as a candidate for election.

A nomination form, which includes an explanation of the requirements for the election of candidates to the CISI Board of Directors, is available on the CISI website. Alternatively, a hard copy of the nomination form is available, on request, from Linda Raven: linda.raven@cisi.org or call +44 20 7645 0603.

The closing date for nominations for Board membership is Friday 22 July 2016.

INTRODUCING THE CISI'S NEW HEAD OF FINANCIAL PLANNING

Campbell John Edgar, Chartered FCSI, tells us how he was tempted out of retirement to help integrate financial planning into the CISI



Why did you apply for the job?

I had retired in July 2014 to look after my wife, who had been diagnosed with terminal cancer. Interestingly, it was only after consulting my personal financial plan and projected cash flow that I determined that I could stop work. I was doing some pro bono work for The Pensions Advisory Service (TPAS) and continued to sit on the Education and Standards Committee of the Financial Planning Standards Board (FPSB – UK). When the IFP merged with the CISI, I continued to help with work on the syllabus for a financial planning and advice exam.

“Jacqueline and I share the functions to ensure all bases are covered”

Just before Easter I received a call from an old colleague, who drew my attention to an advert being run on a CISI financial planning update. She said that it “had my name all over it”. I thought about it, saw that the job specification required the skills and knowledge that I still retained, and decided that I had nothing to lose.

Is it what you expected?

Yes and no. Yes, in that the CISI is well organised and structured, and prides itself on its levels of professionalism with a high regard for ethical behaviours. No, in as much as the primary focus is on qualifications and supplying member services. This is in contrast to the IFP, which was primarily a members’ organisation which also provided the CFP™ certification and Fellowship. This tension between the cultures will reduce as time progresses, but the enlarged CISI will undoubtedly benefit.

What’s in your in-tray?

The workload is varied. Jacqueline and I share the functions to ensure all bases are covered. Membership renewals issues are being resolved as the business support team step up to the plate. We have just had a very successful Paraplanner Conference (the first that the events team have had to do on this scale). The conference was remarkable for a financial services professional event in that the average age was under 40 and 75% of the delegates were women.

Focus has shifted from the Accredited Financial Planning Firms™ Conference in June to the Financial Planning Annual Conference at Celtic Manor, 3–5 October. We have a large number of corporate sponsors who are keen to get involved in these events, and much time is spent ensuring that they get good value for their support.

Finishing touches are being made to a new level 4 regulatory examination qualification, Financial Planning and Advice, which is the third exam in the trinity of papers which will enable newcomers to the profession to gain their qualifications in-house, without having to take exams provided by a third party. This exam, which goes live in August, will also form the pathway to the CFP certification, the internationally recognised benchmark

qualification for financial planning professionals.

I am taking every opportunity to visit branches at CPD and networking events to meet members and to support financial planning topics being included in branch committees’ agendas.

“I am taking every opportunity to visit branches at CPD and networking events to meet members”

What CISI forums and interest groups are relevant to those interested in financial planning and paraplanning?

The CISI has a number of forums and interest groups, of which the two most relevant are the IFP Professional Forum and the Paraplanner Interest Group (interesting acronym!), and their committees. All the previous IFP members are automatically members of the IFP Forum, and it is from this group that the IFP Forum Committee is formed.

The Committee does not have an executive function but is very influential in the organisation of, and input to, conferences, working committees, CPD and networking events, as well as supporting the Institute in articulating its position with regulators and other third parties. Jacqueline and I are now co-opted members of the IFP Forum Committee.

The Paraplanner Interest Group exists because paraplanning is recognised as a career option in its own right and requires a different set of skills and attributes from the client-facing financial planner. It is currently discussing the definition of the paraplanner function and looking at a universal set of standards for paraplanning in practice.

INTRODUCING THE CISI'S DEPUTY HEAD OF FINANCIAL PLANNING

Jacqueline Lockie CFP™ Chartered FCSI discusses her career and why she's looking forward to bringing financial planning expertise to the CISI



Why did you decide to apply for the job?

Since leaving the Association of Investment Companies 18 months ago, I have been spending more time at home supporting my son and working part-time on financial planning and advice areas with various companies, including the CISI. That has included being a CFP™ certification assessor. As time went on I felt I wanted to get more involved, and, as I'm still very passionate about financial planning, I thought it would be right up my street. Being able to work alongside Campbell again is also a bonus. Knowing someone who knows you well and that can be relied on right from day one is a huge boost.

You worked at the Institute of Financial Planning (IFP) from 1999 to 2002. How does it compare with working at the CISI?

Everything is on a much bigger scale at the CISI. When I was Director of Training and Education at the IFP, it was very hands on, with limited resources. There were so many things we wanted to do but just couldn't. Being part of a much larger organisation is proving invaluable because I can call on many individuals in other teams for help and support to make

improvements to member benefits and the CFP certification assessment, and support the level 4 examination pathway.

What is the biggest challenge you face and how do you intend to overcome it?

There are several large and looming challenges. First, to grow the numbers of people who do financial planning, not just advisers but also paraplanners. That will include more financial advisers who turn to planning, as well as wealth managers. Second, to help overhaul the assessment and to support the membership and help with relevant content of events. Finally, I feel it is important to support the CISI staff and help them understand what financial planning really is.

How do you think the integration has gone since the merger?

I have been staggered by the amount of work going on behind the scenes by a large number of people trying hard to sort various issues out and make the transition as smooth as possible. The transition has caused some issues with communications with members, and we are working hard to correct this. I hope that by the time you read this, all will be settled and we can move forward together to spread the word about financial planning.

“Being part of a much larger organisation is proving invaluable”

What do you expect to achieve over the next one and five years?

I hope that in the next 12 months we can ensure that the old IFP membership is settled and happy in the new structure. That starts with improving our communications with you all, and I hope you will have already noticed our regular email bulletins. These will start to incorporate much more information

and blogs from me, as well as a revamped quarterly magazine with lots of monthly content going up online too. I expect real progress on the review of our existing CFP certification assessment and development of an alternative. But you can be sure of one thing, that won't dumb down the standards required or make it easier! The CFP examination is an assessment of application of technical knowledge – you can't write the right answer next to the wrong answer and get full marks!

Longer-term we will be looking to the membership to guide us on the way it wants to move forward. Expansion of the CFP to more firms across the UK and supplying specialist information and support to paraplanners will be at the forefront of our progress. A boost to the regions' networks of meetings, CISI TV and other media platforms will help support that. We are also continuing to develop exam workbooks and ebooks with videos to support the examinations and help others learn how to actually do financial planning.

What's happening in the immediate future?

Well, July will see the last edition of the *Financial Planner* magazine. However, this is not another nail in the coffin for financial planning from the CISI (I can hear some of you moaning already). All of the content that you know and love, and much more is being transferred to the newly revamped version of *The Review* magazine. With the help and guidance of our Editorial Panel, we are delving much deeper into subjects that will inform and develop all our knowledge in different areas.

I look forward to hearing what you all think about it. There is also the annual Financial Planning Annual Conference, 3–5 October, at the Celtic Manor in Newport. I'm very pleased with the program of events for the three days and we have some new and exciting speakers for you all.

All systems go

MANY INDUSTRIES ARE NOW OFFERED STATE SUBSIDISATION. IS OUR CURRENT ECONOMIC SYSTEM STILL CAPITALISM?

✦ ANTHONY HILTON ✦ JOHANNA WARD

Driving at 70mph along the busy five-lane freeway connecting the airport to the centre of San Francisco, the driver of a Tesla electric vehicle removed both hands from the wheel and his foot from the accelerator, then turned to talk to your author, a passenger in the back seat. The car was left to drive itself amid an ocean of traffic, with its speed and position controlled by on-board sensors and cameras. It can park itself too.

With Silicon Valley just a short hop down that same road, it is easy to think of this as yet another triumph of US capitalism – and up to a point it is. But the other truth is that the Tesla is heavily subsidised by a state and government keen to encourage the technology. Without the subsidy it would be too expensive for a mass market.

Capitalism is supposed to be about free markets and individuals pursuing their own desires and paths, but Tesla is a reminder to ask how much freedom there really is. Sussex University Professor Mariana Mazzucato has written extensively on innovation and what spurs it. She points out that even such an iconic invention as the iPhone depends heavily on technologies which were originally discovered in US government labs under government funded research programmes. Did this mean even Steve Jobs needed a helping hand from government? In effect, yes.

HELP AT HAND

How truly capitalist is the FTSE 100? Analysis by another academic a few years ago pointed out that the current and future prosperity of many of its companies was far more a function of how well they handled their relations with government than how good they were at satisfying customers.

Many, including transport and phone companies, or electricity, gas and water utilities, are told by a regulator directly or indirectly what they can charge, and are near, if not actual, monopolies.

Others have the state as a major customer. The generosity or otherwise of government procurement contracts drives the profitability of defence contractors, drug firms supplying the NHS, and educational establishments dependent on research contracts. The outsourcing contractors like Serco and Capita get a huge slice of their revenues from government. Alienate government, as Serco and some others did, and business plummets.

Other industries benefit from barriers to entry imposed by government licencing requirements. Competition in banking has long been restricted by the difficulties of getting a licence, while potential innovators in insurance, fund management and a host of other financial activities face similar obstacles. But they benefit once they are established, as having insurance is a legal requirement, not a commercial decision, for many activities – as indeed is saving for a pension.

CHANGING OF THE GUARDS

External regulation is an issue even in something as ferociously competitive as food retailing. For many years Tesco dominated the industry, not because its food offer was miles better but because it was far more effective at managing the planning process and could open new stores at two or three times the rate of its rivals.

All this is before you get into the big picture stuff, like an assisted bailout of Tata Steel. Similarly you have to question how much control a business has over a significant slice of its costs when it is governed by health and safety and employment legislation, and has to pay at the very least the minimum wage. When you then factor in that over 30% of the economy is public sector employment, tax and revenue collection, education and health, you begin to wonder what we actually mean when we talk about capitalism. If it exists today, it is down in the SME sector, because it is only down there that business is still business rather than bureaucracy.

But does it matter? Less perhaps than we think. It is generally accepted that the UK became much more free market focused and capitalist with the arrival of Prime Minister Thatcher in 1979. A recent study by Cambridge economists of Britain's economic performance in the 30 years before Thatcher's liberalisations and since, found, however, that by almost any metric we were more efficient before.

Not many people believe that.

Anthony Hilton is the award-winning former City Editor of *The Times* and the *London Evening Standard*





Ikory/Neil Webb

The risks ahead

THE METHODS FINANCIAL PLANNERS AND WEALTH MANAGERS USE TO ASSESS CLIENT ATTITUDES TO RISK ARE UNDER REGULATORY SCRUTINY. HOWEVER, RISK PROFILING HAS COME A LONG WAY OVER THE LAST DECADE

SELWYN PARKER AND JACQUELINE LOCKIE CFP™ CHARTERED FCSI

The Financial Conduct Authority (FCA) describes the difference between CF30 regulated client facing advisers in two main ways. Financial planners are those who traditionally work on a transactional basis, using suitable investment products to fill gaps to help clients achieve their stated objectives. Cashflow modelling goes hand in hand with this process. As far as the

regulator is concerned, suitability of the investment for any given client is at the point that the advice is given for that product, and thereafter when a review takes place. However, there are other CF30 client facing advisers who offer a discretionary management service, where the client signs an agreement allowing the adviser to manage and change the

investments on an ongoing basis, without having to seek permission each time from the client. In the past we may have termed the former as financial advisers or financial planners and the latter as wealth managers. However, the lines are blurring as financial planners and wealth managers compete in the same space, giving comprehensive financial planning/cashflow analysis advice to clients as their main service, into which the investment selection vehicles then feed to ensure the client's objectives are met as they arise.

HISTORY

Assessing a client's attitude to risk has developed over the last 30 years, starting in the early 1980s with a rough-and-ready questionnaire that resulted in, by general agreement, a hit-or-miss scoring system which advisers then used to set overall asset allocation percentages of cash, fixed interest and equities. Product wrappers were then assessed for tax advantages and suitable investments made. A widespread understanding developed that it was the returns from the underlying asset classes that drove the returns that clients achieved, thereby, hopefully, meeting their objectives. By the late 1980s a bigger element of risk tolerance was included in questions that clients were asked.

“Nobody really was asking very much about people's attitudes to risk”

Then from the mid-1990s the introduction of stochastic modelling, where computer software was designed to produce a range of probabilities of an investment return being achieved, was used to try to predict future investment returns, which ushered a modicum of science into the process. It was then up to the advisers to explain these ranges and make suitable investment recommendations to their clients. Soon after, psychometric questionnaires started to develop. These were based on carefully constructed risk questions that each client answered individually. Finally, from the early years of the millennium, discussions with clients included capacity for loss, eg, how well they slept at night if markets suddenly fell overnight, even if the money wasn't needed for years. This was evaluated through stress-testing, with the use of cashflow modelling being done on spreadsheets and specialist software. The

cashflows were designed to show the inflows and outflows of money over the clients' entire lifetime. These discussions about capacity for loss, coupled with psychometric questions, became two important developments in financial planning advice in the UK.

David Hazelton, Head of Business Development at wealth manager Raymond James, says that things have progressed over the past 15 years. “If I go back maybe 15 years, I started working with a company called Selestia [now part of Old Mutual] who were the first platform providers to talk about asset allocated portfolios and measuring clients' attitude to risk. They were building portfolios that were adjusted to the level of risk that clients were required and were prepared to accept.

“At Selestia, we prepared a reasonably thorough questionnaire, but in today's terms it probably wasn't very sophisticated. At that stage, nobody really was asking very much about people's attitude to risk. There would generally be a discussion about their objectives and then somebody would give them an investment solution. There wasn't really a lot of focus on whether that was entirely appropriate to their needs and their risk.”

In 2010, the FCA investigated the 13 types of risk profiling tools that were available at the time. Only two were deemed adequate. The message was that, if a firm was going to rely on a tool, it had to meet four criteria. First, it must be fit for purpose. Second, it should only be used in the circumstances for which it was designed. Third, its users must understand how it works. And finally, the client must know what is happening and be comfortable with the process.

One of those tools which was deemed satisfactory was produced by FinaMetrica, a specialist in risk tolerance toolkits. The FinaMetrica toolkit is used by many financial planners and an increasing number of wealth managers. The initial research from 2010 was targeted at financial planners and advisers rather than wealth management firms, and so it was only in 2015 that the regulator turned its attention onto those firms, alongside private banks.

As Paul Resnik, Co-Founder of FinaMetrica, points out: “Advisers and clients share a common interest; neither one wants the relationship to end unhappily.” And, as Resnik acknowledges,

it's the mismanagement of risk that is the most likely cause of a relationship that ends in tears or legal action.

“Advisers and clients share a common interest: neither wants the relationship to end unhappily”

In December 2015 the FCA published a report called *Wealth management firms and private banks: suitability of investment portfolios* which looked at how well the UK wealth management industry was assessing client risk and consequential suitability of advice. The report highlighted a number of areas where improvements could be made, with broadly a third of firms falling “substantially short” of the regulator's expected standards.

Having reviewed 150 customer files from 15 firms as part of its 2015 review, the FCA found that 34 (23%) indicated a high risk of unsuitability, 55 (37%) were unclear, and 61 (41%) showed a low risk of unsuitability.

The FCA's director of policy, David Geale, underlined in a speech late last year that the regulator had identified “poor risk profiling or mapping” as one of three main areas in the flawed design of some investment portfolios. The others were: inadequate consideration of costs and inadequate due diligence on products and services. We are seeing the FCA discuss what it believes good due diligence looks like at its roadshows around the country at the moment.

THE PROCESS

As financial planners point out, there are three quite distinct elements in the client education and advice process when establishing risk. There should be a comprehensive and detailed process which should examine the client's history with investments and how he or she perceives risk within the investment space. But it should begin with a psychometric-based questionnaire, suggests Nick Grogan, paraplanner with PWS Financial Consulting: “[The questionnaire] should represent a starting point for a wider conversation with the client surrounding risk.”

As Grogan adds, it boils down to a three-pillared approach: “How much risk clients need to take (a financial fact), how much risk they are willing to take, ➤

(a psychological trait), and finally how much risk they can afford to take (another financial fact)."

Wealth managers are also changing. "The way in which advisers and clients use risk profiling tools has changed," explains Andy Cumming, Head of Advice at Close Brothers Asset Management. "Outcomes have become easier to illustrate."

It is good practice for advisers to obtain full details of the client's current and anticipated income and expenses

"We put a slightly different twist on matters," he adds. "Standard risk profiling takes you through a series of psychometric questions and then bespoke discussions to establish an attitude to risk, which is then used to influence the choice of investment." Close Brothers uses a modelling tool that incorporates these aspects, but also shows the client a range of potential outcomes that would be expected to result from the various risk-profiled investments. It makes risk-related adjustments; different trajectories, to the portfolio as clients age and their appetite for risk changes.

An important benefit of this approach is a client who is in the loop, which is what the FCA says it wants. "As we can show clients both the upside and downside of taking

more or less risk, they can have a much more informed conversation with the adviser [that is] not just about how they feel 'emotionally' about risk, but also about how the potential outcomes influence their willingness to take risk," says Cumming.

Mark MacLean, Director at Cantab Asset Management, says: "We take the results of the analysis [from a psychometric questionnaire] and compare it against the client's expected score, as this can help with assessing the client's subconscious and conscious understanding of risk. We also consider the individual answers provided, to check for any inconsistencies or outlying answers, which are discussed with the client."

A client's previous experiences and understanding of the investments they have held is then discussed. Having used a psychometric risk profiling tool and discussed the client's investment experiences, Cantab determines whether the risk and return strategy is realistic, or if it has gone against the client's individual lifetime objectives.

Hazelton agrees that the psychometric tools are certainly useful, but don't "look at the whole picture". Sometimes they don't "take into account the client's objectives and what they are trying to achieve". He gives the example of a naturally cautious investor who has a quite ambitious return target. "To achieve that target, they would

actually need to take more risk in order to achieve their goals."

Another system, Dynamic Planner, is based on the six-stage financial planning process. It starts with a review of the client's existing portfolio and goes on to an assessment of a client's attitude to risk. A check is made to establish any inconsistencies in the answers. The client is then assessed for capacity for risk. In the final two steps, the adviser confirms the value at risk and matches the resulting portfolio against defined goals.

MOVING PARTS

Psychometric risk profiling tools aim to reflect the inevitable fluidity involved in the design of portfolios. As a paper issued by FinaMetrica explains: "In a comprehensive advice scenario there are 'moving parts' to be considered." In this environment, good practice first requires the adviser to elicit information about the client's objectives. Each objective should in turn be quantified, have a set time horizon and prioritised. It is good practice for an adviser to obtain full details of the client's current and anticipated income and expenses, plus current and anticipated assets and liabilities as part of a comprehensive advice scenario.

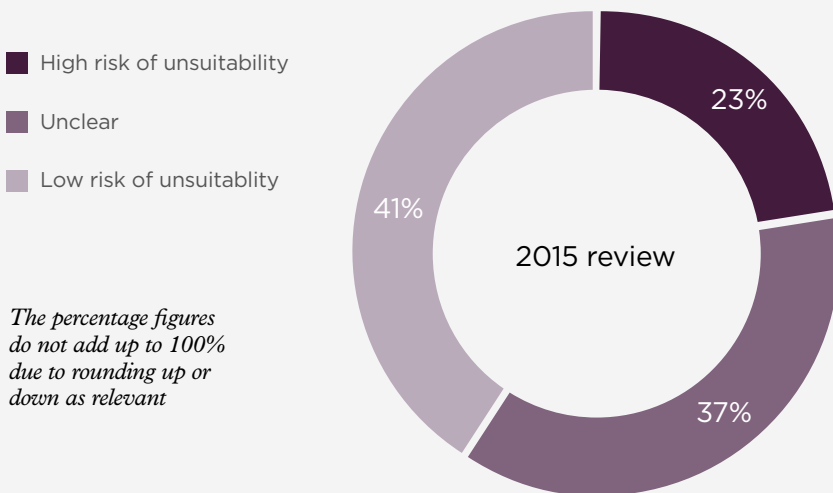
A lot of other numbers, some of them based on future assumptions, should be used within the spreadsheets or cashflow modelling software to comprehensively analyse a client's situation.

Assumptions, however, need to be realistic. Being optimistic with investment returns may mean in reality that a client would run out of money in retirement. However, being too cautious may mean that a client will need to invest much more to achieve their goals and run a risk of dying with large amounts of assets. The challenge for financial planners and wealth managers alike is to apply the various tools effectively in a way that gives suitable advice to clients that satisfies the regulations. And this is a process that involves insights and judgments as well as numbers-based decisions. In short, it can't all be done by the book.

THE FUTURE

Under MiFID II, firms will be required to focus on suitability further, with the potential that non-complex products may expand in number, depending on the appropriateness test, and increases in pre-sale cost disclosure. But the biggest impact is likely to be the personalised post-sale disclosure of the

FCA REVIEW OF 150 CUSTOMER FILES AT 15 FIRMS



The percentage figures do not add up to 100% due to rounding up or down as relevant

Source: FCA TR15/12 – Wealth management firms and private banks - Suitability of investment portfolios



actual costs incurred by any given client, which will increase the focus on risk, costs and suitability of recommendations. The Tax Incentivised Savings Association, Wealth Management Association, Association of Investment Companies and others are working with the European Securities and Markets Authority to clarify the areas of concern.

But how will the introduction of MiFID II influence the direction of assessment of client risk? Not favourably, according to FinaMetrica’s Resnik. “Unfortunately, regulatory standards around the world, such as MiFID II, leave a lot to be desired when it comes to offering guidance on how to effectually evaluate an individual’s risk tolerance,” he says. “This is disappointing for investors as research shows they are likely to receive lower returns than the market if risk tolerance is poorly assessed.”

Hazelton says that maybe the wealth management sector was “a bit slower to genuinely understand the client’s attitude to risk”. He adds: “Their approach has

been typically to describe the portfolios that they run, often in language that clients don’t understand, and ask them which they think is most appropriate. Typically this may be an equity based portfolio that may not be appropriate for all clients.”

“Advisers really need to understand the products they are recommending”

However, he adds that the wealth management industry has “really upped its game” recently. “I think it’s true in the past the wealth management industry has lagged behind, but I think now they’re probably at a good place in terms of the way they assess attitudes to risk.”

The FCA is currently working on a thematic project that seeks to understand where the industry stands on due diligence. In this, specific firms are being measured against current suitability rules. “Firms will be

required to have policies and procedures in place to ensure they understand the nature and features of the products they select for their clients,” warns the FCA’s Geale. “This is a clear signal that advisers really need to understand the products they are recommending.” MiFID II may also impact in this area.

While there are still some uncertainties for what is to come, what is evident is that assessing suitable investments starts first with an in-depth analysis to develop an understanding of the client’s attitude to, capacity for and tolerance of risk.

Part of that understanding clearly depends on the effectiveness of the client risk profiling and questioning process, of which psychometric tools are just a part. While it appears that progress is being made by wealth managers and financial planners, it is evident that the FCA will be watching intently to see that risk profiling standards are both improved and maintained.

Indian summer

DESPITE A BLEAK OVERALL GLOBAL SCENARIO, INDIA'S ECONOMY IS GROWING AT AN IMPRESSIVE PACE OF OVER 7%. SWATI PRASAD EXPLAINS HOW THE COUNTRY IS OFFERING HEALTHY RETURNS AND NEW INVESTMENT OPPORTUNITIES TO THE GLOBAL INVESTOR

◆ SWATI PRASAD



Getty

In March and April this year, when multilateral agencies like the International Monetary Fund (IMF) and the Asian Development Bank (ADB) came out with their annual outlook reports, they pointed to one bright spot in the bleak global picture – India.

According to the IMF, India will be the fastest growing major economy in 2016–17, growing at 7.5%, ahead of China. The ADB projected India's economic growth for 2016–17 at 7.4%.

"The macros of the Indian economy look healthy," says Dharmakirti Joshi, Chief

Economist, CRISIL – a Standard & Poor's company. This can be seen in several areas. PwC's *India budget 2016: accelerating the momentum* says that economic growth is moving up while fiscal deficit came down to 3.9% of GDP from 2015 to 2016, against 4% the previous year.

Inflation is under control, with the consumer price index declining to 4.9% from April 2015 to January 2016, against 5.9% in the corresponding period for the previous financial year.

Its current account deficit is down too, dropping to 1.4% of GDP in April to

December 2015, against 1.7% in the corresponding period for the previous year. And last year India bettered China in foreign direct investment (FDI) inflows.

Even more encouraging for investors, the country has a majority Government at the centre after 15 years of coalitions.

Led by Prime Minister Narendra Modi, it is pushing for reforms in key areas like job creation, rural and urban development, power and banking. "The Modi Government's performance has been very positive," says Puranam Hayagreeva Ravikumar FCSI(Hon), President of the

CISI's National Advisory Council in India, and Chairman of SKS Microfinance.

Besides, India's long-term prospects look good due to its "young population, healthy savings and investment rates, and increasing integration with the global economy," says Deena Mehta, Managing Director, Asit C. Mehta Investment Intermediates, a broking firm.

REFORMING THE TITAN

For many years, India has been known as the market with strong potential but feeble performance. Despite 25 years of its New Economic Policy, India continues to have widespread poverty (170 million Indians live on less than \$1.90 a day) and a largely agrarian economy.

But the Modi Government is addressing the challenges, and foremost amongst them is generating employment. "Job creation is a large challenge to tackle," says Ambarish Datta, Managing Director and CEO of BSE Institute, a training partner of the CISI in India. With 50% of its 1.25 billion population below the age of 25, one million people are known to join India's workforce each month.

Initiatives like Make in India (which seeks to make the country a global manufacturing hub) and Startup India (an action plan that eases various regulatory, legal, financial and other challenges faced by startups) target employment generation. Launched in September 2014, Make in India has reportedly begun to make a difference – FDI into India has increased 37% since October 2014. During the period, overseas inflows grew 29%, according to a statement to Parliament by Commerce and Industry Minister Nirmala Sitharaman. The recently launched Stand Up India scheme supports entrepreneurship among women and people from the backward communities.

"India is potentially a high-growth wealth management market"

Increased economic growth is putting pressure on urban infrastructure. To address this, the Modi Government's Smart Cities Mission – an urban renewal programme – hopes to create 100 smart cities by 2020.

The Government is also targeting corruption through programmes like Digital India, which seeks to transform India into a digitally empowered society.

And a recently launched Government scheme called Ujwal Discom Assurance Yojana (UDAY) seeks to revive loss-making power distribution companies, while Indradhanush is a plan to revamp public sector banks.

"The Government is addressing key challenges through these programmes. Clearly, it has the right intent," says Ravi Raman, CISI trainer and Managing Director and Chief Operating Officer of InfraHedge, a subsidiary of State Street Corporation.

FAVOURABLE FUNDAMENTALS

While most nations are getting affected by the crash in commodity and oil prices, India has benefited by virtue of being a major importer of commodities and energy. Being an IT superpower, its growth relies more on the services sector, including IT and software exports.

Besides, the Government has been pushing hard to ease FDI regulations in sectors such as railways, medical devices, insurance, pension, construction and defense, agriculture and animal husbandry, plantation, broadcasting, civil aviation and manufacturing. "The focus is clearly on

putting more FDI proposals on the automatic route," says Mehta.

In the latest World Bank 2016 *Doing business report*, India ranked 130 out of 189 countries for 'ease of doing business' – it ranked 142 under the previous government. The current Government is targeting to be in the top 50 by 2019.

India ranked 130 out of 189 countries for 'ease of doing business'

Moreover, India's foreign exchange reserves are at an all-time high, according to the Reserve Bank of India, covering imports for over eight months. And the rupee has performed the best amongst BRICS (Brazil, Russia, India, China and South Africa) currencies over the same period.

Besides, middle-class and upper-middle class incomes are booming. "India is potentially a high-growth wealth management market," says Ganesh Iyer, CISI Country Head, India. "With a large, young and affluent customer base and a



Getty



tightly regulated financial market, it offers huge potential for advisory firms,” he adds. CISI India has made good progress in meeting training needs in the field of wealth management, with its qualifications gaining popularity following recent collaborations with the National Institute of Securities Markets (NSIM) to launch the International Certificate in Wealth and Management (ICWIM) India. This qualification ensures candidates have a basic knowledge of the regulations and legislation underpinning the financial markets and the conduct of investment business in India. And, upon successful completion, practitioners will qualify as a level 1 Investment Advisor in India.

When compared with other peer group stock markets, Indian stocks have higher price-earning ratios. Strong economic growth justifies the high valuations. A report by Financial Services company HDFC says that over the last 12 calendar years, Nifty50 (National Stock Exchange of India’s benchmark stock market index for the Indian equity market) has given a positive return in eight. “Equity markets have generally been able to deliver steady returns over the long term, irrespective of the magnitude of any near term event,” the report says.

LEGISLATIVE DELAYS

Despite its enviable position amongst the BRICS, India has several challenges to contend with. Apart from the need to create millions of jobs each year, India also has to contend with a paralysed legislative machinery which takes a long time to pass critical bills.

“Retrospective taxation and clarity in policy regime have been major concerns”

“Investors are looking at the execution of big ticket policy changes,” says Datta. The ruling party needs to get major policy-related bills cleared in both the houses. Unfortunately, it lacks majority in the Upper House. And this is where critical bills get stuck. Amongst these are the Land Acquisition Bill and the Goods and Services Tax Bill.

Despite improvement in the ease of doing business, operations on the ground are still difficult with too many legislations and compliances with many agencies. “Poor bankruptcy laws and inadequate capital market activity in the primary market are all signs of weaknesses,” says Raman.

Moreover, investors continue to fear retrospective taxation. Ravikumar says: “Despite assurances from the senior governmental officials, retrospective taxation and clarity in policy regime have been major concerns for a section of portfolio investors.”

“Private investment is still not picking up,” says Joshi. The financial sector is not in a position to aggressively finance growth due to non-performing assets. But then, when you compare India with its peer group, “it definitely looks better,” he adds.

Agriculture has been a cause of concern. Climate change and droughts have hurt India’s farmers, who continue to rely on rains for irrigation. But things might change soon, as India is likely to get a good monsoon this year, which in turn should increase rural demand.

Moreover, the Seventh Pay Commission – (applicable to 4.8 million central government employees and 5.5 million pensioners) – has proposed salary hikes of 23.55% and is likely to release over \$7.5bn (INR 500bn) in the form of hikes and arrears, providing additional money in the hands of consumers. “Beyond 2016–17, the corporate cycle has to revive,” says Joshi. It seems like there is no stopping this emerging economic superpower.

A problem solved

SHAREGIFT IS A RARE ENTITY - A BUSINESS SOLUTION WITH A CHARITABLE OUTCOME. VISCOUNTESS MACKINTOSH, FOUNDER AND EXECUTIVE CHAIRMAN, AND JULIAN ROBERTS, CEO, EXPLAIN HOW THE ORGANISATION SAVES BUSINESSES MONEY AND SHAREHOLDERS A NUISANCE WHILE CONTRIBUTING MORE THAN £23M TO CHARITY

✦ GARETH FRANCIS ✨ ROB GREIG





“I realised the solution to this problem would be a technical one, but with a charitable outcome”

Claire Mackintosh, Founder and Executive Chairman of ShareGift, and Julian Roberts, the organisation’s CEO, meet for our interview in the grand headquarters of wealth manager Killik & Co., a beautiful old building in Mayfair. ShareGift was generously donated office space here (and in Killik’s other offices) in its early days, occupying for a time what is now a small, hidden away meeting room, but was then filled with filing cabinets and a shared desk. When a few more hands joined, Mackintosh secured her own office in what was effectively a cupboard. While Killik & Co. have continue to support the organisation at an operational level, very little else has stayed the same. Now based in its own office, ShareGift has come a long way.

Mackintosh had not originally envisioned herself living a life in finance. “I came into the City slightly by mistake as a junior investment manager, but I’ve never regretted it,” she explains. “My childhood and early life were spent all over the place.

My father was a Polish refugee. I was born in Canada, lived in Europe and went to school and university in England. I had a big interest in wine and it was in the course of trying to find a job in that trade that I found an intriguing advertisement for a job within investment management at a mutual life office in the City. I started as an investment dogsbody doing a bit of everything. It was a fantastic background and it’s fair to say that a strong grounding in settlement was the door opening for me to be able one day to think of ShareGift and execute it.”

Meanwhile, Roberts finished A levels before joining ShareGift in its infancy after being introduced to Claire by a friend. Initially planning to stay for a few months, he worked at the organisation for one year before starting university. It was all completely new to him – he did not know what the par value of a share certificate was. “It was a vertical learning curve for a year. Then I went off to university to study accountancy, steering my learning

more towards corporate finance. Even in my final year I was being taught things that I had already dealt with hands-on. I then left university and started in private equity, working on industrial and infrastructure deals.” After a few years, Roberts decided he wanted to try something different. He set up a short-lived property business, but also returned to ShareGift as its corporate finance-type work increased. It was then that Mackintosh asked if he would step into the role of CEO, which he did in 2014. But a lot happened in-between.

A DEMANDING PUZZLE

Simply put, ShareGift’s purpose is to provide a charitable solution to the business problems associated with small shareholdings. Often unwanted because they are too small to sell, these shares can be transferred to ShareGift at no cost to the shareholder, aggregated and sold to benefit different registered charities. This in turn saves companies money, cutting out the number of mail-outs needed and reducing their share registry workload.

While the concept of ShareGift came from an initial flash of an idea, Mackintosh said that figuring out how it could work was more of a slow burn. “At the time of the original privatisations – such as British Airways, British Gas and BT – I was very conscious of wider share ownership. There were a lot of scaled back initial public offerings (IPOs). With BT for example, every member of the family might apply and get their allocation of shares. At the same time, companies were encouraging scrip dividend mandates, which resulted in small scraps generated after a main shareholding had been sold. Although I was managing pension funds and not private clients at that time, that was the spark of inspiration. I asked myself, where do these odd lot shares go?”

“In the early days businesses thought we might be pitching to become their charity of the year”

From there, Mackintosh started thinking of practicalities. She knew the shares were out there, and in more hands than ever before, but many holders would not have enough to profit from selling them after brokerage fees. She also began considering the cost implications for businesses having to correspond with each and every one of their shareholders. If the owner of a small holding died, more issues were created. If these businesses undertook corporate actions, such as a merger or a disposal, fractions would be created and new shares might be issued along with miniscule fractional cash amounts. These might go uncashed, resulting in additional administrative cost for businesses. Additionally, companies face the cost of maintaining records of dividend accounts, which become ever more complex and onerous as small shareholders change address and may not advise the company.

“This question of where the shares go made me think about the ripple effect,” Mackintosh explains. “It wasn’t just the shares; it was all the other things that were generated by them. I realised the solution to this problem would be a technical one, but with a charitable outcome central to the concept, and in the meantime I was pressing ahead with my City career.”

Implementing her idea was a whole new challenge. Mackintosh faced a world where the problem had been accepted as unsolvable. “Most companies took the view – understandably – that it was a running, grumbling cost, but otherwise did not affect

their business. Nobody was very interested because this problem was thought to be insoluble. That was a further trigger for me, people saying it couldn’t be done!”

A PROOF OF CONCEPT

An ideology which Mackintosh and Roberts mention often is that of innovation becoming template. Mackintosh was sure her initial idea was watertight, but at the start all the transfers had to be undertaken manually, which was immensely time-consuming. There was no CREST – the equity settlement system was still on the drawing board – little retail business was done via nominees and all shares were certificated. She had to prove not only that people would donate their odd lot share certificates in the first place, but also that she could deal with all the administration.

“The concept was to transfer, to aggregate and eventually to realise the value of the shares for donation to a range of charities. The premise was not an active charitable gift, but reflecting that holders had something that was a nuisance to them and I could solve that problem – with a charitable outcome.”

Mackintosh decided to impose a personal deadline by which she would know if her idea worked, but choosing the right measure was important. “I decided that I wouldn’t look at it in terms of money; I would look at it in terms of time. I felt that maybe after a couple of years it was likely I would know if the proof of the concept had come, if there was critical mass. It was incredibly laborious, but I could see the concept being proved fairly quickly. ShareGift was unlike anything else; there was no template for it so I had to write every letter and work out every process. Even if I’d had a lot of people to help me I wouldn’t have known what to tell them to do.”

Thankfully, the certificates did start rolling in, her administration practices worked, and Mackintosh fondly remembers the first donations ShareGift was able to make. “The very first cheques, each for £1,000 for five charities, although that’s very little money in terms of what we do now, were absolutely key to the proof. Those five cheques were among the most significant ShareGift has written.”

“Also significant was the first major company to acknowledge ShareGift,” adds Mackintosh. “BAA put ShareGift in their annual report. They said that while they welcome shareholders of all sizes, there was now a way of dealing with small, unwanted shareholdings. Though it was tucked away in a tiny font size under ‘Additional shareholder information’, it’s hard to explain, looking

CLAIRE MACKINTOSH FCIS: THE CV

PRESENT SHAREGIFT, FOUNDER, EXECUTIVE CHAIRMAN; ROYAL AUTOMOBILE CLUB, NON-EXECUTIVE DIRECTOR

1996 – 2014 SHAREGIFT, CHIEF EXECUTIVE

1991 – 1996 PEREGRINE SECURITIES, ASSOCIATE DIRECTOR, KOREA

1990 – 1991 INVESCO MIM, CONSULTANT EAST EUROPE DEVELOPMENT FUND

1985 – 1989 HENDERSON ADMINISTRATION, PENSION FUND MANAGER

1981 – 1985 UK PROVIDENT, ASSISTANT INVESTMENT MANAGER

1980 – 1981 HARRODS, WINE DEPARTMENT

JULIAN ROBERTS: THE CV

2014 – PRESENT SHAREGIFT, CHIEF EXECUTIVE

2009 – 2013 VARIOUS PROJECTS, RETURNS TO SHAREGIFT

2007 – 2009 ADVENT INTERNATIONAL, PRIVATE EQUITY

2004 – 2007 TERRA FIRMA CAPITAL PARTNERS, PRIVATE EQUITY

2000 – 2001 SHAREGIFT, ASSISTANT

back, how important that was. It was an enormous privatised company referring to and recommending a one-woman organisation. I could – and did – show this to other companies, and such mentions in annual reports are now routine.”

With the idea now a reality, it was important to find ways to operate on a larger scale. Having rejoined ShareGift, Roberts says the next struggle was to be recognised as a business solution rather than as a charity asking for support. “When we found

ourselves talking to public companies saying that we're a charity that can help them manage their share register, the immediate reaction was to shut us down, thinking we were fundraising. There was a tendency not to realise we're an organisation providing a solution to their own problems arising from small shareholdings – a solution that has a charitable outcome. In the early days, they sometimes thought we were pitching to become their charity of the year. We would get shifted towards the community affairs team when we should have been speaking to the company secretariat."

It was a clear-cut example of the organisation's intent to be, foremost, a business solution. "ShareGift is not selling something; it's providing something that is of enormous benefit to all," Mackintosh says. "At the beginning there was the mindset that if it was that good, it would have been thought of before. Happily, not every good idea has been thought of before."

A CHANGE IN PERCEPTION

ShareGift was soon included in corporate share register management programmes. An example would be where a company sends a mail-out to its shareholders on a low-cost dealing programme. They give shareholders of less than a certain value the option to buy more shares, sell the shares or donate them to ShareGift. When BT and O2 demerged in 1998, ShareGift was included in that programme. "It could have been any corporate action that we were first included in, but it was a massive one," says Mackintosh. "You sometimes have to be careful what you wish for, but I worked very hard to make sure that everyone was happy with the way the ShareGift element went. Crucially for our small organisation, in these programmes the company's registrars undertake the administration. From that moment on this opened up working on corporate finance-type solutions, which is why it was such a great joy to bring the experience of Julian Roberts to ShareGift."

"From the start it was a problem solver, not a fundraiser"

In another breakthrough, ShareGift was invited to be transferee of last resort after the register was closed during the administration of RT Group. "This was incredibly significant for us as an organisation," says Mackintosh. "In a politically charged



corporate situation, the administrators and the registrars saw the benefit of designating ShareGift as the potential recipient of small holdings as the administration progressed. Postal and other administrative costs were reduced, and from our point of view it supplied further proof of our concept."

Highlighting this point, Roberts says: "While giving over £23m to charity, ShareGift's work has saved UK companies a factor of that, and it's very difficult to put a number on it."

Mackintosh adds: "From the start it was a problem solver, not a fundraiser. For me personally the impetus wasn't that I'd had an interesting career and I wanted to 'give something back', though that is in fact what has happened; it was an intellectual challenge, and I knew that it would bother me forever if I did not at least try to solve it."

ShareGift has since been included in some of the largest UK corporate transactions of recent years, including the Lloyds/HBOS acquisition in 2008 and the Vodafone return of value to shareholders in 2014. In both instances, the involvement of ShareGift resulted in significant sums being distributed to charities, while reducing the administrative burden on the companies involved.

A LOOK AHEAD

Now firmly established and widely used in the UK, international versions of the organisation have emerged in Australia and the US. Mackintosh assisted in their establishment and allowed them to use a version of the logo, but their workings are somewhat

different to meet the demands of their location. Roberts has recently been working to establish ShareGift's presence in Ireland. The organisation was already receiving shares from shareholders based there, and as this has increased they have included donations to charities in the country to reflect this. "The Irish market holds a lot of opportunity as such share register programmes have not really featured," says Roberts. "It's also interesting as there are a lot of mergers and acquisitions going on."

Huge sums of money are tied up in dormant assets. ShareGift has, for a long time, worked with asset reunification specialists to release some of these monies. However, Roberts believes that this is just the tip of the iceberg: "New regulation in respect of client assets, and a drive from the Government to release, discharge or free dormant assets, presents another significant sphere of interest for ShareGift."

This ongoing pursuit to improve and grow ShareGift is unsurprising with two such ambitious individuals at the helm, a trait that continues in their personal lives. With a lifelong love of cars, especially fast ones, and an interest in the heritage and governance of London clubs, Mackintosh is a board member of the Royal Automobile Club. Roberts meanwhile appears to be some sort of superhuman, competing in ultra-marathons while pacesetter for other runners in the London Marathon. Fitting interests for an organisation that requires drive and endurance to succeed.

Challenge and opportunity

THE UK'S NEWEST BANKS ARE GAINING INVESTORS' ATTENTION BY EXPLOITING MARKET NICHEs WITH LOW-COST BUSINESS MODELS

DOMINIC DUDLEY NEIL WEBB

When Metro Bank received its banking licence in March 2010, it became the first new high street bank in the UK in more than 100 years. It also set the scene for a transformation of the market.

A raft of others have launched since then, helped by a revised licensing process that carries less risk for would-be bankers. In the past three years alone, 14 new banks have started up. Some are foreign banks entering the UK, but the number also includes local start-ups like Atom, Paragon and OakNorth banks.



These new entrants are generally known as ‘challenger banks’, a term which also covers far older institutions, such as Yorkshire Bank and TSB. In fact, the only characteristic shared by all of them is that they aren’t one of the big four of Barclays, Lloyds Banking Group, HSBC and Royal Bank of Scotland (RBS).

“The mainstream banks have moved back to their core operations”

It will take time to see whether these challengers can really shake up the market and put pressure on the established giants. Inevitably, there will be some winners and losers, but for now, investors in many of these institutions are doing well.

Shares in Aldermore, OneSavings Bank, Shawbrook Bank and Virgin Money have all outperformed the banking sector as a whole over the past year. On an earnings per share (EPS) basis they also often do better than many of their larger rivals.

Lloyds had a diluted EPS of just 0.8p last year, while RBS and Barclays both had negative results. In contrast Aldermore, Virgin Money, Shawbrook and OneSavings Bank reported a diluted EPS of between 22.6 and 34p. Secure Trust Bank did best of all, with a diluted EPS of 104.1p.

“We’re very open minded to [the challenger banks] and have invested in many of them,” says Gervais Williams, Managing Director of investment firm Miton Group. “The mainstream banks have moved back to their core operations. Many of them have legacy issues to deal with and that’s constraining their ability to flex to the changing environment. Many of the challenger banks are smaller and more agile because they don’t have the legacy issues, so they’re able to take market share.”

RISING TO THE CHALLENGE

How much market share they can capture is an open question, but some at least are making reasonable headway. TSB has set a target of attracting 6% of all new bank account openings, but says it hit 7% in the first quarter of this year. “We’ve now seen nine consecutive quarters in which we’ve beaten our 6% target,” says Ian Firth, the bank’s treasurer.

The challenger banks vary enormously in almost every aspect, including their age,

scale and business model. TSB and CYBG (the parent company of Clydesdale and Yorkshire banks) are unusual in running large branch networks. Most challenger banks opt for lower cost platforms, like websites and mobile phone apps. They also tend to be very picky in terms of the sectors they target.

Shawbrook, for example, focuses on property lending and loans for small and medium-sized enterprises (SMEs). It also targets a few consumer niches by offering loans through tie-ins with home improvement firms, retailers and holiday ownership companies. Since it was founded in 2011, it has lent over £3.3bn and raised more than £3.2bn in deposits. One of the company's spokesmen says the loan book grew by 23% in 2015 alone.

STARTING SMALL

Targeting the SME and property sectors is a popular tactic among other new banks. OakNorth also names them as core markets and OneSavings Bank says it is targeting residential and buy-to-let mortgages as well as SMEs and personal loans.

"OneSavings Bank is a specialist lender and identifies gaps in the market that larger banks do not serve well," says Chief Executive Andy Golding. "In the specialist lending sub-sectors such as buy-to-let there is significant room for growth."

Civilised Bank, which is hoping to launch its services later this year, is aiming squarely at the SME market. Its strategy is based on hiring relationship managers to go and meet customers at their place of work. Chairman Chris Jolly says one of the main differences between his bank and the incumbent clearing banks is that his staff has the power to make lending decisions.

"The relationship managers at the clearers don't have any delegated authority anymore"

"There is a real opportunity to provide proper relationship management and banking services to SMEs in the UK," he says. "That is a sector which is grossly under-served by the clearers these days. The relationship managers at the clearers don't have any delegated authority anymore, they can't really transact, and lending decisions are at head office."

Other banks are aiming more at the mass consumer market. Metro Bank's network of retail branches puts it in this category, although it has corporate customers too. In its latest trading figures, covering the first quarter of 2016, the bank reported a 75% year-on-year growth in deposits to £5.9bn and a 125% increase in loans to £4.1bn. Atom Bank is also very consumer-focused, although instead of relying on branches or a website, it is providing its services via a mobile phone app.

Even the banks that are focused on SME lending still often rely on consumer deposits to support that lending activity. A key factor for many of them is that, with a lower cost base than traditional banks, they are able to offer better interest rates to savers.

But to attract such savers they also have to grapple with the related issue of consumer trust. This is something of a double-edged sword. On the one hand, the financial crash of 2008 undermined confidence in big banks, but customers may also struggle to trust an institution they haven't heard of and which doesn't have much of a track record.

One thing that helps the banks overcome that is the UK's deposit guarantee scheme, which insures deposits up to £75,000. Added to that is the relatively easy way of reaching savers through the many online comparison sites.

"The evidence we see is if you can remain in the top quartile of the various price comparison websites then you will attract deposits," says Jolly. "The deposit guarantee scheme is very important because people know they'll be protected. That means putting money with a new entrant is much less risky."

The long-term future of these challenger banks will depend to some extent on how the big traditional banks react. If they prove successful, the clearing banks may alter their own methods to mimic them, or they may choose to acquire some of them. Atom Bank has already attracted investment from Spanish banking giant BBVA. In the medium-term the challengers may need to expand their range of products. There have been some questions raised around Atom's decision to launch with only a savings account on offer. However, the bank is in the process of beta testing a current account, with launches of mortgages and credit cards planned later this year.

Customer reaction has yet to be fully tested too. SMEs might welcome more flexible and sympathetic lenders, but while simple deposit accounts and loans will meet the needs of many, anyone wanting more complex services is likely to find that they still have to go elsewhere.

"New banks are a key part of bringing innovation to the sector"

The current crop of challenger banks may also find themselves under pressure in the future from fresh waves of new banks. The current licensing process is designed to encourage new entrants and the regulators appear keen to ensure that more come forward. In January, the Prudential Regulation Authority and the Financial Conduct Authority jointly launched a New Bank Start-Up Unit for that very purpose.

"New banks are a key part of bringing innovation to the sector, particularly where there is a gap in the market," said Andrew Bailey, Deputy Governor for Prudential Regulation at the Bank of England, when announcing the launch of the new unit.


REMOVING BARRIERS

Some bankers suggest that other changes ought to be made to support the new entrants. Rishi Khosla, Chief Executive of OakNorth Bank, has called on the government to lower the capital requirements for smaller lenders. He has also warned that too many banks could prove to be a problem, particularly if they are targeting similar market segments.

"Having 15 new banks would be very positive for the market, but only if they are not at a disadvantage compared with the incumbents, are spread out across different target segments, and are established on a staggered basis," he said in January, in response to the launch of the new start-up unit. "Otherwise you effectively reduce the probability of success for all of them."

Others agree that more doesn't always mean better. "Lots of choice isn't necessarily the same as lots of competition," says TSB's Firth.

For now, it seems unlikely that such fears will put off new entrants. Investors too are likely to continue to get involved if the current rate of return is maintained.



User Name: *****
 Password: *****
 Login

Threats from within

ALREADY UNDER THREAT FROM THE OUTSIDE, FINANCIAL INSTITUTIONS INCREASINGLY HAVE TO DEAL WITH CYBER ATTACKS THAT STEM FROM INTERNAL FAILURES. HOW CAN FIRMS PROTECT THEMSELVES?

◆ JULES GRAY

Over the last few years, a number of high profile and extremely damaging leaks have hit many of the biggest institutions in the world. The US National Security Agency leaks by Edward Snowden in 2013, the US State Department revelations by Wikileaks in 2010, and a number of disclosures from the Vatican have highlighted the danger of internal leaks, either as a result of deliberate action by whistleblowers, revenge attacks by disgruntled employees, or by sloppy adherence to security procedures.

Sir David Omand GCB of the Global Commission on Internet Governance (profiled in the December 2015 *Review*) gave a stark warning to 1,300 senior investment professionals at a conference in Berlin in early June: “There is no profit without risk. The financial sector lives on calculated risk. Uncertainty on the other hand is very bad for business and the international security situation creates an environment of real uncertainty at the moment. One of the biggest uncertainties is cyber crime and how the criminal attacks against the financial sector are going to be repelled. So investment in security is my message to this conference.”

According to PwC’s Global Economic Crime Survey 2016, cyber threats have increased over the last year, “but business preparation is not keeping pace”. Cyber crime has risen to second in the list of economic crimes against companies, with

32% saying they have been affected, and it is steadily catching up to the usual leader of asset misappropriation.

ATTACKS ON THE RISE

Many of the respondents said they were not adequately prepared, while some did not even understand the risks faced from cyber crime. Worryingly, while 61% of CEOs said they were concerned about cyber crime, “less than half of board members request information about their organisation’s state of cyber-readiness”. Only 37% said they had a cyber incident response plan.

About 22% of respondents have seen losses of between \$100,000 and \$1m as a result of cyber crime, while 14% have suffered even bigger losses. Approximately 50 respondents said they have suffered losses of more than \$5m, and almost a third of those companies have experienced losses of more than \$100m.

A number of companies offer security assessments to financial institutions so that they can see how strong their online defences are. One such firm, MWR Infosecurity, offers a range of services that help bolster finance firms’ defences. These services include vulnerability assessments, targeted attack simulations, and internal process analysis.

Jason Kerner, Senior Platform Developer at MWR’s business division Phishd, says weak passwords are a particularly easy way to access networks for attackers, as staff “often use the same password, or a close variant, on multiple accounts”.

Perhaps the most alarming recent example of this is the case of Facebook founder Mark Zuckerberg, whose Twitter and Pinterest accounts were hacked into in June. His password was reported to be ‘dadada’ – in apparent disregard of his company’s recommendation to choose a “complex combination of numbers, letters and punctuation marks”.

There are also the usual malicious phishing emails or online links that employees can be duped into clicking, leading to malware being spread across a company’s network and its systems being exposed to attack. Kerner says: “Simpler emails, such as ‘Your delivery is on its way – track it here’ often do very well. Everyday tasks that attackers can latch on to generally raise less suspicion than emails asking you to log in straight away.”

He adds: “If the objective is to capture credentials, internal messages [that appear to be] from the IT department often perform very well, but even third party sites, such as LinkedIn connection requests, produce a good result.”

Kerner cites the recent example of toy manufacturer Mattel, which last year was the victim of a phishing email scam that nearly lost it \$3m. Chinese hackers used the fact that the company had recently employed a new CEO, Christopher Sinclair, and sent an executive a request for a transfer of funds.

Temporary staff and contractors can also present a problem to companies, as they are

unlikely to be fully up to speed with security procedures, having not been subject to the same induction and training processes. “If organisations use temporary or contract staff, it is advisable that the risk of their access and what they have exposure to is addressed and limited if necessary,” said Kerner.

In addition, they may have not received the proper vetting that full-time employees receive. Edward Snowden, after all, was a contractor at Dell Computers and Booz Allen Hamilton, both of which were clients of the NSA.

HIGH COSTS

The cost of cyber attacks to global business was last year estimated to be \$400bn by Lloyd’s of London CEO Inga Beale. It is also the financial services sector that suffers the most attacks, with 300% more than any industry, according to a 2015 white paper by cyber security firm Websense (now known as Forcepoint after a recent merger with Raytheon and Stonesoft). US insurer AIG says in the white paper that the largest amount insured by a bank for cyber security was \$400m, but most large policies for cyber attacks are between \$100m and \$200m.

One major breach to hit the banking industry in recent years was the 2014 attack on JPMorgan Chase that exposed contact information of 74 million US households, even though it had spent \$250m on cyber security that year. The attack was made easier by the company’s servers, which didn’t require two-step verification to gain access.

Another example of lax security measures is the vulnerable client portal used by Mossack Fonseca, the law firm at the centre of the Panama Papers (for more on the Panama Papers and tax evasion, go to page 34). The portal hadn’t been updated since 2013.

According to Paul Brucciani, Account Director for Cyber Security at BAE Systems, which provides cyber security technology to corporations and governments, this should be “a reminder that failure to keep up-to-date internet facing applications and to monitor networks for unauthorised use” can lead to severe harm to businesses.

For example, he says: “Basic procedures, like updating to the latest version of a web browser, can ensure that malware and privacy is maintained. Such measures will either prevent an attack or alert defenders in time to respond before damage was done.”

SECURITY TRAINING

Clearly there is a need for staff training, so that vulnerabilities can be dealt with as soon

as possible. “Whatever decisions you make need to be made at executive level,” says Brucciani. “You have people in the company who have a perspective across the whole business, across technology, security, sales, legal, and at board level. That expertise comes together and can [allow you to] make a sensible risk-based decision about what security is needed. This needs to be done on a unique basis, specific to your business.”

“You need to invest in [monitoring] threats, because they’re changing all the time”

It certainly seems like there is a concerted effort to highlight and address cyber crime within the financial community, and in particular where the buck stops in attributing responsibility for misconduct. This is the overarching theme of the 2016 Cambridge International Symposium on Economic Crime, the largest and most highly-regarded event on this theme globally (and which is again being sponsored by the CISI). Professor Barry Rider, Executive Director of the Symposium, said: “Simply stated, the question is who should be held accountable for the misconduct of others, whether colleagues, employees or customers and clients, and what is a proportionate and practical way of bringing this accountability home?”

In a speech at the CISI Awards Ceremony in April this year, Sir Alan Yarrow, Chartered FCSI(Hon), CISI Chairman, spoke of a new Joint Fraud Taskforce which brings together business and law enforcement agencies. He

said: “It will be building on – and utilising – much of the knowledge and expertise that the CISI has developed in this area.

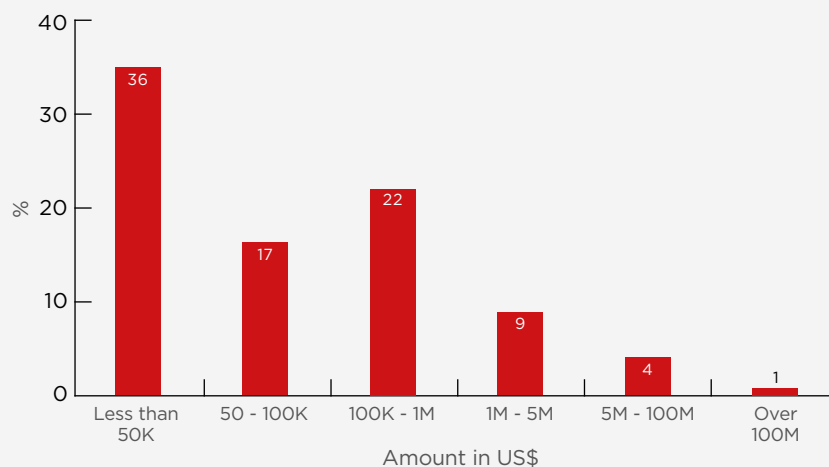
“The internet has brought a world of advantages to our industry, but it has also made access to vital financial information much easier and we must all work to ensure the security of this data. With that in mind, the CISI now has two qualifications available to the industry, focused on financial and cyber crime prevention.”

One of the qualifications, Combating Financial Crime, has been revised and updated, and now has an increased international focus and emphasis on practitioner responses to financial crime, as well as highlighting practical business safeguards and specific considerations for financial services.

The other qualification, Managing Cyber Security, was released earlier this year and is an entirely new exam that provides candidates with a grounding in the threat of cyber crime, including how to evaluate the risks to financial services and develop effective security solutions to prevent, detect and mitigate cyber attacks.

This type of awareness training is exactly what financial institutions need to be engaging in, says Brucianni, preferably by taking a layered, or ‘stratified’ approach to cyber security. “You need to invest in [monitoring] the threats, because they’re changing all the time. Financial institutions should use very specific intelligence about their digital footprints and how that is changing, and look at whether or not it can be exploited.”

FINANCIAL IMPACT OF ECONOMIC CRIME



Source: PwC Global Economic Crime Survey 2016

Life saver

DOES THE UPCOMING LIFETIME ISA REPRESENT A VIABLE ALTERNATIVE TO TRADITIONAL PENSION SCHEMES?

JILL INSLEY

Rumours that individual savings accounts (ISAs) could soon replace pensions were rife in the run up to the 2016 Budget, and the announcement of a new type of ISA has done nothing to stop such speculation.

Chancellor George Osborne was expected to scrap the current regime of pension tax reliefs and introduce a new ‘pension ISA’. Instead, he left pension tax reliefs untouched – for the time being – and announced the launch next year of the Lifetime ISA, otherwise known as LISA.

The LISA, which will be introduced on 6 April 2017, is a halfway house between a pension and the traditional ISA. It has been designed with just enough flexibility to persuade a younger generation to start saving, initially towards something they really want: a deposit for their first home. The Government hopes that, having developed a savings habit, investors will then use their LISA to save for retirement. LISAs are in addition to, and do not replace, the existing ISAs.

ISAs have long been used as a weapon in the financial adviser’s armoury when devising a strategy for retirement funding. But while standard cash and equity-based ISAs have promised completely tax-free proceeds, they lack the strong incentive of tax relief on contributions on the way in, but do offer tax-free benefits upon withdrawal.

Pensions only allow 25% of the fund to be taken free of tax, then any remaining income

is liable to income tax at the individual client’s marginal rate. But because they offer tax relief on contributions, they have remained the retirement savings vehicle of choice for most people.

“The state adding 25% on top of what you save means nothing else comes close”

However, the LISA (but not the traditional ISA) includes a bonus: the Government will contribute a sum equivalent to 25% of the amount an investor puts into their account, subject to a maximum annual investment allowance of £4,000. This makes it very attractive for those wanting to save towards their first home: the scheme benefits from a bigger potential Government bonus than the recently launched Help to Buy ISA (a maximum of £32,000 compared to just £3,000). You would have to be extremely good at selecting investment funds or shares to beat this risk-free rate of return. It is worth remembering, however, that if you encash the LISA early for reasons other than buying a house or retirement at age 60, then the government will take back 25% of the total fund value as a penalty.

Experts have described the LISA as a ‘no brainer’ for younger workers saving towards their first home. Martin Lewis of MoneySavingExpert said: “The fact that the state adds 25% on top of what you save

means nothing else comes close – it is, literally, money for nothing.”

But the case for investors using the LISA to save towards their retirement is less straightforward. The choice of whether to use pensions or LISAs depends on several variables, including the tax status of the investor while saving and in retirement, whether they are employed or self-employed, whether they work for an employer that will contribute to their pension, and whether they have access to salary sacrifice. Other considerations, such as how disciplined the client is on accessing funds, will also impact the decision. It’s not necessarily wise to recommend a LISA to a client if they tend to lurch from one emergency to the next, encashing policies and draining bank accounts as they go! However, if you can educate a client and you can plan for them to have an emergency fund plus shorter-term access to other monies, then they may develop the required discipline.

This means that we cannot generalise on whether it is better to use a LISA or a pension to aid retirement planning.

CRUNCHING THE NUMBERS

Richard Parkin, Head of Pensions at Fidelity International, has ‘number-crunched’ the impact of these different variables on someone investing in a traditional ISA, a LISA and a pension, to find the cost to them of getting £1,000 income after tax on retirement. As the table below left shows, the benefits of investing in a pension can still outweigh those of a LISA, but it helps to be a higher-rate taxpayer.

“We’ve heard no end of debate around how the LISA will leave any form of pension out in the cold,” Parkin said. “Yet some simple number crunching shows that, for those looking to save for retirement, the LISA is not the ‘cure all’ for every retirement need.”

If you are a basic-rate taxpayer now and at retirement, you will do better by investing in a LISA, according to Parkin’s calculations. Higher-rate taxpayers who become basic-rate taxpayers are better off investing through

NET COST TO EMPLOYEE OF PROVIDING £1,000 AFTER TAX AT RETIREMENT

	ISA	LISA	Pension (Basic rate relief, basic rate on income)	Pension (Higher rate relief, higher rate on income)	Pension (Higher rate relief, basic rate on income)
Without salary sacrifice	£1,000	£800	£941	£857	£706
With salary sacrifice	£1,000	£800	£800	£828	£682

Figures from Fidelity International

pensions as they could benefit from a 42% uplift on their original saving. Those who remain higher-rate taxpayers will be slightly better off (7%) with the LISA.

“For retirement savers, the LISA is not the ‘cure-all’ for every retirement need”

However, these figures only look at the difference taxation can make; they do not incorporate employer contributions. “Joining an employer-sponsored pension scheme remains the best option for all those who are saving for retirement,” says Parkin. “Come April 2019, the employer contribution [of 3% of the employee’s qualifying earnings] plus the tax benefits delivers a return of 70% on a net contribution for a basic-rate taxpayer under automatic enrolment. Compared to the 25% tax benefit under the Lifetime ISA, employer-sponsored pensions win hands down.”

An employee who saves through salary sacrifice – contributing money directly from their salary before tax and national insurance (NI) has been paid by both the employee and employer – may also find their employer is prepared to boost contributions by adding some of the NI it has saved.

TOO MUCH CHOICE

One of the biggest problems with pensions is their complexity. There are myriad types of pension schemes, so investors – and often experts – struggle to keep up with the rule changes introduced by successive governments. As we saw some years ago with the abolition of Mortgage Interest Relief, successive governments have first tinkered around the edges of allowances and reliefs, before eventually removing them altogether. Could this happen to pension tax relief? It does seem unlikely at this point, as we still need to encourage more people to save for the long term and for their retirement.

LISAs are likely to appeal to a young audience because they are clean and simple to understand. How much easier it is to take a dollop of cash out of a LISA as and when you need it, than to face the excruciating complexity and possible expense of putting a pension into drawdown, or taking uncrystallised funds pension lump sums under the new pension freedom rules. Ironically, many clients with sizeable pots to invest are likely to be too old to invest for their own purposes, ie, are over 40. However,

that does leave the planning potential to talk to them about helping their children save via LISAs, using gifts out of normal expenditure or the annual exemption.

David Crozier, a CERTIFIED FINANCIAL PLANNER™ with Navigator Financial Planning, says this may encourage people to choose them over pensions, regardless of their tax situation or the availability of an employer-sponsored pension scheme.

OPTING OUT

The Work and Pensions Committee recently expressed concern that employees could be encouraged to opt out of auto-enrolment in order to invest in LISAs, leaving them worse off in retirement. “Whatever the attractions of the LISA, it must not be presented as a direct alternative to automatic enrolment,” the Committee said. Tom McPhail, Head of Pensions Research at Hargreaves Lansdown, agrees this could become a problem. “Many employers are likely to offer the option of a LISA alongside their company pension,” he explains. “Given the better returns available through workplace pensions, it is vital that employees are given clear and accurate information and guidance on which choice is likely to be best for them.”

There are some other issues that investors should consider before deciding which tax-efficient scheme is best for them. One is the question of what happens when the investor reaches the age of 50. Investors can only make contributions into a LISA if they open an account between the ages of 18 and 40, and must stop on their fiftieth birthday. Presumably, they would then wish to start a pension.

If the investment maximum remains at £4,000 a year, this will limit LISA retirement savings to a possible maximum of £160,000. A 65-year-old investor, in good health, buying an annuity with that amount today, would get income of just £8,365 a year, according to retirement income specialists Age Partnership. Although we should remember that ISAs can also be used too.

“When you die, your ISA will become part of your estate and subject to inheritance tax”

Crozier also points out that pensions can provide a huge inheritance tax benefit compared to any type of ISA. “When you die, your ISAs will become part of your estate and subject to inheritance tax,” he says. “Pensions, by comparison, sit outside your estate, and are never subject to inheritance tax (except in very limited circumstances). In fact, if you die before age 75, your pension fund can pass to your beneficiaries free of tax of any kind.”

Good estate and retirement planning is needed to balance out the conflicting issues. Ultimately, the best outcome for investors building up retirement funds is likely to result from using a combination of these products, including LISAs and pensions. “Their use should be considered as part of a wider financial plan,” says Crozier. “The plan should be reassessed every year or two to see if the investor’s circumstances have changed and whether the mix of investments is still appropriate.”



ikon/Frazer Hudson

A taxing issue

ATTENTION HAS FALLEN ON OFFSHORE TAX HAVENS IN RECENT MONTHS, WITH CALLS FOR GREATER TRANSPARENCY IN ORDER TO RESTORE PUBLIC TRUST

◆ HEATHER CONNON

The Panama Papers, as the 11.5 million documents leaked from the world's fourth largest offshore law firm Mossack Fonseca have been dubbed, have resulted in the resignation of the Icelandic prime minister and Spain's minister of industry; sparked criticism of politicians from countries as varied as Malta and Pakistan; and, of course, enveloped the UK Prime Minister David Cameron in a media frenzy over the revelation that his father ran a fund registered in the Bahamas.

But the long-term impact of the leak could go far beyond a few political upheavals. It may end up changing the complexion of offshore investment forever. For what was truly startling about the Panama Papers was not just that a few politicians were using tax havens to conceal wealth; it was how widely and deeply these tax havens have permeated all corners of the world and are used by people from all walks of life. Coming on top of revelations that banks like HSBC and UBS helped their clients evade tax, it underlined the popular perception that a self-serving elite is concerned only for its own interests.

CHANGING ATTITUDES

George Bull, Senior Tax Partner at RSM, thinks that leaks like this have caused a shift in attitude. He said: "For my entire career, there has been a perception that, somehow, offshore does equate with something to hide but, for a long time, the public view was that it was a victimless crime. [The driver of the current concern] is the growth of what is seen as excessive inequality of wealth, and the fact that most of the northern hemisphere countries of the G20 suffered from the financial crisis. While governments have

assured the public we are all in it together, the evidence of overseas tax avoidance says to large swathes of the electorate that we are not in it together."

Fiona Fernie, Head of Tax Investigations at Pinsent Masons, added: "A number of people with a high profile in public life are more worried about having even legitimate vehicles which could be subject to attack. [They] are beginning to think that, even if their offshore operations are entirely legitimate, for their own reputations they cannot afford to have them."

The leak may end up changing the complexion of offshore investment forever

In fact, the professionals all agree that there are legitimate reasons for offshore investing – and that many of us may be doing it without realising it; whether through having a foreign bank account or a product like an exchange-traded fund or an Undertakings for Collective Investment in Transferable Securities (UCITs) vehicle, many of which are based in Dublin or Luxembourg. According to the Association of Investment Companies, 117 investment companies, around a third of the total, are domiciled overseas. While there may be some tax savings – there is no stamp duty on the purchase of shares in offshore investment companies, for example – for many companies, domicile offshore is an administrative convenience.

"The fact is that collective investment vehicles based in what are commonly known as tax havens are seeking to attract investors



iStock



from all over the world, therefore there are attractions in the idea of a tax neutral conduit through which people can invest so that there is no obscuring of what should be taxed at what level,” said Fernie. “The companies in which the vehicle invests are taxed on the profit they make in the appropriate countries in which they operate, and the investor at the top pays tax on the returns they take out of the investment, assuming it is correctly entered on their tax returns.”

CLOSING IN

However, the further tax havens stray into exotic territories, the more questions are raised about their legitimacy. Ian Shipway CFP™ Chartered FCSI, Managing Director of HC Wealth Management, said: “Tax havens more off the beaten track, like the British Virgin Islands, the Cayman Islands or Panama become less and less visible. There can be totally legitimate reasons for investing through the Cayman Islands, not involving any tax avoidance – for example, investment vehicles can be based there because of the freedom it gives the investment manager to invest in a range of vehicles that may be restricted by regulators in the UK. That is not avoiding and it is certainly not evading tax.”

For many companies, domicile offshore is an administrative convenience

Bull accepts that, for many, the main reason for choosing these offshore havens will be tax – but he believes that the tax authorities are catching up. “Over the last few years, HM Revenue & Customs (HMRC) has changed the tax code to a remarkable degree and has brought in substantial amounts of extra tax as a result. Clearly, though, they could do more. There is a strong argument that to do so would not need more law, it would need more resources.”

Fernie adds that HMRC is already actively investigating individuals identified as investing in tax havens. For example, HMRC has known about the HSBC leak for some years and has been chasing every name on that list. New legislation, such as the US Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard for automatic exchange of tax information, is being introduced, and tax authorities are gearing up to use that information. There is also a new offence ➡

“We need a targeted, joined-up, global approach to combat corruption wherever it is flourishing. But we shouldn’t assume that all offshore financial centres are inherently corrupt. Indeed, most international financial hubs are now largely well-regulated, co-operative and transparent, plus there is both an economic and moral case for so-called tax havens that is often, perhaps conveniently, overlooked.”

NIGEL GREEN, CEO, DEVERE GROUP

“Individuals have a responsibility to be honest and careful in advising tax authorities, including not failing to disclose taxable information. There are a range of other reasons [for going offshore] but, in reality, most of these reasons can be fulfilled in a tax advantageous way if you go to a country offering the greatest tax advantages, even if it is not tax evasion.”

GEORGE BULL, SENIOR TAX PARTNER, RSM

“It would be a shame if we couldn’t have some form of privacy for investing offshore. But society is moving to such an extent that the interests of the whole might supersede the interests of the individual.”

IAN SHIPWAY CFP™, MANAGING DIRECTOR, HC WEALTH MANAGEMENT



of corporate failure to prevent facilitation of tax evasion. “Only time will tell how effective these are,” said Fernie.

But she doubts if the impact on the amount of tax collected would be as great as some seem to believe if offshore tax havens were to be abolished, and there may have to be changes in domestic legislation in some countries to avoid double taxation on certain types of investment.

NEED FOR REFORM

The growing furore over the extent of tax haven investment means there is growing pressure for reforms to make it more difficult to conceal assets and income overseas. The key concern for most is transparency. How much should investors be made to reveal? Shipway said: “On the one hand, I am tempted to say that, from the privacy point of view, individuals should be free to deal with offshore centres as they wish. There is a requirement on UK individuals to declare all their worldwide income, although a smattering of individuals are unaware of that requirement.”

He points out that, for many foreign residents, the UK is considered a tax haven. “For example, you do not pay capital gains tax if you are not a UK resident, although that is starting to change with property. If you are, for example, a non-resident investor in the UK, the UK taxman will not come after your income or assets.”

The issue of nominee ownership further complicates this. This allows investors to list another person as owner or director in a

company. They can then still take any profits without having to pay the same tax as they would as an owner of the business.

Bull thinks that the public disquiet could, in itself, help to clamp down on offshore activity. “There is also pressure on firms [to look more closely at what their clients are doing]. Reputable firms already have sophisticated ‘know your client’ and anti-money laundering procedures in place because that is the law and that is what you do. But I think all financial services companies are now super-conscious of having a proper understanding of what is going on if they are advising clients on a proper basis. I would not be surprised if one consequence of this is that it makes individuals who want to invest offshore deeply unattractive to professional advisers.

Public disquiet could help to clamp down on offshore activity

“We saw this in the past for US expats in the UK post FATCA, where a US expat working in London with all the legitimate credentials found it impossible to get a mortgage from a high street bank because they put that category of people into a ‘too difficult’ pile.”

Shipway thinks one solution to increasing transparency may be a centralised authority, with wide powers of investigation. He said: “The debate has started and it might get to the stage where some authority somewhere would be allowed to get information and inspect affairs.”

CHANGE: REGULATORY UPDATE

The new CISI regulatory coverage is well-developed. The first regulatory section in the March edition of the *The Review* was enthusiastically received by readers – managers as well as compliance professionals. The first specific financial sector coverage (private wealth management) on *The Review* digital platform in April was the most popular article on it for some time. The next (on derivatives) was published in May, with the third (on asset management) in June. We plan to add to these with one-off opinion pieces on the impact of regulation more generally. I am very grateful to the practitioners who write these sector reports.

This edition of *The Review* was printed before the EU Referendum, so we decided to hold off on analysis until after the vote. Look out for an opinion piece on the digital platform shortly after 23 June!



Christopher Bond, Chartered MCSI, *Change* Editor



Christopher Bond, Chartered MCSI is Senior Adviser to the CISI. He has extensive experience in financial regulation, both as lawyer and as the Editor of the CISI's well-regarded regulatory magazine, *Change*, which he edited for ten years. He gives presentations on many EU and UK regulatory subjects in the UK and Europe, and writes for a number of regulatory publications. He also supports the CISI's Compliance and European Regulation Forums and advises on Professional Refresher modules. He is a bank board director and Editor of *The International Banker*, the magazine of the Worshipful Company of International Bankers.

Top regulatory developments

1. MiFID blues

News about MiFID has been strangely absent recently, perhaps because firms had been seeing its adoption as inevitable.

But is there a bigger picture? Is there a strong enough consensus between firms and even regulators that MiFID II is too impractical in some important requirements ever to be implemented? Such as in bond pre- and post-trade price transparency damaging liquidity in both corporate and sovereign bond markets; or that some of the transaction reporting requirements require data that does not exist and even if it did, that the regulators could not consolidate or even use it; that product governance does not work with execution only platforms, and many more problems. More significantly, is there a growing consensus that the totality of regulatory changes is damaging economic growth? The Capital Markets Union is one example of this. However, changing a Level I Directive painfully agreed by the Commission, the Parliament and the Council is a difficult and controversial process, rarely done.

So, what is the future for MiFID II? Perhaps that it is likely to happen, but that some of the more impractical requirements will be diluted or even dropped – for example through the use of the 'proportionality' approach; and that its implementation will be staggered over several years, with conduct of business requirements starting in 2018.

What should firms do now? Each is affected differently by MiFID II, but you could make a roadmap of the relevant areas, how long

preparations will take to meet the earliest likely date and to keep in place an implementation team to watch developments closely.

2. The renewed focus on anti-money laundering

The release of the Panama Papers after the HSBC Swiss private bank disclosures has spurred on the growing clampdown on money laundering by regulators worldwide. The Financial Conduct Authority (FCA) has understandably made enforcement of its anti-money laundering (AML) rules a priority, with warnings to banks about new customers, which has resulted in long onboarding times and in them increasing their monitoring of politically exposed persons (PEPs – including those from the UK), with pressure growing on even small ones to adopt automatic surveillance systems for PEPs. However, it is asset managers who are increasingly expected to have robust AML procedures, particularly those with international high-net-worth retail clients. This follows from London's success as a global asset management centre. Smaller firms with such clients may find it increasingly costly to reach the "highest possible standards" mandated by the FCA, eg, in performing due diligence on new customers and monitoring them regularly for 'red flags' (which can give larger asset managers a cost advantage).

In the UK

The Bank of England and Financial Services Act 2016 introduces a more risk-based approach to the PEPs regime in the UK. In response to criticism of disproportionate application in practice to medium-ranking and junior officials, the Act requires the FCA to issue guidance on the definition of a PEP, which may require firms to take a proportional, risk-based and differentiated approach to different categories, and empowers the Government to regulate the FCA's handling of complaints about the way in which firms have interpreted their obligations under the PEP regime. This follows the extension of the PEP regime under the Fourth EU Money Laundering Directive (4MLD), which will see UK officials fall within the PEP definition (although many would say the FCA already expects firms to do this anyway). The FCA's PEP guidance is expected later this year.

In the EU

The Fourth EU Money Laundering Directive will introduce significant changes, such as a public register of people with significant control (more than 25%) directly or indirectly of private companies, which the UK has already recently introduced (however, firms whose sole shareholder is a foreign company are not caught by the public register) in advance of the Financial Action Task Force's (FATF's) review of the UK's AML regime later this year. The Treasury plans to issue a consultation on how it will implement 4MLD also in late 2016.



3. The new Market Abuse rules are about to start

The EU's new Market Abuse Regulation will start on 3 July this year. There are many significant changes in it, such as: extending the scope of securities covered to commodity derivatives; extending the scope territorially; and to orders where there is no transaction; guiding firms to use automatic transaction and communications monitoring systems, and requiring records to be kept for five years.

Firms are also concerned about more sector specific points, such as restrictions on market soundings (corporate finance), the wide definition of 'recommendations' which includes some trade ideas and requires many disclosures, such as the writer's name (the sell-side) and tougher rules on managers' transactions (corporate brokers). There is fixed income criticism that the regulators have adopted an equity approach to a market which functions in a different way.

4. Mass file check to review advice suitability

Responding to criticism from the National Audit Office on how effective the FCA is in preventing and dealing with poor advice, the FCA has launched a mass file check of retail advisory firms to see if there is indeed a serious problem. The questionnaires have a pensions focus but extend to financial planning and securities advice as well. Over 700 firms covering different types of advice have been asked to provide a wide range of data at fairly short notice on the number of suitability assessments made, including samples of them, the use of single or multiple fact finds and more. Assuming the Retail Distribution Review approach, these will be subject to a desk-based review, with visits to specific firms made to obtain more practical detail across a representative sample, with a report published to inform those and other firms of the extent of any misselling. The FCA has previously published examples of good and poor suitability practice.

Model portfolios are also under review. A study by FE, an investment ratings and research agency, found that the majority of advisers use only one model portfolio service for all their clients. This has raised concerns that consumers may be 'shoehorned' into unsuitable models (and investments). The advisers suggested a lack of transparency and inadequate holdings information made the comparison of different portfolio services difficult and time consuming. The FCA earlier commented on the need for advisers to perform sufficient due diligence on providers in connection with "asset-allocation tools and model portfolios". It is clear that model portfolios are here to stay as a good outsourced solution for some discretionary managers, but advisers need to be very aware of the regulators' expectations and of clients' cost disclosures.

5. How do managers make decisions under the Senior Managers Regime?

The introduction of the Senior Managers Regime (SMR) has raised this important question. Many firms expect employees to act on decisions to the best of their ability, once made by senior management or a parent company. How does this sit with the SMR, which gives individual managers responsibility for any decision they carry out, without them necessarily having any internal authority to question or even refuse it? The individuals' Statements of Responsibility tend to be just that – placing responsibility only. To the credit of the regulators, they have in parallel boosted the 'whistleblowing' structures in firms (new rules start on 7 September 2016) through requiring firms to put in place internal whistleblowing arrangements able to handle all types of disclosure from all types of person. However, this is a 'nuclear' option which few want to use. So managers will need to decide how far to protest a decision internally.

The drive towards individuals taking personal responsibility for their corporate actions will require a major adjustment in the expectations of senior management of firms and parent companies if the regulators carry out their responsibility under the SMR with enforcement actions. Overseas-owned firms where the home country does not have this concept will find it particularly difficult. This is an issue for all types of firms, not just banks, since the plan is for all firms to come under the Senior Managers and Certification Regime (SMCR) in 2018.

Apart from this general trend, banks are still working their way through the practicalities of the new regime. Some practical issues are in handover certificates where there is no template and there is a conflict of interest between the outgoing employee (who wants maximum disclosure) and the incoming one (who wants the minimum) and the care needed to agree the new individual's Statement of Responsibility (this last can lead to it taking several months to appoint a new manager when the outgoing manager may only have a short notice period). Firms may therefore decide to lengthen employee notice periods.



6. How safe are contingent convertible bonds?

The simple answer is that contingent convertible bonds (cocos) are as safe as the issuing bank. The possibility that these perpetual bonds (formally Additional Tier 1 bonds) may be converted into equity or coupons suspended or even capital cancelled, depends upon the bank continuing to meet its debts and its prudential requirements, and upon the regulator supervising it to achieve this. These bonds have been popular with both institutional buy-side wanting higher than normal yield, and banks required to hold more capital under the EU's Capital Requirements Directive IV (CRD IV) – nearly €100bn has been issued. As a new class of instrument, risk is unclear and market sentiment has shifted dramatically – at some times the new issue market has closed. Indeed the FCA has banned banks' retail sales.

There are several big unknowns. The first is how investors will react when an issuing bank comes close to the 'trigger' of suspending coupons or equity conversion or capital cancellation. The product is designed to create market stability in such an event. Some fear that investors will dump all cocos and this will result in a market collapse. There have been some early experiences. In February this year the market fell sharply when institutions feared that a large bank would not be able to pay its coupons. The European Central Bank is rumoured to be so concerned that it has discouraged some banks from issuing them, and the European Commission is working on proposals to resolve some of the uncertainties around them. Other experiences in Italy and Spain have shown how difficult it is politically for governments to let retail investors take a hit – and how they have avoided the 'triggers', eg, through setting up a bail-out fund to buy doubtful debts from struggling banks. Institutions and banks need to be very careful.

7. Lots of enforcement developments

Here is a small selection from a large choice:

- The FCA will use pre-emptive powers, eg, preventing the Bank of Beirut from onboarding new customers for 128 days; and removing regulated activities from a firm.
- Reduction in the number of formal Section 166 Skilled Person Reviews, with only a few (2% in 2013–14) ending in enforcement. That said, these powers are not subject to judicial review.
- The apparent failure by the FCA to verify many firms' attestations; however, recurrence of the problem covered could expose the individual attestor to penalties.
- Increase in the amount of fines to deter others, such as the fine of £27m in addition to disgorgement of profit against Barclays Bank for not applying enhanced due diligence to PEPs.
- The two year period for customers to claim PPI misselling. There is likely to be a flurry of claims before the largest ever misselling is finished.
- The closing of the Serious Fraud Office's (SFO's) large investigation into claims of fraudulent conduct in the forex market because, although there were "reasonable grounds to suspect the commission of offences involving serious or complex fraud", the evidence is not strong enough to obtain criminal convictions. The US Department of Justice is continuing and the FCA will assist it. The FCA has also decided to stop its inquiry into bank culture.
- The change in enforcement procedures by the FCA following the Treasury's review. These include a "streamlined" process for "focused resolution agreements", better communications to the firm or individual from the FCA, eg, on its early intervention work, and speeding up the time between a warning notice and any decision notice. The FCA has, however, refused to incentivise firms to make earlier settlements, because it does not know the extent of any breach.
- Confirmation (for PRA firms) that the FCA will continue to be the primary enforcer, although the PRA reserves its use of such powers, eg, against Qatar Islamic Bank (UK) for prudential failings.
- A large increase (80%) in the number of cases referred by firms to the Regulatory Decisions Committee. The RDC has overturned the FCA's findings occasionally (three times in 2015).

8. A new world for forex dealing

Substantial progress has been made in the global code of conduct for forex markets developed by the forex working group chaired by Guy Debelle. This initiative is designed to remove uncertainties and inconsistent practices for dealers and for the buy-side. It results from the forex trading scandals which led to many dealers being suspended or dismissed by their firms. The UK, led by the Bank of England, has been very active in designing the code, with 35 sell-side and buy-side firms joining the various work streams. The code addresses such practices as the last look, fix pricing and code adherence. It will replace six existing forex codes and is a remarkable example of global co-operation not driven by the G20.

The code will affect both sell-side and buy-side institutions which had the opportunity to comment on it to the forex working group in May in New York, and which continue to be able to do so. Once agreed it is likely that regulators will expect firms to adhere to it, although its status may be guidance rather than strict regulation.

Meanwhile there have been a number of employment tribunal cases brought by individuals dismissed in the forex investigations. Many of these have been won by the employees.



9. How will the FCA use its new competition powers?

The FCA has launched market studies (the first step in a competition investigation) into six areas: investment banking; asset management; cash savings; retirement income; credit cards and general insurance. The result of its investigation into primary equity markets is an interesting example. It has banned contractual clauses tying in corporate customers from giving first refusal for valuable equity and debt issuance business, in loans and corporate broking services. It stopped short of banning the provision of such services in agreements.

The FCA has other competition powers which enable it to take action against specific firms for breaching competition law. It is now proposing to use these. Deborah Jones, Head of Competition at the FCA, said in a recent speech: "For the last year, we have been talking about enforcement cases in the future tense. Very recently, that has changed and I can now confirm that we are taking active steps towards the opening of Competition Act investigation." Among other powers, the FCA can issue 'on notice' letters – sent if the FCA has concerns, but instead of conducting a full investigation, asks what the firm will do to resolve these. A possible example is meetings among distributors where they appear "to operate without any competition compliance protocol to prevent the disclosure of commercially sensitive information". Trade bodies are aware of this potential problem.

More generally, the FCA has the problem of internal conflict of priorities. As it makes new rules it is increasing the cost of regulation for firms, resulting in smaller firms dropping out or merging, and increasing the barriers to entry for new ones, for example in asset management and deposit taking.

10. Who should pay for market data?

Traditionally, members have provided market data to trading venues, such as exchanges, and then paid to buy the consolidated result from the venue or information provider. Clearly there is a cost in consolidating, but firms argue that it is often overpriced. Indeed, exchanges have increasingly relied upon data sales for their profits rather than on fees for matching orders (which some venues do not even charge for – The Intercontinental Exchange (ICE) CEO recently said: "The matching engine that was so valuable that started this company at the height of the dotcom boom – today others are not only giving it away for free but will pay people to use it"). The tension between market participants and venues has increased with the regulatory extension to over-the-counter (OTC) derivatives, where exchanges are keen to provide. The regulators are observing this question in order to decide whether to intervene or not. Recently the FCA did see this need in the case of benchmarks, where there is an obligation to provide data access at reasonable cost. However this applies to specific data rather than generally. As exchanges consolidate (for example the LSE/Deutsche Börse merger proposal), these pressures will increase.

11. Regulators demand more capital

The UK has long had a reputation for gold-plating global and EU requirements, and nowhere is this clearer than in prudential capital. The Bank of England/PRA/FCA has anticipated many of the Basel III/CRD IV requirements, and sometimes required specific firms to hold more capital and to increase their liquidity because of perceived risks. Banks are the main firms affected, with the latest change being the proposed increase in capital to cover risks in the trading book. (this has long been an area of different practices in countries, but the Fundamental Review of the Trading Book will align these, resulting in some CRD IV firms – both banks and capital markets – having to increase their trading book buffer; in one case by 800%). The Financial Stability Board (FSB) has also now made its policy recommendations on the total loss absorbing capacity (TLAC) of globally significant banks which may increase the amount of capital these banks need by €2.1tn by 2022. The FSB accepted that this may reduce the amount of credit available, but expected this to be "very limited". Other commentators think it may have a more profound impact.

As well as banks and the sell-side more generally, some UK fund managers have also received regulatory demands for them to increase both capital and credit lines to enable them to cope with mass redemption requests. This in itself has increased the cost pressure on fund managers at a time when the sector's charges are under regulatory review.

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BRINGING FINANCIAL ECONOMICS TO LIFE

Accessibility and relevance have long been keynotes of Professor John Kay's wisdom in the world of economics, combining stringent academic research with the ability to convey that to a (relatively) lay audience. We strive to achieve these objectives in this Review of Financial Markets, for our wide range of readers in wealth management and financial planning, in investment banking, and much else besides.

In an address in May 2016 at the Royal Institution, for the third annual Cazenove Charities investment lecture, Kay pondered the work of that other great economist, Harry Markowitz of the University of California, who won the Nobel Prize in economics for his 1952 essay on 'modern portfolio theory'. By combining assets, said Markowitz, it was possible to benefit from diversification and get a better risk-adjusted return. In this authoritative work, Kay pointed out, risk was described mathematically as the volatility of the portfolio value. But he warned: "This model forms the basis of much of the current advice given to endowments. It is also the origin of the derivatives and asset-backed securities markets; with the boom that followed their introduction eventually leading to the credit crisis; and the value at risk metrics that spectacularly failed the banks in 2007."

There are many examples, Kay pointed out, where models are of limited real life use. These include a Professor of Decision Science, who was unable to make an important investment decision because "this is serious"; or Markowitz himself (quoted by Jason Zweig in *Your money and your brain: how the new science of neuroeconomics can help make you rich*) on his own investment portfolio: "I should have computed the historical co-variances of the asset classes and drawn an efficient frontier. Instead, I visualised my grief if the stock market went way up and I wasn't in it – or if it went way down and I was completely in it. My intention was to minimize my future regret. So I split my contributions 50/50 between bonds and equities."

People make decisions based on what is important to them, said Kay, a key theme in his latest book, *Other people's money: the real business of finance*, and many other works. This month's CPD article on pp. 60–61 covers some of this ground.

Of great importance to CISI members are new rules on investment research, evolving approaches to money laundering and its control, and conduct and culture in financial institutions.

Alistair Haig ACIS, Fellow at Kay's alma mater, Edinburgh University, and Neil Scarth of Frost Consulting focus their beady eyes on the market for investment research in our first article, with practical guidance for asset managers and asset owners on this issue, driven by the provisions of the second Markets in Financial Instruments Directive, which remains topical post Referendum.

Next, Kenneth Murray, Head of Forensic Accounting at Police Scotland, concludes his groundbreaking research on the challenge of organised crime. Money laundering and related activities are of serious concern to many CISI members round the world; our understanding of money laundering models must keep up with the reality, and Murray's front-line experience responsibilities bring Kay's 'accessibility and relevance' directly to our members' desks.

CONDUCT AND CULTURE IN UK LISTED BANKS

Last but far from least, Dr Paul Cox, Senior Adviser at NEST – the National Employment Savings Trust, the UK Government's workplace pensions scheme – and his colleague Diandra Soobiah have conducted a detailed study on conduct and culture in UK listed banks. A summary is published here, the full paper is available online and Cox will be discussing the results with CISI members in London on 13 July (and later available on CISI TV).

Without stealing the thunder from what promises to be a fascinating event, staff were a special focus for the survey - they were viewed as the front line of conduct and culture, as well as key touch points for customer experience. The banks the research team met wanted staff to have greater competence, professionalism, integrity, diversity of thought, and ability to break through existing ways of doing. Interviews with professional bodies by Keyur Patel for a 2014 report by the Centre for the Study of Financial Innovation (funded by the CISI) reported similar results. "One part of delivering on that intent was to recruit people who'd taken and passed appropriate exams, who were members of a relevant professional body, and who had different skill sets," says the paper. "Some banks were purposefully hiring from outside the financial services sector to bring in new types of people and personality, particularly within areas such as human resources, conduct and culture, and business development. Those who'd joined conduct and culture programmes from outside the sector had many ideas they were hoping to take forward. The other part of delivering on the intent was to raise competency among current staff and signal that aiming higher is part of what professionalism and performing effectively now means.

"Many staff metrics were being used to track the recruitment and professionalisation of staff. Professionalisation involved continuing workshops, seminars, training programmes, refresher courses, and exams. Metrics included the number of refresher courses carried out, training programmes completed, memberships of professional organisations, exams taken and passed, and an overall average for the professionalisation of staff.

"With assurance of confidentiality and a more honest and open environment within banks, staff were also being encouraged to speak up about moral and ethical issues, the work environment, colleagues, grudges, likes, and dislikes. Personal conduct and whistleblowing cases were on the rise."

REVIEW OF FINANCIAL MARKETS

We are always keen to gain access to those 'accessible and relevant' papers to which we aspire. Ideas and contacts are most welcome. Please mail or call me with any thoughts.

Thank you

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THE ROLE OF ASSET OWNERS IN THE MARKET FOR INVESTMENT RESEARCH: WHERE ARE THE FIDUCIARY CAPITALISTS?

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ABSTRACT

Fiduciary capitalists,¹ such as leading pension plans and endowments, can be influential in aligning the interests of asset management firms with their clients. In the market connecting investment professionals with the information they need to meet client goals, we identify numerous conflicts of interest, but find little action has been taken by asset owners. Interest in the obscure practices surrounding the use of dealing commissions for research has heightened since 2014 due to regulatory scrutiny in the UK and the impending implementation of the second Markets in Financial Instruments Directive (MiFID II) in Europe. The authors make recommendations to guide asset managers and asset owners through a complex information market during this time of dramatic change.

INTRODUCTION

Financial capitalism, the prevalent operating system behind global financial markets, has been highly criticised in the years since the 2008 financial crisis. Despite this, we can find examples where the collective power of asset owners has succeeded in improving end-investor outcomes. Hawley and Williams² observe the emergence of an alternative system driven by asset owners acting as 'fiduciary capitalists' to improve alignment with end-investors' long-term goals.

Fiduciary capitalists select managers based on the efficiency of their research utilisation and the total cost of management. As a result, they are in a strong position to call for transparent and objective research spending by asset managers.

We briefly review the forces of change in the information market connecting fund managers to external sources of investment research. Despite its obscurity, this market provides an important link between investment management firms and thousands of research providers, such as brokers and independent firms, around the world. It is also large: estimated to turn over in excess of \$20bn per annum.³

Our ongoing work with firms, regulators, industry and professional bodies, combined with evidence collected through surveys and interviews, reveals little evidence of fiduciary capitalism in this particular market to date. Asset owners, who represent end-investors and therefore could be expected to reduce agency problems inherent in fund management, have been quiet in this debate. Regulators, entrepreneurs and indeed the buy-side and sell-side firms themselves, appear to be the agents of change.

ASSET MANAGERS REMAIN HUNGRY FOR INFORMATION

Rogers⁴ cites the shift to lower cost index-based strategies as a result of fiduciary capitalism. Passive index strategies have grown since the introduction of index funds in the 1970s, and now account for some 14% of assets under management.⁵ This does not include fast growing smart beta innovations. Rogers notes the important role played by asset owners in shifting to such strategies to meet investor goals, rather than overpaying for the hope of short-term performance.

Despite the ascent of index investing, active management remains the prevalent type of equity fund management around the world. Indeed, it will do so even if passive management doubles in size. Active management is likely to remain an important segment of equity ownership for decades, much as it prevails in most other asset classes.

Active managers need research in order to make decisions in the face of uncertainty to meet investor goals. Buy-side firms therefore have to either produce their own research or buy it from third parties. Most choose ingredients from both sources and the recipe will depend on the availability, quality, trustworthiness and cost associated with each source.

WHAT EXACTLY IS RESEARCH?

Investment research comprises much more than written analyst reports.⁶ Customised analysis, quantitative models and analyst time are just some of the services that investment managers value. Despite frequent claims to the contrary, most asset managers remain heavily dependent upon broker research.

In the US, fund managers can use commissions to purchase data and gain access to company management in addition to procuring financial analysts' research. In the UK, only the latter is eligible and buy-side firms must also pay for raw data and corporate access with their own, not their clients', money. Rules in other markets tend to fall between the UK and US definitions.

Unlike some economic goods, research can be worth different amounts to different consumers. Consequently, by definition, there is no 'right price'. Regulators are in no position to tell an asset manager that a particular product or service is not 'substantive' in relation to their investment process.

Many asset owners would also find it difficult to evaluate research efficiency, but this is largely due to lack of information. Research is procured to improve the chances of meeting investor goals. While this may be consistent with asset owners prioritising investor goals over short-term alpha,⁷ it is perhaps puzzling that scrutiny on research costs, or at least demand for attempts to value research, has not been higher in the past. This puzzle can be explained at least in part by lack of understanding of this complex market, which is briefly explained in the following section.

HOW DOES THE RESEARCH MARKET WORK?

The means of paying analysts for investment research is strikingly different to markets for most other professional services. Investment management companies can charge the cost of research to the funds they manage, meaning that their clients pay for research. This

1. John Rogers, 'A new era of fiduciary capitalism? Let's hope so,' *Financial Analysts Journal*, 2014.

2. J.P. Hawley and Williams A.T., *The Rise of Fiduciary Capitalism*, University of Pennsylvania Press, 2000.

3. Frost Consulting Estimates. The UK Financial Conduct Authority estimates the UK market to be £1.5bn.

4. Rogers, 'A new era of fiduciary capitalism? Let's hope so,' 2014.

5. *Boston consulting group global asset management report*, 2015.

6. CFA Institute and CFA Society of the United Kingdom, *Investment research valuation approaches: A framework and guide for investment managers and asset owners*, 2014.

7. Rogers, 'A new era of fiduciary capitalism? Let's hope so,' 2014.

is done using research commissions that are paid to brokers when shares are bought or sold. Unsurprisingly, most research has typically been purchased using commissions, because this way the fund management company does not bear the cost. Additionally, it is most unusual to find contractual arrangements based on billable hours or specified deliverables.

Fund managers decide how to reward analysts for various research services on an ex post basis, ie, after consumption. A typical broker vote process would involve fund management staff deciding how to allocate commissions at the end of each period (typically six months), on a percentage basis. For example, an equity fund manager might pay a given brokerage firm 7% of her firm's total commission allocation as payment for research. This information would be translated into a target allocation for the buy-side dealers to execute in the coming period. As a result, research would be paid in arrears. Detailed analysis of a US broker vote process can be found in Maber et al,⁸ but such processes no longer comply with UK regulation or European regulation post MiFID II. In 2006, UK regulation created a payment mechanism which allowed research commissions to be paid away to other research providers, thus ending the one-to-one mapping between execution and research relationships. It also paved the way for hundreds of independent research providers. This mechanism, analysed by Haig and Rees⁹ and usually called the Commission Sharing Arrangement (CSA), has equivalents in the US and other markets. Figure 1 shows estimated CSA adoption aggregated across US and European markets.

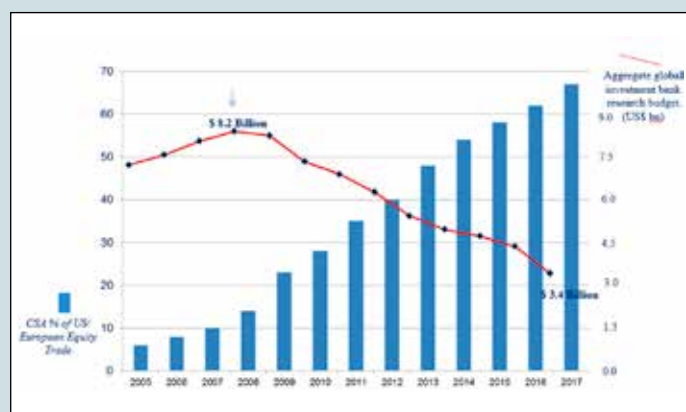


Figure 1: Adoption of commission sharing arrangements (CSAs) and investment bank research budgets 2005–2017

CSA adoption (bars; LHS axis) was relatively slow but now accounts for more than half of commission payments for research. Investment bank research department budgets (line; RHS axis) have more than halved since 2008. Source: Frost Consulting

PROBLEMS ASSOCIATED WITH THE BROKER VOTE

The traditional broker vote process has a number of problems.¹⁰ First, because the vote payments are percentages of commission paid, which outside the US is typically determined by the trade value

rather than number of shares, the price of a certain service in dollar terms can fluctuate from year to year due to changes in funds under management (which is affected by market prices of underlying securities, fund performance and fund flows) as illustrated in Figure 2. The fund manager would be charged more for exactly the same research just because of an increase in stock prices or fund inflows. Second, the fund manager needs to trade in order to pay commissions to the broker, which creates the incentive to trade even if transactions are not required. Traditionally only the executing broker could be paid for research, and brokers competed for bundled commissions on the strength of their analyst research. Third, broker votes have often failed to provide useful feedback to brokers regarding the services required. We have strong evidence¹¹ that the process has been lacking in detail, accuracy and timeliness. The UK Financial Conduct Authority (FCA) views the broker vote as “inherently flawed”.¹²

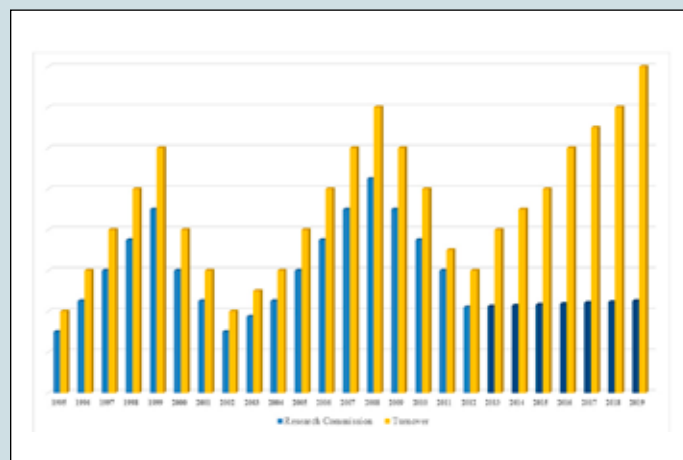


Figure 2: Research commissions before and after the introduction of research budgets. Source: Frost Consulting

Asset management firms, particularly those operating in the UK, have been moving from percentage-based broker votes to dollar-based budgets. The effect, stylised in Figure 2, is that research spending is no longer tied to the volume of dealing commissions as portrayed by the diagram.

CURRENT STATUS: A MARKET IN FLUX

Some 15 years after the influential Myners¹³ report, which proposed a ban on research commissions in the UK, the UK regulator has finally succeeded in elevating the importance of the research market. The FCA's 2011–12 thematic review and subsequent consultation lead in 2014 to clarification on the definition of research and the requirement for the CEO of the largest 200 asset management firms operating in the UK to make a personal attestation regarding the use of commissions for research. By interpreting research as an inducement to trade under MiFID II, it also supported further restrictions on research commissions commencing in 2018. As a result of London's scale in global investment management, research payment has ascended the 'to do' list for asset

8. David A. Maber, Boris Groysberg and Paul M. Healy, 'The use of broker votes to reward brokerage firms and their analysts' research activities,' Working paper, 2014.

9. Alistair Haig and Bill Rees, 'The changing market for investment research: the impact of innovations in the payment mechanism on market structure and information flows,' SSRN Working paper, 2016.

10. CFA Institute and CFA Society of the United Kingdom, 'Investment research valuation approaches: A framework and guide for investment managers and asset owners,' 2014.

11. Extel, 'Buyside broker reviews: commission or omission?' 2011.

12. FCA, 'The use of dealing commissions regime Discussion Paper 14/3,' 2014.

13. Paul Myners, 'Institutional investment in the United Kingdom: a review,' 2001.

management firms around the world. The regulatory spotlight on this area has intensified and is unlikely to diminish.

The UK and some other European regulators have sought to break the link between turnover and research payments. Rising equity markets led to larger assets under management, higher share prices, and often increased turnover, typically resulting in larger research commission payments, even if most asset management organisations consume similar levels of research service from one year to the next. Going forward, payment for a similar service level is likely to vary much less over time.

The FCA is expected to require investment management firms to create Research Payment Accounts (RPAs) based on a research budget that is to be set in advance. The research budget must be independent of trading, thus removing any incentive for fund managers to trade excessively in order to purchase research.

By mandating finite monetary (rather than percentage-based broker vote) research budgets, and encouraging managers to adopt board-level research budget approval processes, the regulators have largely achieved their aim of breaking the link between equity turnover and research payments. The outcome echoes Myner's call for fund management firms to compete by using research efficiently to meet client objectives. Yet the impact is now far wider than Myner's UK remit. Research consumers and producers around the world have tightened up policies in this area.

Given the vast change in regulatory environment, and the resulting change in the economics of the research industry, asset owners should now question how their underlying managers are responding to these industry changes. Most asset owners routinely and systematically measure the impact of their managers' trading decisions via trade cost analysis. The efficiency of execution commissions has been regularly reported to asset owners since MiFID (2007) or before. In contrast, research commissions have typically not been reported. Ironically, the performance impact of sub-optimal execution, which could exceed 100 basis points in only the most extreme cases, is dwarfed by the impact of sub-optimal use of research: poor asset allocation or stock selection decisions could easily lead to underperformance of 100bp per annum or more depending on the strategy.

Many investment management firms have collected insufficient information on their use of research commissions, and as a result have been unable to measure the return on investment of their research spend. Consequently, few have been able to present such information to end-investors. Senior officials at investment management firms consistently report that clients remain generally uninterested in valuing research.

WHY HAVE FIDUCIARY CAPITALISTS NOT BEEN MORE VOCAL?

We believe that the following reasons have impeded asset owners from demanding clear and transparent information on the cost and efficiency of research purchased with their money.

First, other regulations aimed at improving alignment with end-investor goals, such as the 2012 UK Retail Distribution Review, have been taking effect. Investment managers and advisers have been right to focus on implementation of these high-profile regulations.

Second, the opaque nature of the payment mechanism made it hard to see the costs involved. Limited awareness even of the existence of research commissions is perhaps understandable given that few buy-side firms presented research costs at all.

Third, low awareness of the mechanics of research commissions provided media and the public with limited understanding of the issues.

The UK FCA's 2013 Thematic Review changed this, and specialists within the financial press now keenly study the issue on both sides of the Atlantic and elsewhere.

Fourth, the 2008 financial crisis and resulting gyrations in equity markets required asset owners to focus on other priorities in order to survive long enough to consider this issue of longer-term consequence.

It remains unclear whether asset owners have a fiduciary responsibility to monitor their managers' research spending and its relationship to fund returns. CFA members will recognise their responsibility to meet CFA soft dollar standards which provide guidance on how to use client brokerage ethically. The standards recognise the possible conflict of interest between the buy-side firm and its clients that arises from the opportunity for an investment management firm to offset some fixed costs through the use of services paid for via client commission. The standards seek to require members to manage that conflict appropriately through their own actions and by providing clients with the information that they might need to monitor their managers' behaviour.

Note that fund managers can buy whatever research they want if they pay with their own money and asset owners should also consider procurement in their evaluation.

WHAT CREATES THE BEST OUTCOME FOR INVESTORS?

Is the lowest possible research cost in the best interest of the asset owner if it results in sub-optimal research provision and investment decision making? We believe that efficient use of research spending is the key. Asset managers should be expected to align the research budget with the investment strategy, investible universe and expected returns at the fund level.

As always, there are likely to be costs to regulation as well as benefits. Close relationships with sell-side analysts provided fund managers with tailored information, thus allowing the best shot at market outperformance, and this is entirely in the end-investor's interests. Cross-subsidies between business units at banks provided a model that allowed fund managers to benefit indirectly from expertise and services beyond research. Investment banks struggled to limit the dissemination of research and much was often available to smaller fund managers, thus helping them to compete against larger firms. Given the social complexity and economic dynamics of the interface between buy-side and sell-side experts, it seems unlikely that more rigid regulation could not come without costs to the end-investor. This key point is frequently lost in the debate.

The original MiFID II proposal to require asset owners to approve their asset manager's proposed research budgets would directly involve asset owners in the research funding discussion. UK pension trustees are frequently not investment professionals and therefore not usually qualified to judge complex and variable research budget proposals from widely differing investment strategies. They face the following questions: Is the same research budget appropriate for a distressed debt fund and a highly leveraged emerging market equity hedge fund? What is the 'right' price for research? What is the relationship between research budget spending and end-investor's outcome (expected returns)?

It is likely that multiple answers will emerge. This need not be a poor outcome. Different firms representing different sets of asset owners should be encouraged to articulate the best practice to suit their end-investors. The UK National Association of Pension Funds has recognised the need for a principle-based approach, balancing the appropriateness and alignment of the research budget with the underlying investment strategy and expected returns.

HOW MIGHT ASSET OWNERS EFFECT CHANGE?

While acknowledging that there are different ways to succeed in aligning research procurement with client interests, we identify several ways that influential asset owners, such as sovereign wealth funds and pension plans, could effect change.

First, fiduciary capitalists will lead the efforts to compare research costs to investment goals and will demand information be presented in their preferred format and frequency. Asset managers will then be required to provide such information in the course of client reporting and when competing for mandates. International regulatory co-ordination on research procurement has typically been limited. Major asset owners have the power to improve the practices of investment management groups worldwide. This could avoid damage to competition between geographic investment management hubs due to regulatory arbitrage. Although MiFID II provides the opportunity of consistent regulation across one continent, therefore reducing the risk of regulatory arbitrage, a relatively stricter interpretation of the delegated acts in some European markets could discourage fund managers from operating in there. Reduced competition has also been argued to result in a loss of high quality fund management jobs in countries where research payments are most restricted.

The likelihood of differing national interpretations of the same MiFID II text presents a key risk to the entire process if it creates an un-level playing field across Europe. If all or any part of Europe bans the use of commission for research, this will represent a significant trans-Atlantic non-tariff barrier in international capital flows. At the time of writing, European regulators have stepped back from such draconian plans. The use of commission for research is enshrined in 28(e) of the Securities and Exchange Act of 1934. This venerable Federal statute is unlikely to change.

Second, asset owners need to be aware that unbundling could lead to potential concentration in the investment management industry. Bundled commissions supported smaller buy-side firms: effectively they were subsidised by larger buy-side competitors. Although undesirable in terms of fiduciary responsibility, this acted to level the playing field. Start-up investment management firms would often seek access to investment bank research in their early days while operating on seed funds. Unbundling therefore presents a higher barrier to entry to new fund managers and may encourage a further shift in power to large investment management groups.

Third, asset owners should demand that investment managers adopt the following practices:

1. Research budgets should be set based on an independent review rather than by portfolio managers. Aggregate research commissions should require board approval. Ongoing internal consistency checks under the oversight of the investment management firm's Chief Financial Officer or equivalent should be reviewed in an annual audit.
2. The firm's compliance team, not the portfolio management team, should manage the process. Portfolio managers may, however, shape the design of the policy within their firm.
3. Appropriate records of research consumption should be maintained to the highest regulatory requirements globally. In most firms this will require improved accounting practices.
4. Provide clear and consistent feedback to research providers as to what products/services are valued.

In time, research budgets should be monitored against quantitative benchmarks. Such benchmarks are likely to emerge and become available by the end of the decade. In the interim a clear comparison with

previous years will allow asset-owners to evaluate research efficiency. MiFID II delegated acts, released in April 2016, can be interpreted to include fixed-income research where commission is not paid and therefore has been sheltered from regulation on research payment. Moves to bring fixed income markets into line will present a major change for many bond fund and multi-asset managers who were not able to use CSAs but will be required to initiate RPAs as they move to price research. In particular, multi-asset managers may be asked to present research costs for equities, bonds and other types of investments. We believe that asset owners may be more effective than regulators in non-commission markets.

CONCLUSION

Research procurement has seen a murky past. Ten years after the 2006 introduction of CSAs in major equity markets, transparency is improving. Investment managers are moving towards better practices.

Significant improvements in the first half of this decade largely stem from the responses of research consumers and producers to UK regulatory change. Such practice has been mirrored around the world to varying degrees. The spotlight has been directed to research procurement, and as a result the topic has moved up significantly on the 'to do' list for those managing investment firms. The issue is here to stay. End investors stand to benefit.

Yet fiduciary capitalists appear to remain largely silent on the issue. Like other participants, asset owners will have been watching the interplay between regulators, government agencies, firms and bodies representing industries and professionals in the lead-up to MiFID II. The interpretation by regulators in Europe and other important markets and the response from firms developing global policies will take longer to emerge. In the coming years, from 2017 to 2018, research valuation information will become more available for asset owners who will then aggregate and compare research costs to custodial and other costs. More informed asset owners will become more vocal and will perform an important monitoring function.

In this paper we provide recommendations to assist them to make this important change. We expect the current level of scrutiny of research procurement will reach a higher bar. Compliance, transparency and fiduciary responsibility is likely to increase, and compliance departments the world over will be busy ahead of MiFID II taking effect, which is widely expected to be during 2018.

The impact has spread well beyond the UK. The CSA mechanism allowed independent research providers to enter the market. Buy-side research budgets are expected to fall as poorly justified elements of bundled research are removed. However, despite the challenges to research budgets, there is sufficient commercial demand for independent research to fuel innovation both directly and indirectly.

Rather than acting to minimise the cost of research, we recommend aligning the research budget with the investment strategy, universe and expected returns at the fund level.

Asset managers have fiduciary responsibility to act in their clients' interests. When paying for research there should be a clear demonstration of the expected value of that research in obtaining the investors' goals. Research consumers and producers have been vocal in providing feedback to proposed regulations. Asset owners, in contrast, have been watching quietly. Given that they may have a fiduciary responsibility to evaluate research spending, we expect this group will be the next to take action to further improve the lot of the active investor. Most likely this shift will occur once MiFID II has been integrated into member state regulations. Fiduciary capitalists will then use their power to improve alignment of investment manager action with end-investor goals.

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Alistair Haig ACSI worked in buy-side and sell-side investment research for 15 years before joining the University of Edinburgh Business School in 2012. All his academic projects are motivated by live practitioner questions, and his primary focus is on how professional investors choose to procure information from external sources, such as sell-side and independent research firms. This has become known as the market for investment research. He teaches financial markets and applications of finance on MA, MSc and executive education programmes, is an active member of several professional bodies and takes a long-term approach to investing.

Neil Scarth has held a wide range of roles in asset management and investment banking in Europe and North America over the last 25 years, ranging from running equity businesses at global banks to launching and managing various asset management products. Neil has comprehensive knowledge of the strategic and competitive framework that governs the inter-relationships between plan sponsors, asset managers and investment banks. Neil was a member of the UK Investment Management Association's Research Review Advisory Panel, which helped craft the association's response to the FCA on research commissions. Neil holds an MA from the University of Southern California and a BA from Carleton University.

Haig and Scarth will be speaking about their research at CISI events in Edinburgh and London in autumn this year. See cisi.org for details.

POCA – UP TO THE CHALLENGE OF ORGANISED CRIME?

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In a previous contribution to the Review of Financial Markets, Kenneth Murray argued that money laundering offences are not being used against organised crime in the manner originally envisaged. "The concept of predicate offence often persists in the discourse yet is not a requirement of the act. It distorts our understanding of what money laundering is and how it can be prosecuted." The case continues.

The essential question is whether the Proceeds of Crime Act 2002 (POCA) is up to the challenge of dealing with the realities of the crime as it is conducted, given the conceptual influence of the 'placement-layering-integration' model read into its construction and the atavistic influence of 'predicate offence' in terms of how it continues to be interpreted. The UK legislation was designed to be sufficiently flexible in its drafting to offer ways of meeting the related challenges, but perhaps the question is whether it is being fully allowed to in practice.

POCA has been described by one eminent QC as "draconian and manifestly unjust"¹ in respect of its confiscation provisions and some judicial interpretations of it in recorded cases appear to have been more concerned to limit the scope of its application in ways that can be considered to affect its suitability and ability to tackle the money laundering crimes it was enacted to tackle.

JUDGMENTS

The judgment in *R v NW*, for example, effectively sought to re-establish the eminence of predicate offence, in apparent contradiction of the spirit of the Crown Prosecution Service (CPS) guidance: "we do not consider that Parliament can have intended a state of affairs in which, in any given circumstance, no particulars whatever need be given or proved of a cardinal element in the case, namely the criminal conduct relied on."² Although the subsequent 2010 judgment in *R v Anwoir*³ subsequently affirmed the principle of irresistible inference in proving the necessary criminality, this is not a development that has been welcomed by everyone in legal circles, with *R v NW* still being defended as 'good law'.⁴

The ability to prove that money is criminal through circumstantial evidence implies acceptance that the necessary tests can be conveyed by the way the money or property is treated. It is difficult to see how convictions could be obtained if this were not the case. It is how this is ability is interpreted by the courts, however, that determines perceptions of how it can be applied.

A key judgment in this area was given in the *Geary*⁵ case, and the findings of this case have been further endorsed recently in the case of *R v GH*.⁶ These judgments say that s328 offences relating to arrangements have to apply to property that can be identified as criminal at the time

1. Sir Ivan Lawrence QC, 'Draconian and manifestly unjust: how the confiscation regime has developed', *Amicus Curiae*, Issue 76. (2008).

2. *R v NW*, SW, RC and CC (2008) EWCA Crim 1354.

3. *R v Anwoir* [2008] EWCA Crim 1354; [2008] 2 Cr. App.R.36.

4. Vivian Walters, [2009] 'Prosecuting money launderers: do the prosecution have to prove the predicate offence?' *Criminal Law Review* (2009): 571–575.

5. *R v Geary* (2010) EWCA Crim 1925 para 19.

6. *R v GH* (2015), UKSC 24.

the arrangement begins to operate on it: "In our view the natural and ordinary meaning of section 328(1) is that the arrangement to which it refers must be one which relates to property which is criminal property at the time when the arrangement begins to operate on it. To say that it extends to property which was originally legitimate but became criminal only as a result of carrying out the arrangement is to stretch the language of the section beyond its proper limits."⁷

R v GH clarified the issue as follows: "Criminal property for the purposes of sections 327, 328 and 329 means property obtained as a result of or in connection with criminal activity separate from that which is the subject of the charge itself."⁸

So the property must be criminal at the outset. How can that be proved? 'Criminal property' is defined at s340 as follows: "a) it constitutes a person's benefit from criminal conduct or it represents such a benefit (in whole or in part and whether directly or indirectly), and b) the alleged offender knows or suspects that it constitutes or represents such a benefit."⁹

When, according to POCA, does the property become criminal in terms of proof?

Because criminal property is defined in the Act at s340 in terms of knowledge, it could be construed that what the Geary and GH judgments are saying is that there is a requirement to prove the accused knew the property was criminal when he first came into contact with it. A difficulty arises, however, if this proposition can be interpreted as meaning that the method of treatment by the accused cannot be used as a basis for determining his knowledge of its criminality prior to receiving it.

When, according to POCA, does the property become criminal in terms of proof? Criminal awareness is clearly connected to the nature of the arrangements the accused participates in. That awareness may well develop and become clear when he is able to properly appraise the true nature of these arrangements. It is not clear from the text of the relevant POCA provisions that this has to be at the start of his involvement in these arrangements. This is a matter of considerable practical significance since it is often the case that proof of awareness in these circumstances is established by the manner in which the accused treats the relevant funds.

The implication of the Geary and GH judgments is that there are two distinct parts of the criminal property definition that have to be separately proven and that the criminality of the property has to be proven at the outset of the arrangement starting to act on it. In other words, it appears to take away the possibility of establishing cases where the relevant criminal knowledge is revealed by means of the way in which the money is treated.

The R v GH judgment appears to confirm this through its discussion of the drafting matter at the heart of this issue as follows: "As a matter of strict English, the way in which the section has been drafted may be criticised for condensing the separate ingredients of actus reus [guilty act] and mens rea [guilty mind] into one. But it places no undue strain on the language to read the section as providing that a

person commits an offence if a) he enters into or becomes concerned in an arrangement (relating to criminal property), and b) he knows or suspects that it does so."¹⁰

The judgment then follows this with a sentence which has profound significance, notwithstanding its almost throwaway nature: "It has to be sensibly read in that way or else a party might be guilty by reason of having the necessary mens rea even if it transpired that the property was not criminal."¹¹

What this last sentence might imply is that a catch all defence is available to all organised crime groups using money laundering schemes which show the most basic levels of sophistication. No matter how compelling the evidence might be relating to the accused's treatment of the money concerned, the lack of any direct evidence proving its criminality at the outset of his engagement with it means he cannot be found guilty – in case it turns out that it isn't.

It is not easy to reconcile this with the 'irresistible inference' doctrine unless it can be subsequently made clear by the courts that actions of deceit in treatment can qualify as evidence of criminality in cases where, as is often going to be the case, there is a lack of evidence of criminal source.

In Scotland, in the wake of a judgment (in the Sarwar case¹²) which has been interpreted as emphasising the need to prove all the constituent parts of the offence, prosecutors in practice are following a construction which relies on the relevant proof requirements being an objective test (the criminality) and the subjective test (knowledge of the criminality). Again, if it is to be insisted that these are two separate tests and that evidence of treatment cannot simultaneously meet both tests then, as far as most forms of organised crime money laundering encountered in practice is concerned, the legislation might be regarded as simply not fit for purpose.

The Handley case referred to above indicates that it is possible to achieve 'irresistible inference' convictions in Scotland on the basis of evidence that relates to how money is treated, but that was a case settled by plea. If legal agents acting for money launderers are encouraged to consider that de facto proof of predicate offence is a requirement for successful prosecution, then the plea bargaining dynamic is materially altered. We will have reached a position where the signals taken from judicial interpretation of the legislation have arguably gone some way to neutering its effectiveness, certainly in the context of how it applies to the crime of money laundering as perpetrated by organised crime groups.

THE GROWING ROLE OF TRADE BASED MONEY LAUNDERING

Probably the principal means by which serious money is laundered across the world is trade based money laundering (TBML). This is a method which essentially depends for its successful execution on the creation of self-contained modules in the money laundering process, which make prosecution extremely difficult unless the method of treatment can be used as the principal source of founding evidence.

What is TBML? A shorthand way of getting to the essence of it is by considering an invoice, or whatever paperwork provides the reason for funds to be transferred from one place to another, to be a passport. TBML essentially involves the use of false passports.

7. POCA s 328 (1).

8. R v GH (2015).

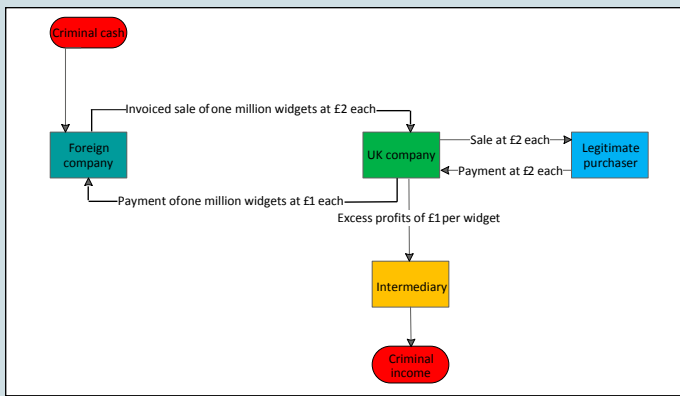
9. POCA s 340 (3).

10. R v GH *ibid*.

11. R v GH *ibid*.

12. Sarwar v HMA (2011) HCJAC 13.

CONSIDER THE FOLLOWING EXAMPLE:



The criminal cash travels from the foreign company to the UK company under the false passport of the invoice, which overvalues the price of the goods actually transported. This additional value can then be realised through normal trading at normal prices. The proceeds of this legitimate trade can then be distributed by way of dividends or loans or other transfers to a vehicle in the UK, which in turn enables access to the laundered funds – or more precisely funds representing the laundered funds – in the UK. The same process works in the field of securities and investments.

There are many variations on this theme. For example, it may be that the quantities of the commodity are falsified rather than the values relating to it. The key defining characteristic is the existence of some form of deceit in the passport. Any evidence of a falsified passport in the context of commercial trading is, or at least ought to be considered, strong prima facie evidence of a TBML mechanism being in place.

The global significance of TBML can be grasped from a 2015 Global Financial Integrity report¹³ which estimated that as much as 80% of illicit financial flows from developing countries were accomplished through TBML – increasing from more than \$200bn in 2002 to more than \$600bn in 2011. PwC consider these figures “represent the tip of the iceberg in showing TBML’s growing scale.”¹⁴

TBML represents a challenge for Law Enforcement and it is not clear it has the resources or expertise to adequately deal with it. The duty of law enforcement in this context clearly entails an ability to understand the manner in which the crime is perpetrated and develop the capability to develop prosecutions using relevant evidence. It is surely not enough to be in the vanguard of proceeds of crime initiatives or to demonstrate public hostility to money laundering as a crime if it turns out the channel through which most money is laundered, TBML, is not capable of being policed. An obvious consequence of this is that the more effective you are at clamping down on the obvious channels, the more TBML will dominate as the route of choice for launderers.

There is indeed evidence that the incidence of TBML may be positively correlated to the effectiveness of ‘orthodox’ AML controls: countries which have strict anti-money laundering legislation experience

more trade related money laundering.¹⁵ This has led to claims by the accountancy profession – no doubt identifying a new source of fee income – that increasing attention is being given by regulators to TBML in their discussions with financial regulators, and PwC considers it is “a matter of time” before this results in “concrete action.”¹⁶

The tendency with such intractable problems is to reach for an all-encompassing solution. In the case of TBML this is unlikely to exist, but the extent of the challenge is not a justification for ignoring it. The challenge might be more usefully considered in terms of how the response to TBML could be improved given the current tool box – in terms of legislation, regulation and law enforcement response – so that any major decisions regarding future regulation can at least be made on a more secure and knowledgeable foundation. This is not just a matter of improving the empirical data. It is a question of trying to better understand the nature of the challenge and to develop better approaches to dealing with the relevant criminality.

How do we go about this challenge? Simon Mackenzie and Niall Hamilton-Smith of the Scottish Centre for Crime and Justice Research, University of Glasgow, emphasised the need to understand context: “The point is simply that unless we know the context within which these targets operate, then we are working ‘in the dark’. So either we need to generate this contextual knowledge in order to make sense of current targets (which is a large and serious research undertaking) or we need to set different targets that make sense within the knowledge we currently have (or can reasonably be expected to get) about the real incidence and impact of organised crime.”¹⁷

In a paper for the International Drug Policy Consortium in September 2013,¹⁸ Professor Mike Levy of Cardiff University added to the voices of academia calling for better data, but he also made a number of other points in the context of drug law enforcement and financial investigation strategies, which pointed to a more nuanced appreciation of the key issues on the ground that require to be considered in more depth before any proper assessment of the efficacy of this legislation can safely be made. The paper included the following:

- The term money laundering may conjure up too vague and unspecified an image to fit the reality. ‘Crime money management’ may be a productive alternative.
- Financial investigation is often mistakenly seen only in the context of proceeds confiscation rather than in revealing forensically the financial relationships in drugs networks.
- Financial investigators – whether police, civilians or trained accountants – need to be embedded with operational and intelligence units, so that they are brought in early enough to help the investigation as well as to take away proceeds of crime.
- Criminal finance analysis and UK post-conviction Financial Reporting Orders can be used fruitfully to target the most harmful networks – local, national and international – but this needs to be mainstreamed.
- Financial investigation and proceeds confiscation/recovery can impact upon public reassurance and the behaviour of financial intermediaries as well as drug offenders – but these goals need to be separated out and evaluated, not just asserted.

13. Global Financial Integrity report 2015, *Illicit financial flows from developing countries: 2004–2013*.
 14. PwC, ‘Goods gone bad: addressing money laundering risk in the trade finance system’, January 2015.
 15. Ferwenda, Kattenberg, Chang, Unger, Groot and Bikker, ‘Gravity models of trade based money laundering’, DNB Working Paper No. 318/September 2011.
 16. PwC, ‘Goods gone bad: addressing money laundering risk in the trade finance system’, January 2015.
 17. Simon Mackenzie and Niall Hamilton-Smith, ‘Policing: An International Journal of Police Strategies and Management,’ Vol 34 Iss 1 (2011).
 18. Michael Levi, ‘Drug law enforcement and financial investigation strategies’, International Drug Policy Consortium, Modernising Drug Law Enforcement, Report 5 (2013).

These points also chime with some of the concluding points made by Ian Davidson at a 2014 workshop at Sussex University,¹⁹ paraphrased as follows:

- The strategic objectives in tackling the criminal finances of organised crime groups are currently unclear.
- There is a need to move away from law enforcement activity in this area being based primarily on opportunity rather than intelligence.
- There needs to be a better understanding of how Proceeds of Crime activity can drive operational activity and impact. If it doesn't impact on organised crime, what is the point of having it?

An initiative has been developed within Police Scotland which has the intention of meeting some of these challenges in this area: Project Jackal.



The specific challenge addressed by Project Jackal is to translate a conceptual framework based on business strategy analysis to a practical programme capable of being absorbed into practical models of policing and deliver tangible results.

In the field of organised crime, the principal theme of law enforcement models is that they are intelligence-led. The nature of the intelligence to hand is accordingly a key determinant of what is done. If the intelligence requirements set emphasise the 'hands-on' aspects of drug trafficking (where the evidence indicates direct or traceable contact between the physical commodity and the accused), then it is coverage of that side of the business that will be most extensively covered in terms of intelligence capture. The training of intelligence sourcing personnel often reflects a background in an anti-drug trafficking enforcement with substantial expertise in that field built up and absorbed into the knowledge fabric of the respective law enforcement bodies. That body of knowledge is commonly strong on the side of the transaction which relates to the transfer of commodity and weak on the part of the transaction which relates to the money.

Project Jackal seeks to broaden the range of the relevant officers' interest from: (i) the drugs; to (ii) the money; to (iii) the business processes. The effort required encompasses a need to broaden education, encourage new skill development, recruit the right specialist support, and drive cultural change. The essential proposition is that a modern law enforcement operation cannot meet the challenges of organised crime without a willingness and ability to develop an understanding of organised crime as a business. The question is how it can be done. The method to be described below is clearly not the only way it can be done, but it is a way that is currently being tested in practice by Police Scotland.

Project Jackal was launched in June 2014 primarily as a means to encourage the capture of intelligence relating to organised crime group (OCG) businesses and finances. The two principal areas of focus were cash flows and business networks. A toolkit was designed based around simple questions with the aim of encouraging relevant police personnel to develop an awareness of these factors and record the intelligence that improved awareness in intelligence logs. In terms of generating intelligence logs, the early signs have been encouraging.

The impact on organised crime of improving understanding of business structures will hinge upon developing workable methods for using that intelligence in ways that can translate into tangible results in terms of convictions, disruptions and asset recoveries.

The basis used for the transition from a raw collection of business oriented intelligence to an effective analysis of the strengths and weaknesses of an OCG or network is a matrix arrangement adapted from that developed by Osterwalder and Pigneur in their manual for generating business models, *Business model generation: a handbook for visionaries, game changers, and challengers*.²⁰ The attraction of the approach developed in the book is that it uses a matrix concept which, in the authors' words, is "simple, relevant and intuitively understandable, while not oversimplifying the complexities of how enterprises function".

This is a prescription that seems ideally suited to the law enforcement community in respect of the challenge of tackling organised crime: a construction that everyone can relate to and contribute to, yet capable of grasping and making sense of the relevant complexities.

Such a model offers possibilities of developing a language that can be shared across the many platforms in terms of agencies, nationalities and territories relevant to the realities of organised crime business. It can in short be applied to any situation, any collection of organised crime groups forming a network, any organised crime process that constitutes a profit stream. Whatever the local differences or variations in custom and method, such a model will be able to accommodate them in the field of organised crime, just as the original conception of the model by Osterwalder and Pigneur was designed to accommodate any kind of legitimate business. In their words: "We believe a business model can best be described through nine basic building blocks that show the logic of how a company intends to make money. The nine blocks cover the four main areas of a business: customers, offers, infrastructure, and financial viability. The business model is like a blueprint for a strategy to be implemented through organisational structures, processes and systems."²¹

The matrix arrangement used by Osterwalder and Pigneur to group these factors is shown on the next page, adapted to make it more relevant to organised crime.

The key differences from the Osterwalder and Pigneur matrix is that along the bottom row, 'Cash resources' is substituted for 'Cost structure' and 'Revenue spend' is substituted for 'Revenue streams'. This is in order to match up the idea of cash flow through an organised crime group, network or process, with the intelligence capture efforts relating to cash described above.

The middle box seeks to gather together the principal themes and narratives emerging from appraisal of the contents of the boxes to the left and to the right of it under the heading In this box the key strengths and weaknesses of a group, network or process are identified in order to suggest options and opportunities for suitable exploitation by law enforcement and partner agencies.

The other boxes remain as Osterwalder and Pigneur designed them for legitimate businesses. The main body of the matrix divides into a left-right division between product supply processes on the left and customer facing processes on the right.

The matrix can initially be used as a sorting box for relevant intelligence and analysed in terms of the principal characteristics associated with each box heading. For example, in respect of a straightforward drug trafficking process involving an OCG, the partners required to establish

19. <http://www.sussex.ac.uk/law/newsandevents/dirtyassets/successes-failures-crime-approaches>.

20. Alexander Osterwalder and Yves Pigneur, *Business model generation: a handbook for visionaries, game changers, and challengers* (London, Wiley, 2010).

21. *Ibid.*, p15.

the business are in the far left box under KP (key partners); the key activities of the group, such as import and distribution, are under KA (key activities); and the supply sources of the drugs are under KR (key resources). On the right hand side, the methods used to exercise discipline and maintain market share are grouped under CR (customer relations); the warehousing and distribution networks accessed and used to generate the relevant sales revenues are grouped under CC (customer channels); and the various end markets served are grouped under CS (customer segments).

The box that requires a degree of analytical thought is VA (vulnerabilities & actions). The challenge here is to bring together the information contained within the matrix in such a way that explains one basic thing: why is this group/network/process profitable? What are the distinctive capabilities that make it successful, or at least help it to survive? Assessment of strengths goes hand in hand with assessment of weaknesses, and the action driver of this approach derives from these weaknesses being identified as vulnerabilities that can be exploited in terms of options and opportunities for convictions, disruptions and asset recoveries. In essence, every identified vulnerability should obligate the generation of actions to exploit these options and opportunities.

A guide to generating meaningful answers in terms of distinctive capabilities and vulnerabilities is provided in terms of the questions posed in the respective matrix segments above. The questions are not necessarily definitive and of course may vary in respect of contexts – one of the key benefits of this approach being flexibility. The essential proposition, however, is that there is no organised crime group, no organised crime network, and no organised crime process that cannot be meaningfully subjected to this analysis.

A further advantage of this approach is that it ought to drive continuous improvement in the quality and quantity of relevant business intelligence sourced on organised crime across the EU territories. The matrix offers a natural collaborative platform and the use of it will encourage the upgrading of intelligence gathering efforts through the identification of conspicuous systemic gaps and the competitive effects within the EU law enforcement community of natural peer pressure.

But what of the products? A better understanding of business process enables improved capture of intelligence relevant to the formation of money laundering cases and legislation designed to punish direction and involvement in organised crime. A better understanding of key supply and distribution networks enables targeted programmes of disruption to be constructed in ways that can more accurately predict punitive effect and displacement fallout. There will be a direct positive impact on the amount and value of criminal assets and property that comes within reach of the various criminal and civil asset recovery mechanisms. There is a basis for more effective integration of anti-OCG activity with tax enforcement measures both within and across borders. There is finally the ability to generate narratives that can influence participants’ and enablers’ perspectives of the risks versus the rewards of getting involved in organised crime. In this sphere, credibility of response is of fundamental importance.

Project Jackal is in its early days. It is anticipated it will improve the capabilities of law enforcement in establishing and developing money laundering cases against organised crime groups and develop a better understanding of the processes and structures they use. It emphasises that getting a better grip on how money is handled, channelled and used by organised crime groups is not an optional extra for law enforcement and it acknowledges that a commonly and dangerously underestimated feature of criminal cash is the acute and far reaching harm its deployment brings to people, jobs, markets and communities.

This is a subject that can attract cynical responses, but the challenges faced by law enforcement in terms of money laundering might echo those successfully overcome in respect of insider dealing – another money based offence widely criticised as being impractical and almost prohibitively difficult to prosecute. The shock of the 2008 financial crisis proved the spark that created the will to take action to turn around a hitherto dismal and routinely derided prosecution record. The first criminal sentences were in 2009 and a number of prosecutions and heavy fines have followed since. The *Daily Telegraph* reported last year that the incidence of insider trading had “plummeted” since the financial crisis.²² The FCA is reported in the same piece as claiming that nothing proved so effective in achieving this result as “the willingness and ability to prosecute”.

KP = KEY PARTNERS	KA = KEY ACTIVITIES	VA = VULNERABILITIES & ACTIONS	CR = CUSTOMER RELATIONS	CS = CUSTOMER SEGMENTS
Accountants Lawyers Surveyors Logistics Bankers Landlords Suppliers Import/export agents Money changers Financial planners Fund managers Wealth managers	Business activity Criminal Legitimate criminal service to legitimate customer Criminal service to criminal customer Legitimate service to criminal customer	Assessment of OCG in terms of organisation, network or process Distinctive capabilities exploited by OCG Distinctive capabilities exploited by OCG Assessment of <u>vulnerabilities</u>	How do they look after their customers? How do they keep them? How do they get new customers?	Customer markets serviced: Legitimate Criminal Public sector Private individuals Foreign criminal Partners
	KR = KEY RESOURCES Access to specialised expertise commodity channels money laundering channels	Actions based on options and opportunities suggested by <u>vulnerabilities</u>	CH = CUSTOMER CHANNELS Routes to market How do they reach customer? Advertising and distribution channels	
CS = CASH RESOURCES – Sources of working capital; sources of loan finance; recycling of criminal funds; co-investment of criminal partners			RS = REVENUE SPEND – Dividends; wages; cash exports; cash placements into the banking system; asset purchase; investment funds	

22. 'Insider trading has plummeted since the financial crisis,' *Daily Telegraph*, 11 July 2014.

CONCLUSION

There is a responsibility on law enforcement to up its game in terms of improving intelligence capture and how this intelligence is used with a view to better understanding the methods used by organised crime groups to launder their money and manage their economic affairs. That will provide dividends in terms of placement evidence, which might enable classic predicate offence type charges, but it will also provide the potential to posit evidence of schemes in such a way that enables the prosecution of money laundering schemes in the contexts in which they actually exist, which feature the disconnects that make reliance on proving criminality through provenance, rather than treatment, so difficult.

POCA was designed in such a way to help meet that challenge. If interpretations placed on it by the courts restrict that, then perhaps there is a case for revisiting the legislation. Ultimately, we may need to redefine perceptions of what money laundering is and what it looks like. As Professor Michael Levi has suggested: "The term 'money laundering' may conjure up too vague and unspecified an image to fit the reality."²³ In the meantime, however, the establishment of a consensus which accepts a principle of culpability arising from evidence of manner of treatment – such as the use of 'fake passports' in the form of false invoicing, fake loans arrangements or other means of discovered subterfuge – is a long overdue and necessary development to our approach to dealing with and containing this pervasive, distinctive and deeply serious crime.

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From 1998 to 2007 he was engaged by the Institute of Chartered Accountants of Scotland, as Assistant Director, Legal Services, to provide a forensic accountancy capability to its investigation and discipline functions. In 2004–5 he was seconded to provide forensic accountancy advice to Strathclyde Police Fraud Squad. In 2005–6 he provided a consultancy service to international professional accounting institutions as acting Head of CA International Services. He joined the Scottish Crime and Drugs Enforcement Agency as Head of Forensic Accountancy in May 2007. He was appointed to the same role for Police Scotland in March 2013.

He is the author of a number of published papers in the academic press and has recently completed an extensive contracted paper for the European Monitoring Centre on Drugs and Drug Addiction (EMCDDA) on organised business structures and processes. He is accredited as a Forensic Accountant by the Institute of Chartered Accountants of England and Wales.

A STUDY ON CONDUCT AND CULTURE IN UK LISTED BANKS

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INTRODUCTION

A few banks make up a substantial part of what is a relatively large banking sector within the UK economy. The centrality of the banking industry to all our daily lives means that a few major banks can pose a systemic risk. An event can spread among them and drag down the whole financial sector and real economy.

One systemic risk is conduct, the banking term for behaviour – the doing of banking. In the last few years there have been a succession of very serious conduct issues in banking, including market rigging, misselling products, giving misleading impressions, and failing to have proper controls to prevent financial crime. Banks have paid more than £200bn in fines and damages worldwide as a result of inappropriate conduct,¹ leading misconduct risk to rapidly rise up the hierarchy of key financial risks when investing in banks. Misconduct has cost UK banks £26.5bn.²

With public trust in the banking sector now low, the focus on conduct and culture has sharpened considerably.³ Banks are under pressure from the Banking Standards Board (BSB), Financial Conduct Authority, Prudential Regulatory Authority, and Financial Reporting Council to improve conduct and culture. But while regulators can regulate

structure, even help to create the right behavioural environment, they cannot directly regulate conduct, or behaviour, per se. That means it's up to non-regulators, such as member associations and those with a vested interest, to keep the pressure on banks and to maintain focus on conduct and culture. The UK Stewardship Code aims to energise the vested interests of major shareholders in support of these ends by encouraging large investors to reach out to companies in the form of engagement to help improve long-term risk-adjusted returns for end customers.

This study concerns the meetings one large, long-term investor held with officers and directors of UK banks to discuss their conduct and culture programmes during 2014 and 2015. Meeting with officers and directors of banks was considered the right approach, because the decisions banks are making on conduct and culture remain largely obscured from public view. Major shareholders are fortunate in the UK to have good access to company boards, so can fill information gaps in this way.⁴

The investor in this study is a pension fund, one of the largest in the country by membership, with more than one million members. The pension fund invests in equities mostly via a diversified equity index, meaning it invests in all the large listed banks. The pension fund will continue to hold each bank all the time each remains in the index. This continuous holding period creates a very long-term time horizon and motivates the pension fund to expend a great deal of effort on engaging and working alongside companies to try to improve risk-adjusted returns where doing so is cost effective and accretive financially for members.

A key reason for the pension fund meeting with the officers and directors was to gain the confidence that its investments in the banking sector are being appropriately managed by companies. Another reason was to reduce systemic and systematic risk by encouraging banks to work together, to share good practice and to facilitate an improvement in integrity, conduct and competence to lift the performance of all

2. Ibid.

3. *Banking Standards Board*, 'What is the BSB?' <http://www.bankingstandardsboard.org.uk/what-is-the-bsb/>

4. While operating within disclosure restrictions about material information.

23. Michael Levi, 'Drug law enforcement and financial investigation strategies', International Drug Policy Consortium, Modernising Drug Law Enforcement, Report 5 (2013).

1. *CCP Research Foundation*, 'Conduct costs results,' <http://conductcosts.ccpresearchfoundation.com/conduct-costs-results>.

banks in the sector. The pension fund recognises that it's not the only shareholder meeting to discuss conduct and culture, but its approach of wanting to see the whole industry succeed is different.

Positive change was further encouraged by feeding back results in the form of a report to the BSB as well as each bank. The pension fund believes that sharing good practice is good for UK financial services and the investments that members have with it.

The study found that conduct and culture in 2014 and 2015 encompassed six different behavioural 'domains'. Each of these has its own findings. Expert interviewees thought these domains were key to improving conduct and culture. The domains are:

1. Simplification of the business
2. Corporate purpose
3. Organisational culture
4. Focus and engagement by the chair of the board
5. Staff in the business
6. Customer experience

Baselines were developed to capture where banks are in relation to these six domains. Explanations were derived for why banks were where they were in relation to each baseline. Pressure was put on those below the baseline, and particularly in the lower quartile, to improve conduct and culture. The pension fund also gathered a large number of metrics used to measure conduct and culture change, with the aim of assessing their value relevance.

Of the six domains identified, corporate purpose, organisational culture, and staff in the business, were the heart of conduct and culture. Two domains, simplification and customer experience, were more peripheral. The other domain, focus and engagement by the chair of the board, was between the two.

A second overall finding is that greater improvement in culture was made when not set from the top. This finding contrasts with the recommendation of the UK Corporate Governance Code that a key role for the board is to establish the culture, values and ethics by setting the correct 'tone from the top'. A board can set values, mission, and purpose, but people together constitute the culture. Culture is an outcome. Culture is interpersonal, and embedded by people doing banking day-by-day, which comes from a myriad of interrelationships and interactions at a grassroots level. To get to the heart of culture and provide the shift that banks and regulators desire, much more effort needs to be expended at the grassroots level where interactions, intent and action occur. Culture change was more innovative and dynamic when strategy and implementation was 'driven' from within the business and not from the top. The vital role for the chair and the whole board is focus, engagement, appraisal, and trained questions about the culture programme designed and delivered by the department most apt to handle it. From a culture perspective, the board should not set the tone from the top. As a myriad of people interactions constitute culture, we are in danger of reductionism to believe that a board can simply do this. Culture is a slow-moving constitution and the evidence from this study is one of years of effort for slight improvement.

The third overall finding is that conduct and culture was highly metricised, but there are contradictions and ambiguities with many of the metrics. The contradictions and ambiguities present in many of the metrics posed difficulties about which to give attention to, and how. For example, one typical metric was the number of personal conduct cases per 1,000 staff. Is a falling number of personal conduct cases good, as this could indicate improving conduct, or bad, as this could indicate a culture in which situations are not being dealt with at an early stage?

Banks making the largest improvements in conduct and culture were those grappling most with, and solving, the ambiguities with metrics. For example, less ambiguous whistleblowing metrics were based on service, and included availability of different channels to whistleblow through, response times, resolution, and feedback from users. Metrics and measures represented a key source of management information about conduct and culture.

The study makes the following three contributions to knowledge in the subject area:

First, the paper reports new and recent research into how small groups of people – officers, directors, and managers – are designing and delivering conduct and culture programmes at UK listed banks. The project, spanning two whole years between 2014 and 2015, represents a rare insight into an industry-wide attempt to improve intent, motives, action, and outcomes.

Second, how conduct and culture is done is far more critical to performance than the structure that surrounds it. Structure can help improve conduct and culture, but is not nearly enough because conduct and culture is about people in the workplace, their actions, and interactions. Far more critical to performance than structure is the 'doing' of conduct and culture. 'Doing' conduct and culture rests on the right people giving attention to how other people will of their own accord behave and act in line with a central purpose. When a board put the department most apt to handle the design and delivery of conduct and culture in charge, there was more focus on the grassroots level of the business and more progress. When boards 'set the tone from the top' they tended to focus on structure and made less progress. This contribution helps to explain the second overall finding that from a conduct and culture perspective, banks perform better when the board doesn't set culture.

Third, the research gives a picture of bank conduct and culture just as the BSB was about to start work. The BSB has used the results to establish an initial benchmark on conduct and culture. Since the research took place just prior to the creation of the UK BSB, the effectiveness of the BSB itself could be investigated by looking at how much movement there has been from the snapshot taken by this study and a second snapshot taken in the future. This presents an opportunity to determine the effectiveness of a new type of government encouraged, industry-led but non-law making regulator.

Dr Paul Cox is a Senior Lecturer of Finance in the Business School at the University of Birmingham and a Senior Adviser to the National Employments Savings Trust (NEST).

From 1993 to 2000 he worked at Kleinwort Benson Investment Management as an equity fund manager of actively managed international and emerging market mutual and pension fund portfolios. He has extensive experience of working with investment institutions and with government departmental and non-departmental bodies, and as part of his work with NEST, he has produced with his colleague Diandra Soobiah, Head of Responsible Investment at NEST, a fascinating and groundbreaking analysis of culture and conduct in UK banks, of which the article above is an excerpt.

The full paper is available at cisi.org/rofm, and Dr Cox will be discussing the outcomes of the research at a special seminar in London on Wednesday 13 July, which will subsequently be available on CISI TV. Details at cisi.org.

Prior to Principal

LINDSEY JONES, CHARTERED FCSI BALANCES HER COMMITMENTS AS PRIOR OF A TEMPLAR ORDER WITH HER ROLE AS PRINCIPAL, GROUP RISK AND COMPLIANCE

◆ LORA BENSON

Lindsey Jones, Chartered FCSI and Principal of Group Risk and Compliance at JLT Group in Bristol, belongs to the Priory of the Poor Knights of Christ – a Christian Order which she joined in 2014, and to which she was subsequently elected Prior.

The Priory is the newest Templar Order in the UK, and the name is a nod to the original title of the medieval Order of Knights Templar, whose ethos the Priory has adopted and modernised to meet the challenges of today's society. As Prior, Lindsey's role is primarily to unify a diverse membership and guide the spiritual direction of the Order.

"Templar Knights are active citizens taking our faith with us wherever we go. We are committed to practical Christianity for the 21st century, aiming to be 'the hands and heart of God' in our local communities. We give of our time, hearts and money, befriending the most vulnerable people, whose complex needs leave them struggling to cope in a society which appears only to value the outwardly beautiful and economically viable," says Lindsey.

Lindsey began her working life as a cashier at a bank, followed by several jobs around the UK, including six years in the City of London, working in sales support and compliance for two large life and pensions companies, a private bank and a City IFA. Immediately before joining JLT Group in

her current role, Lindsey spent ten years as a director of an investment management firm in Bristol. "I chose to specialise in compliance as that side of the industry developed, and obtained my CISI Diploma in Investment Compliance in 2008. Without a doubt, integrity, ethics, restoring public trust and conduct risk management are areas of major importance within financial services both now and in the future."

"Our assistance is offered unconditionally on the basis of need, without judgment"

Lindsey's involvement with the Order is very much a way of life. "I feel my aim to ensure that ethics and integrity prevail in the professional arena complements my charity work. Our members support many and diverse charities by acting as volunteers and trustees, including homeless shelters and drop-ins, soup runs, community centres, food banks, ex-servicemen, hospices, an orphanage, a leper colony and elderly care. We are especially proud of our members who channel their vision into their occupations, including the probation service, dementia care, chaplaincy in palliative care and working to improve prison conditions overseas. As Christians of different denominations we are all active in our local churches.

A BETTER FIT

"I was brought up as a Christian and am a member of the Methodist Church, but I have always struggled with the dogma, divisions and traditional views which are prevalent in the mainstream denominations and which, in my opinion, tend to hold them back. Churches can be very insular communities, whereas faith to me should be something you carry with you at all times and in all places, to serve the wider community even if they don't share your views. The Christian chivalric Orders seemed to offer a solution, embracing as they do the values of service, ecumenism, charity, equality and interfaith dialogue.

They also incorporate the discipline of adopting a Rule of Life, but without the rigours of Holy Orders – as I definitely wasn't cut out to be a nun!"

The Order offers financial support at a regional level to the sick and the elderly, and to local community initiatives dealing with inner city deprivation and the relief of poverty: "Our assistance is offered unconditionally on the basis of need, without judgment or discrimination. While we do all this because of our faith, we accept that this is not everyone's way and we do not evangelise. We are keen to join in public forums and debate and will publish statements where we feel our contribution is helpful."

ADDRESSING NEEDS

Some of the charities Lindsey is involved with include Caring at Christmas; Bristol Nightstop; The Stranger's Friend Society, and the Bristol Homeless Forum. "I have a variety of management duties and hands-on volunteering roles which take up most of my evenings and weekends. Luckily my husband Steve is also a Templar and is Chair of the Bristol Soup Run, so he is very supportive."

"Some of the homeless soup runs were quite intimidating to begin with, and also quite upsetting. People often defend themselves from abuse by being aggressive, and mental illness or substance misuse can make people's behaviour very unpredictable. But I've made friends with the 'regulars' in the centre of Bristol over the years and now I really look forward to meeting with them all."

Lindsey's involvement with the Order gives her a sense of identity: "There is a refreshing lack of red tape and dogma, meaning that we can make decisions quickly and just get things done."

➤ Contact lora.benson@cisi.org if you have a hobby you think will interest other CISI members. You will receive a £25 shopping voucher as a 'thank you' if we publish your story.



Taxing concerns when winding up a business

CAMPBELL EDGAR, CHARTERED FCSI, EXPLAINS HOW HE HELPED A COUPLE WIND UP THEIR BUSINESS IN A TAX EFFICIENT MANNER BY USING THEN CURRENT PENSIONS LEGISLATION

◆ CAMPBELL EDGAR, CHARTERED FCSI

CAMPBELL EDGAR BIOGRAPHY

Campbell is currently Head of Financial Planning at the Chartered Institute for Securities & Investment. Until 2014 he was Head of Private Clients at John Lamb, a financial planning firm based in Southwark, London. When in practice, he was both a CFP™ professional and a Chartered Financial Planner.

CASE STUDY BRIEF

This is a real life case study. Names and some other details have been changed to protect confidentiality.

Derek Jones had been referred to me by an existing client as they both served on the same parish council of their local church in Sussex. Derek had just turned 65 and was planning to run down his engineering consultancy over the next few years and then finally retire. The consultancy was structured as a limited company, with 80% of the shares owned equally between Derek and his wife Susan, who is five years younger than him, with their two children holding 10% each. Susan was the secretary of the firm, but was mostly occupied with teaching part-time at a local primary school. Their two children were both grown up and independent financially.

When Derek and I first met, his primary concern was to sort out the jumble of pension plans and arrangements he had managed to accumulate over a working life of 40 years or so. Over the next four months we were able to construct an initial financial plan together, as well as involving his accountant and solicitor, which covered off many other aspects of Derek and Susan's lives.

Derek paid himself and Susan a small salary below the National Insurance threshold, topped up with a dividend designed to keep them just below the higher rate tax threshold. The children received their dividends *pari passu*.

It transpired that with a joint net worth of £2m, excluding their home, and a relatively modest lifestyle, Derek and Susan were effectively financially independent already. This meant that the plan incorporated not just a pensions consolidation exercise, but also a strategy for giving away assets to children and charities, in conjunction with an investment strategy for the pensions, individual savings accounts (ISAs) and other investment holdings that had been acquired over time.

LOCATING ASSETS

The biggest problem for Derek and Susan, however, was not so much asset allocation as asset location, because the bulk of their wealth was in the limited company. The company held cash balances and deposits (in sterling and euros) of some £540,000, and a property in London estimated to be worth £750,000. The cash was held in the company as undistributed profit while the

property was bought by the company some years ago (in April 2005 for £330,000) and used for company business since. It had appreciated significantly in value, so any disposal would give rise to a significant tax bill. According to the accounts filed at Companies House, the cumulative profit and loss balance was just under £900,000 (which could rise when the company sold the property).

The financial plan therefore looked first at strategies to extract value from the company in the most tax efficient way, as well as other financial planning aspects which were affected by the winding up of the business. In principle, it was reasonably straightforward to collect remaining debts, pay off outstanding creditors and wind up the company. In practice, however, this could have been quite expensive and could have left Derek and Susan open to a number of tax and other challenges. Many of these were handled perfectly well following advice from their accountant, but there were one or two extra strategies that Derek and Susan could use to their advantage.

The biggest problem was not so much asset allocation but asset location

When owner-shareholders want to extract the assets they own within the company, they discover that while they have enjoyed reasonably favourable tax breaks up to that moment, HM Revenue & Customs (HMRC) will tax assets moved from corporate to personal ownership. The

normal first step in the winding up of a company is to sell the company's assets to third parties, which may create a corporation tax (CT) liability which would need to be paid. In the year of cessation, a final dividend distribution of up to £25,000 can be made, which is treated as capital gains, and so uses the owners' CGT allowances. Any further distribution is then taxable. To mitigate this, the company could vote to go into voluntary liquidation, whereby the assets would be distributed in line with the shareholders' rights. Based upon the Articles of Association, this was 40% each to Derek and Susan, and 10% to each child.

Pension contributions could be used to offset the profits on the sale of the property

The difficulty with this approach was the large profit arising on the disposal of the London property. A gain of £400,000 plus would have given rise to a CT charge of the order of £100,000, unless losses could be created elsewhere. This is where it was possible to use current pensions legislation to the couple's advantage.

Contributions by the company to pension schemes for its directors and employees are

a revenue expense allowable for CT purposes, do not attract a benefit in kind charge and are not subject to National Insurance contributions. What this means is that pension contributions could be used to offset the profits on the sale of the property. Under the then current pension regime, the annual contribution maximum allowance was £50,000 (it is now £40,000). It was also possible to pick up any unused contribution allowance in the previous four years, as they already each had a pension in place in those years. In theory, the company could have contributed over £200,000 each to Derek and Susan's pensions, and offset the gains on the sale of the property in the same financial year, if that is what they wanted. HMRC would most likely have challenged this and attempted to disallow the pension contributions as a revenue expense. If the pension contributions were spread over a number of years, however, this was much less likely to happen.

Derek made it clear that he did not wish to retire yet, but preferred to wind up the business over the next few (we planned on five) years and did not wish to sell the London property yet. Because the company had accumulated profits rather than distributed them, it could continue to pay dividends to the shareholders, even if

the company was making trading losses. The trading losses arising through large (but reasonable) pension contributions could be carried forward indefinitely and then be used to offset against the profit on the sale of the property when it is eventually sold.

The recommendation was that the company make annual pension contributions on behalf of its employees (Derek and Susan) of the order of £40,000 each for the next five years.

IN THIS WAY DEREK AND SUSAN WOULD HAVE:

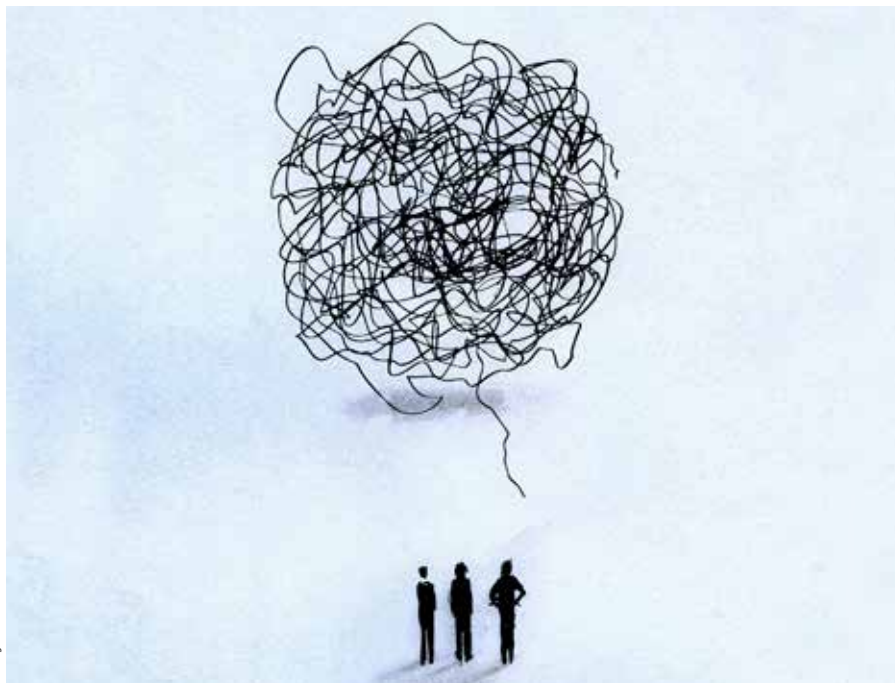
- transferred the large cash balances out of the company into their pensions without incurring tax
- created trading losses (provided the revenue to the company reduces as Derek anticipated) to offset gains made on the property sale
- improved both Derek and Susan's pension provision, with the attendant benefits and issues, which were covered in more detail elsewhere in the plan
- prepared the company for an orderly voluntary liquidation with a significantly reduced tax exposure, while still providing some extra benefit for their children.

WHAT HAPPENED NEXT

Once the strategy was validated by their accountant, the director (Derek) and secretary (Susan) minuted the resolution to make company contributions to pensions and the first contributions were duly made. A trading loss for that financial year was carried forward against future losses. The strategy continues to be played out.

TAKEAWAYS:

- 1. Clients' initial objectives are easy to sort out. It's the hidden problems that need to be teased out.**
- 2. Be an expert in your field. Understand pensions, corporate taxation and their interaction.**
- 3. Think strategy, not tactics.**



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Planning for change

IN THE FIRST INTERVIEW FOR THE REVIEW'S NEW 'MY BUSINESS' SECTION, WHICH PROFILES AN ACCREDITED FINANCIAL PLANNING™ FIRM EACH QUARTER, WAYNE COX, DEPUTY CEO OF FISCAL ENGINEERS AND VIRGINIA BOLTON CFP™ CHARTERED MCSI TALK ABOUT THE VALUE OF RETAINING FINANCIAL CONTROL DURING TRANSITIONAL PERIODS



**Virginia Bolton CFP™
Chartered MCSI, Chartered
Wealth Manager**

Virginia is a financial planner, delivering wealth management solutions to clients while forming deep and enduring relationships with them. She joined Fiscal Engineers in 2004, bringing with her an abundance of experience and mentoring capabilities. Virginia devises and organises Fiscal Engineer's events calendar for both clients and professional partners.

Virginia is a CFP™ professional, a Chartered Wealth Manager and holds the Advanced Financial Planning Certificate. She is a member of the CISI, PFS and CII, and in 2013 was awarded the IFP Branch Chairman of the Year Award.

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Wayne Cox FCA, Deputy CEO

Wayne is a director of Fiscal Engineers and Deputy Chief Executive Officer. Prior to this he was a senior partner at KPMG for 25 years. Wayne is responsible for implementing Fiscal Engineer's business strategy and development, overseeing operational activity, including tax strategy, people, process, compliance and risk.

Wayne is a member of ICAEW and a Fellow Chartered Accountant (FCA).

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

VB: We entered the Accredited Financial Planning Firm of the Year Award in 2013 but we were pipped at the post [see boxout on how to become an accredited firm. This year's award winners will be announced at the Financial Planning Gala Awards on Tuesday 4 October at Celtic Manor Resort, Wales]. We reapplied in 2014 and were

delighted to win! Since then we have grown significantly, and now have 24 staff, including five advisers and six paraplanners. We have 132 clients and £300m assets under management.

WC: What is great is that about 75% of our new clients come from existing client referrals and 25% from professional referrals. We do next to no advertising.

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

VB: It is nice to gain the acknowledgement from peers but it is not just that. Along with the way we work, it sends a message to our clients that we are a serious organisation that does things properly for our clients.

“We help people at significant points of transition in life”

What other accolades and awards has the firm picked up in recent times?

VB: We have won and been shortlisted for the New Model Adviser awards over the last nine years [awards for financial planning firms that have demonstrated their strengths in communicating with clients, educating staff and recruiting new talent into the profession] as well as a number of other awards, but we’ve been so busy that we haven’t found time to enter any awards so far this year.

What sort of business is Fiscal Engineers and what services does it offer? What’s your USP?

WC: We help people at significant points of transition in their lives. Often this may mean moving from having high earnings to living off wealth, perhaps at the point of retirement for senior professionals, or going from being income rich to asset rich for those selling a business. Occasionally it might also be a client facing widowhood or divorce proceedings.

How did you get into financial planning?

VB: I owned my own business for 25 years but then my business partner wanted to retire. I met Shane Mullins [CEO of Fiscal Engineers] in 2004 and it went from there!

WC: My background is as a chartered accountant, having worked at KPMG for 25 years and been a partner there. I was actually a client of Fiscal Engineers.

When it came to the point where I was looking for a change of lifestyle, Shane asked if I would be interested in joining as I already knew most of the clients! I know and appreciate what it is like to be a client of Fiscal Engineers and Gini [Virginia] is my financial planner.

VB: I don’t actually have a financial planner but do it on my own – cobbler’s shoes!

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

VB: During meetings it is a wonderful feeling being able to give comfort to clients and show them that they don’t have to worry, through regular monitoring of their financial plan. Clients really appreciate that. Also the range of different people we meet every day and build relationships with is fascinating.

WC: Having some wealth is fantastic but it is a responsibility for clients. Giving them that feeling where they have things under control means so much.

What do you think about the IFP/CISI merger?

VB: I used to be the branch chair at the IFP East Midlands & Lincoln branch, but stepped down in September 2015 before the merger was announced. We have been concerned about the connectivity that always existed at the IFP and would like to see that replicated at the CISI. We would like to see more branch meetings at the East Midlands & Lincoln branch – they are missed by quite a few.

The Accredited Financial Planning Firms™ Conference [exclusive event for accredited firms – see cisi.org/afpfconf for more details] is always a great event and provides us with the opportunity to connect with each other. However, we must say that we were very pleased to hear of both Jacqueline and Campbell’s appointments!

How have you been affected by the FSCS levy?

VB and WC: It went up 100% in just three years. We do not think it is proportionate. However, we are level-headed about the advice we give clients, but it does feel a bit like we are paying for those who are giving riskier advice!

“Giving clients that feeling where they have things under control means so much”

What does a typical day look like?

VB: There isn’t one. That’s the beauty of it. Today for example looks like this:

08:30 Team huddle

09:00 HR stuff as I am meeting with a new staff member to see how they are settling in

After that I have a client meeting, then a meeting with one of our paraplanners, then

GETTING ACCREDITED

For a firm to become accredited it must:

- evidence that it meets strict criteria in relation to the delivery of financial planning
- place clients at the heart of its business proposition and ensure they receive consistently excellent service
- reconfirm it meets the standards on an annual basis to retain its accredited status.

In addition, at least 50% of the firm’s FCA registered advisers must be qualified as a CERTIFIED FINANCIAL PLANNER professional or Chartered Financial Planner (with AF5). At least one director/partner of the firm must be a current CFP professional.

Consumers can find a list of accredited firms in their area by accessing the CISI’s *Wayfinder* listing through cisi.org/wayfinder and inserting their post code.

Find out more at cisi.org/afpf

a new report to check. Then review our arrangements for a couple of forthcoming client events.

Perhaps a chance of a few holes of golf after work if the weather’s nice!

What do you think about Financial Planning Week?

VB: We have been involved in previous years, but it’s difficult with the level of wealth we are usually involved with. I think it could be more educational, targeting schools and universities.

What are your key tips for other planners?

1. Run your business like a plc – that’s what we do. We have non-executive directors and an advisory board providing an outside influence.
2. Have passion for what you do.
3. Strong teamwork and integrity is vital.
4. Really know your clients. Get to know them outside the financial aspects.
5. Think about things from a client’s perspective.

A REPORT SENT TO THE REGULATOR IS MISLEADING ABOUT HOW PHASED CHANGES WILL BE IMPLEMENTED. VIKRAM, A MEMBER OF THE WORKING GROUP RESPONSIBLE FOR THOSE CHANGES, BECOMES AWARE THAT THE REPORT IS FACTUALLY INCORRECT. WHAT SHOULD VIKRAM DO?

Fat finger



Getty

Toby works as a fund manager for a mid-size firm of asset managers which has been the subject of a recent regulatory visit. A number of procedural weaknesses in the firm's processes were identified. The principal one in which Toby was involved related to the fact that fund managers were permitted to initiate, book and execute their own trades.

In response to this criticism, Toby and his fellow managers said that they were not responsible for introducing the system; they were merely following the firm's

procedures. Accordingly, if the firm wanted them to do something else, it should tell them what to do. However, it all seemed a bit of a storm in a teacup as it had not given rise to any problems. Nevertheless, the firm undertook to the regulator that it would modify its procedures.

Shortly after having provided this reassurance to the regulator, one of Toby's colleagues initiated a trade to buy Norwegian Government warrants, but accidentally placed an order for ten times the required value. With the unaltered

system still in operation, this was not picked up immediately, coming to light only when it was queried by the settlements team because it was outside the normal run of transactions.

IMPLEMENTING CHANGE

This failure was reported to the regulator, which insisted upon an urgent skilled person's review of the firm's systems, with an early date for remedial action to prevent similar and potentially more destructive events. The firm was given a deadline for the implementation of these changes and told to report these to the regulator.

In response to this requirement, the firm set up a working group with representatives of all those areas affected by the regulator's requirements. Toby was somewhat irked to be nominated to represent his area. Over the following weeks a number of meetings were held and new end-to-end processes were designed. Some parts of these were put in place, although it was felt that the introduction of the complete package should be phased in to ensure that the individual stages were working effectively.

Meanwhile, a report was written for submission to the regulator, having been signed off by the head of compliance and the chief executive. This was circulated to the working group only after having been sent to the regulator. Toby read it and was alarmed by statements that a number of new procedures had been introduced, which was not the case, as they were a part of the phased introduction which had not yet occurred. He raised this in the working group, from which he received a variety of responses, ranging from "we must do something – can we get the letter back", to "we didn't sign the letter so it's not our problem", together with a variety of more considered comments.

The upshot of the meeting was that Toby should convey the group's concerns to the head of compliance.

Toby met the head of compliance and told him of the working group's concern that the letter sent to the regulator was factually incorrect, since it stated as fact that processes had been put in place which, although they had been designed, had not yet been implemented. The head of compliance responded that, personally, he was quite relaxed about this, saying that it was really only an issue of timing, and that

during the next few weeks the statement would become fact. Accordingly, he had no intention of telling the CEO that he had been induced to sign a letter to the regulator making untrue statements.

The consensus was that further action was now outside the working group's remit

Having been told effectively to mind his own business, Toby's initial reaction was to let the matter drop. But he communicated the view of the head of compliance to the working group, from which the consensus was that further action was now outside its remit, because the group existed to ensure smooth introduction of the new processes.

Toby was unsettled by what he knew had taken place, and while he was not happy about it, he felt that because of the seniority of those involved, it was really out of his hands. After all, the CEO must have known what he was doing and besides, introduction of the new processes was occupying his every waking minute.

A short while later, Vikram, a fellow working group member, came to see Toby and told him of his discomfort at being aware of the position of the firm, should the regulator discover that it had been misled and that staff knew about this. Surely they all had a responsibility to be honest, but he was in a quandary as to what, if anything, he could do without being implicated.

Vikram's concerns echoed those of Toby himself, who had tried to identify some plausible actions.

He set these out for Vikram:

- Let matters take their course. Undermining senior executives, especially the CEO, would be career suicide. Anyway, the new processes will soon be up and running and the problem will disappear.
- Arrange to speak to the CEO and tell him what has happened.
- Arrange to speak to the firm's senior independent non-executive director.
- Use the firm's Speak Up telephone line.

WINE AND DINE: THE VERDICT

Gratifyingly, 88 readers responded to this dilemma, which revolved around Harriet, the Managing Director of a small firm, receiving at home a gift of expensive wine from a business contact, and her failure to follow her own firm's procedures. Bearing in mind the circumstances, it also called into question the motivation of the person giving the gift.

The giving and receiving of gifts at particular times of the year is something that goes on around the world and so it would be very easy to take the view that "it's just a couple of bottles of wine" (option A), which is what a small number of readers did. This ignores the fact that the Managing Director would consciously have been flouting her own policies.

A slightly larger number of readers voted for option B (contribute value of wine to staff Christmas fund), which is appropriate in so far as Harriet has

recognised that she cannot flout her own firm's policies, but does ignore the motivation of Herman, who gave her the wine, despite being aware of the firm's policy on gifts. So it really only deals with half of the problem.

Responses C (review dealings with Herman) and D (write to him), the choices of the majority of readers, acknowledge that Herman's actions were questionable and that he seemed to be blending a personal and a professional relationship. While there are many situations where this is inevitable, it should not be taken advantage of, therefore Herman appears to have crossed a line. Accordingly, it is sensible that Harriet should write to him from the office to make him aware of this.

Consequently, we consider that **D** represents the most appropriate course of action, while neither **B** nor **C** are wrong in themselves.



Getty

The Efficient Market Hypothesis and behavioural finance: room for both?

HOW DOES HUMAN BEHAVIOUR FIT IN TO THE 'PRICE IS VALUE' HYPOTHESIS?

◆ TREVOR NEIL MCSI, DIRECTOR, BETA FINANCIAL LEARNING AND DEVELOPMENT

Portfolio management and investment theory is still today using tools which we increasingly understand and accept are not correct. Knowledge is moving forwards but many practitioners are not. One reason for this is that many of the individuals who are in charge of managing funds, producing research and managing wealth were educated at a time when there was a solid financial theory: the Efficient Market Hypothesis (EMH). This hypothesis is now considered to be largely incorrect, and many say responsible, for our not having seen the financial crisis coming – worse, paving the way for the next one.

I am an experienced fund manager and derivatives trader, and have been in the business for 40 years. One thing I learned quickly in my first job as a coffee floor trader for Merrill Lynch in 1975 was to be very wary of how theory translates to real life. Good news comes out and markets sometimes go down. Sometimes a rise in interest rates makes bonds preferable to stocks and gold, and sometimes the idea that there is enough

confidence in the economy and that the expected hike is now behind us makes stocks go up and gold go down. All these different combinations of causes and effects amount to one conclusion: there are no certainties in the market other than uncertainty. It is what people think of the news that matters, not the news itself. If you received your financial education or obtained your CISI Diploma more than 15 years ago, you might have also noticed (or, more dangerously not noticed), that what you were taught does not work.

ECONOMICS STUDENTS WERE TAUGHT:

- People (and investors) are rational. We obviously do what is in our best interest. We always make choices which are based on rational calculation.
- Portfolios should be designed by the rules of mean-variance portfolio theory (mean-variance is the process of weighing risk (variance) against expected return).
- Expected investment returns are dictated by standard asset pricing theory, where

differences in expected returns are determined only by differences in risk. There is a direct payoff between risk and return.

- Markets are efficient – prices equal the value of things and are therefore hard or impossible to beat. Burton Malkiel's influential book *A random walk down Wall Street* (1973), popularised the Random Walk Hypothesis and is frequently cited to this day by those who stick with the EMH.

REALITY VERSUS TEXTBOOKS:

- People are normal. They do not always do what is in their own best interest. They can be charitable. They disproportionately value things they own. They are overconfident. They hate losses so much they will often increase risk in order to avoid the discomfort of a loss.
- People look for news that confirms their views. The market gets news which confirms its views. We want to believe there are gurus who can guide us to profits and success, so we create them and ignore many facts which remind us it is not possible.
- We should design portfolios which acknowledge and include behavioural asset-pricing theory, where expected returns are determined by many other factors than simply risk.
- Markets are not efficient (price does not equal value) but they are hard to beat. Behaviourally we are strongly biased towards believing we are capable or even good at beating the market. The market has built-in overconfidence.
- Risk in the markets is greater than that calculated by old financial theory. It is not what has happened, it is what has never happened before that we should fear. Black Swans [an event that deviates beyond what is normally expected of a situation and would be extremely difficult to predict] are lurking and we cannot see or even describe them; 20 sigma events [20 times deviation from the norm] happen quite often.

It's what people think of the news that matters, not the news itself

The EMH is still central to financial theory, and its standard-bearers direct billions in market investments. But many contest that behavioural finance, which takes into account psychological biases when making investment decisions, refutes it. Often

MISBEHAVING

Richard Thaler is the father of behavioural economics. Professor of Economics at Chicago University, he took time out last year while President of the American Economics Association to appear in *The Big Short*, a film about the financial crisis, in a cameo with American singer Selena Gomez. They stood by a crowded Las Vegas blackjack table, illustrating the ruinous domino effect triggered by the collapse of synthetic collateralised debt obligations (CDOs). View the clip at cisi.org/misbehaving.

Thaler laid out the concept of 'extrapolation bias' – the tendency to assume that something that's happening now will continue to happen. "It's a kind of high-low dynamic where we've got Selena playing blackjack as onlookers take side bets on her hand," explains director Adam McKay. "It was investors making those kinds of side bets on mortgage-backed securities through CDOs that drove the whole world economy to where it was poised to crash."

Thaler has spent his career trying to bridge economic theory and the reality that we are none of us rational all, or in some cases much, of the time. *Nudge: improving decisions about health, wealth and happiness*, co-authored in 2008 with Harvard

lawyer Cass Sunstein, has been taken up by financial services firms and governments globally, bent on nudging people to behave the way they'd like them to.

Now, with *Misbehaving: the making of behavioural economics* – just out in paperback for a rattling summer read – he has laid out the bible of behavioural economics, laden with fruity examples of markets going wonky.

Take the Palm Pilot personal assistant, for instance. Readers of a certain vintage will recall the iPhone-like reverence heaped on this gizmo during the dotcom years. Palm, the company that owned it, had merged in 1997 with 3Com, a relatively pedestrian business whose market capitalisation failed to reflect the likely valuation of Palm. When the parent floated off a slim tranche of the wonder business in 2000 – at the height of the dotcom frenzy – Palm ended up worth more than the parent company that still owned most of the equity. Indeed, 3Com at one stage, when the value of its stake in Palm was taken out, was valued at minus \$23bn. The arbitrage opportunities, particularly issues around lending fees and spinoff uncertainty, still thrill academic researchers.

by George Littlejohn MCSI

supporters of behavioural finance cite its main contribution to be that it refutes the EMH (see Dr Andrew Lo's *A non-random walk down Wall Street*). It is true that those in the behavioural corner refute the 'price-is-value market hypothesis' but they strongly agree with the 'market is hard-to-beat hypothesis'. Behavioural finance additionally explains why so many investors believe the markets are easy to beat when, in reality, they are very hard to beat.

Investors, analysts and portfolio managers are people after all; not rational robots. The problem is many do not realise it.

As behavioural finance gains traction, exciting things are happening in the world of financial theory. Established formulae, such as risk models and fair value calculations, are

being reformulated by people like Dr Andrew Lo, Professor Meir Stratman and others to account for the biases of people. We can look forward to a day when parts of the EMH are validated and real world financial formulae are there for us.

Further information

Trevor Neil MCSI MSTA is a veteran portfolio manager and trader. Today he teaches market timing skills and how to use our knowledge of behavioural finance to improve analysis and investment decisions. He is an Accredited Training Provider of the CISI and runs the popular CISI CPD courses: 'Behavioural economics – the FCA, you and your clients' and 'Introduction to technical analysis for wealth managers'.



A debate of meaning

FINTECH MAY BE PRESENTED AS AN EXCITING NEW WAVE OF INNOVATIONS SET TO SHAKE UP THE STAID WORLD OF FINANCE, BUT THE REALITY IS LESS GLAMOROUS. THAT'S NOT NECESSARILY A BAD THING.

◆ ANDREW DAVIS □ JOHANNA WARD



What is the real promise of fintech? This catch-all term is routinely attached to any venture that uses internet-based technologies to deliver financial services in a new way. As such it covers everything from automated financial advice and online investment platforms to new payment providers, peer-to-peer lending, equity crowdfunding, new types of settlement and asset registries based on blockchain, and even app-based banking via smartphones.

There's no doubt that these are all interesting and innovative uses of technology and that in some cases they could ultimately transform the way we access financial services and manage our money. But in most cases the promise runs miles ahead of the reality and for all their novelty (and towering valuations in some cases), the new entrants remain minuscule by comparison with those they seek to disrupt.

This is not meant to suggest that financial technology is all hype or that the entrants are doomed to underachieve. Far from it – some very valuable companies are being created that one day will command huge valuations based on real profits and margins. That day, however, is still some way off.

A NEW CULTURE

My point is that fintech is much more than just a synonym for a new type of financial services business. Arguably, it doesn't have to be about companies at

all. Of course the media loves famous faces, and especially young and free-thinking entrepreneurs, so it's no surprise that fintechs have come to be seen as a breed of start-up that have trained their sights on the stodgy, bureaucratic world of traditional banks and asset managers. This is the narrative that dominates coverage of the fintech world and it is one we all instinctively understand. But there is more to it than that. A lot more.

In mid-May, the Competition and Markets Authority announced its proposals to “reform retail banking, to improve competition and get a better deal for customers”. It rejected calls to break up the major banks. It decided against a

“Change takes time and technology will always be an imperfect antidote to consumer inertia”

ban on ‘free if in credit’ current accounts. Instead, at the heart of its thinking was the need to make better use of data to create a more transparent marketplace and allow consumers to make better informed choices. “To transform the market the CMA believes banks instead need to be made to provide their customers with the right information so that they can easily find out which provider and type of account offers best value for them,” it said. This included

enabling customers to share their personal banking history “safely and securely” via an open application programming interface (API) with other providers to enable them to offer alternative deals.

A few days earlier, Steve Webb, former Minister of State for Pensions, was lambasting the Government in the *Financial Times* for its slow progress in bringing forward a “pensions dashboard”. “The idea of a single place where you can see your state, company and private pensions is not new,” Webb wrote. “For example, in 2014 the Financial Conduct Authority ... recommended the creation of a ‘Pensions Dashboard’ to help people know what pension rights they have.



Yet, while other countries already have dashboards in place, in the UK we remain stuck in the slow lane with only a Budget promise of something by 2019.”

Again, the key to securing better outcomes is to improve access to information and present it in a way that makes it much more valuable for users.

The parallels in just these two examples are striking. This is fintech in action – and it is nothing to do with groups of

entrepreneurs, start-ups with unusual names or grandiose claims about disrupting multi-billion pound industries. Instead, it is all about using technology to structure information so that it will influence behaviour and enable markets to function better.

CHANGING PERCEPTIONS

However, because neither of these examples involves visionary founders creating an innovative, entrepreneurial company with a colossal valuation, it's hard not to be underwhelmed by them. Who feels their pulse start to race at the mention of open APIs or a Pension Dashboard?

Despite this, I suspect that this under-appreciated facet of fintech will ultimately prove much more valuable to more people than almost all the start-ups that we read about so frequently today. Sceptics may argue that similar tech-based efforts to transform other markets have proved disappointing: witness the low rate of energy switching even though excellent comparison services exist. It's a fair criticism. Change takes time and technology will always be an imperfect antidote to consumer inertia. But if we allow ourselves to believe that the promise of fintech begins and ends with the fate of scores of start-ups, most of which will inevitably fail to live up to their own claims, then we are missing an important trick.

Fintech is not about creating companies. It's about harnessing data and delivering services.

Do you feel equipped to combat the growing risk of Cyber Crime?

"Cyber is not just about technology. People matter. More often than not attackers may seek to exploit potential weaknesses in personnel, to establish a bridgehead for attacks. It is therefore essential that firms have the right arrangements in place so that all staff understand cyber risk and their responsibilities for information assurance."

- Andrew Gracie, Executive Director, Bank of England

The CISI has developed a training and CPD programme to support the financial services industry and our members.

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