THE **Review**

Q1 2018 CISI.ORG/REVIEW

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

ifp INSTITUTE OF FINANCIAL PLANNING

GLOBAL STANDARDS

CISI teams worldwide are working with emerging financial markets to promote professionalism in knowledge, skills and behaviour

WHY CHINA IS ON A FINANCIAL SERVICES SPENDING SPREE

WHAT OPEN BANKING MEANS FOR INVESTMENT MANAGERS AND ADVISERS

HOW LIFE PLANNING CAN WIN YOU LOYAL CLIENTS

welcome

Our global network of offices, a portion of which is illustrated on the cover, is a multifaceted unit working to enhance professionalism in financial services.

Our Q1 2018 special cover feature (pp.20–26) focuses on the CISI's activity in frontier and emerging markets. We not only talk to key figures in the regions, but also illustrate our links and relationships with local institutions and members, who give their views on changes in regulation, trends and other factors affecting their jobs.

Looking at the EU/UK, where implementation of the General Data Protection Regulation is imminent, we've spoken to a lawyer and a data protection specialist about the implications for financial services firms (pp.33–35).

We also had the pleasure of speaking to former Pensions Minister Sir Steve Webb, who explains "everything matters" when it comes to forming pensions policy, including housing, jobs and families (pp.14–16).

Other highlights include our feature on the opportunities of open banking (pp.17–19); a look into why Chinese companies have been buying overseas banks (pp.27–29); and a Q&A with two experts on regulation in the pipeline (p.12).

And finally ...
We put production of *The Review* out to tender in 2017 and received many impressive applications. After a rigorous selection process, we're delighted to announce that Wardour Communications will be our publisher for the next five years. We look forward to working with Wardour to continue to improve this valued magazine for CISI members.

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

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

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

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

Advertising sales enquiries
David Poulton
T: +44 20 7010 0915
Cover illustration
Peter Crowther
Published on behalf of the Chartered Institute for Securities & Investment by Wardour, Drury House, 34–43 Russell Street, London WC2B 5HA
T: +44 20 7010 0999
Fax: +44 20 7010 0900
wardour.co.uk
ISSN: 1357-7069

FSC
www.fsc.org
MIX
Paper from responsible sources
FSC® C023802

Contents

FROM THE CISI

FEATURES

REGULARS

City view

Inducements – give us room to manoeuvre

Historically, working in finance has conjured images of long lunches, extravagant gifts and many afternoons spent on the golf course (funded by suppliers). To some, this is ordinary hospitality, but to the regulators, these activities are regarded as inducements, which have been viewed in a rather dim light since the introduction of the UK Bribery Act and the Retail Distribution Review.

In the age of austerity, the regulator is reflecting the public mood to crack down on the culture of greasing someone's palm in exchange for favours, which we applaud. In many cases, these activities did nothing more than benefit the people who were able to take advantage of this system, and did not benefit the end user – clients and consumers – in any way.

However, the CISI has recently taken the controversial view that a proposal by the UK regulator, the FCA, for a blanket ban in offering or accepting basic hospitality within the financial services sector could ultimately hurt consumers.

THE FCA's PROPOSALS

In a consultation on the Financial Advice Market Review, the FCA set out a proposal to amend the rules on adviser charging and remuneration to ban the offering or accepting of inducements, and to extend the Markets in Financial Instruments Directive ban on accepting inducements. Of course, while extravagant hospitality gifts and monetary inducements are clearly unacceptable, this complete outright banning of relatively minor and routine activities which are caught under the general banner of 'inducements' could have unintended consequences which ultimately could disadvantage the consumer.

> The CISI is not alone in raising concerns about a ban on inducements

Even in the age of advancing technology, most business is based on relationships. If firms feel as though they cannot take a client, competitor or supplier out for a simple coffee or lunch, or accept a free or subsidised space at a conference, then opportunities for people to build relationships and understand each other will be missed. These activities offer the possibility of collaboration, communication and development, which ultimately benefit the end user.

While it may not be an argument that plays to the court of popular public opinion, the CISI is not alone in raising concerns about an outright ban on inducements. A study into adviser inducements by Incisive Media notes that "given the educational and networking opportunities that corporate hospitality can bring advisers (things which ultimately benefit their end client), a closed-door policy hardly seems the most enlightening approach".

The Association of Professional Financial Advisers notes in its response to the FCA regarding inducements: "We support the general approach on implementation of the rules on inducements … save to say that we already consider these rules overly onerous and stringent." And the Association for Financial Markets in Europe states that it considers "certain aspects of the proposed UK rules impracticable, potentially detrimental to the operation of financial markets and constituting considerable divergence from European harmonisation".

NOT ALL BAD

Life is never black and white. Ethical choices and behaviour, by their very nature, involve a person navigating 'grey areas' and having to make choices in a situation where the way forward is not clear. Misuse of inducements is clearly wrong, but that does not mean that inducements in and of themselves are bad.

Used wisely, proportionately and cautiously, inviting someone to lunch or for an occasional catch-up over a cup of coffee, or offering a place at a conference, can increase opportunities for development and collaboration. But, for these activities to take place, it is necessary to leave some room for manoeuvre. ●

CISI TO LAUNCH YOUNG PROFESSIONALS NETWORK

If you're aged between 18 and 35, committed to your career in financial services and looking to develop your knowledge and skills while having fun along the way, the CISI Young Professionals Network will be there to support you. The network will focus on harnessing your competitive edge and professional development skills, including leadership, communication, teamwork, problem solving and adaptability – so you'll feel like a superstar in your role.

Dedicated events programme

Available to CISI members and guests (who work in financial services), our Young Professional events will serve not only as a way to connect with other like-minded individuals, building professional and personal contacts, but also as an introduction to the CISI organisation. Unique events led by inspirational speakers will provide the opportunity for you to engage, interact and learn from senior management, and will cover a wide range of professional development skills. Further information will be announced shortly.

Dedicated content

You'll find regularly updated content under our new Career Development tab in *The Review* online edition (*cisi.org/review*). This includes useful and relevant personal development pieces for all ages, alongside more in-depth articles.

Emma Jackson

We will also be publishing snapshots of inspirational young professionals, with our first interview featuring Emma Jackson ACSI, solutions analyst at SEI Investments. Emma successfully transitioned to her current position after completing a rotational graduate programme through her work.

Read her Q&A at cisi.org/ypnemma

To join the network

Members can opt in to receive Young Professionals Network communications through their communication preferences in MyCISI at *cisi.org/communications*

Member Privileges

Save on your weekly shop

The CISI Membership Privileges website has a huge range of offers to help you with your weekly shop.

Browse the discounts on the mobile-optimised site while you're out and about, purchase the evouchers you need, and they'll be in your inbox by the time you're at the front of the queue.

Shop the season collections with up to 20% off your favourite stores. Update your gadgets with 7% off at Argos and Currys, or revive your home with 8% off Wickes and 9% off B&Q.

What's more, you can make big savings on your groceries using available discounts at Asda, Morrisons, Tesco and Sainsbury's. There are even more mouthwatering shopping cards with 4% off at Waitrose and 7% off at M&S.

For health and fitness offers, don't forget to visit the website for tempting savings.

Get 7% off a one-load Sports Direct card, 7% off an Evans Cycles evoucher and 6% off a Decathlon instant evoucher.

New offers are being added every week, so keep an eye out on the Membership Privileges website.

- To benefit from these offers, log in to MyCISI, click on Membership Privileges then View your Membership Privileges, which will take you to the shopping portal.


Events to look out for in London 2018
Annual Integrity Debate
Thursday 7 June
Fishmongers' Hall
London Annual Dinner
Tuesday 9 October
Mansion House
flagship.events@cisi.org
CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Events preview

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

LONDON CPD

26 MAR Physical climate risk

REGIONAL CPD

20 MAR Introduction to Lloyd's of London (Isle of Man)
22 MAR GDPR – How ready is your business? (Liverpool)
23 MAR Senior Managers & Certification Regime; the right culture and how to deliver this cost effectively (Edinburgh)
27 MAR Impact of interest rate rises (Leeds)
29 MAR The state of the Northern Ireland economy: now and looking forward (Belfast)
10 APR Running an efficient business and generating tax free income (Belfast)
10 APR Robo-advice – is this the future for financial planners? & Overview of business protection, looking at the needs of sole traders, partnerships and limited companies (Bristol)
12 APR Developing trends in investment companies (Leicester)
17 APR Understanding your client (Birmingham)
18 APR Brexit – the future for the UK financial services sector: good or bad? (Essex)
19 APR Understanding your client (Yorkshire)

ANNUAL DINNERS

26 APR Ireland gala dinner
10 MAY Liverpool, Chester & North Wales branch dinner
17 MAY East Midlands & Lincoln branch dinner

- If you have an idea for an event or would like to contribute at one of our events, please email *cpdevents@cisi.org*

- For details of conferences, and social events available to members, please visit *cisi.org/events*

"This House believes that fintech will save the City"

The Mansion House City Debate, organised by the CISI and the Centre for the Study of Financial Innovation, has become a not-to-be missed annual event: a black tie dinner, a top-level debate on an issue of burning interest to the City, and all the splendid flummery that the Mansion House does so well.

This year's theme was fintech and the moderator was Angela Knight CBE FCSI(Hon) – latterly chief executive of the British Bankers' Association, who is now chairing the Government's Office of Tax Simplification. Speaking for the motion were Nikhil Rathi, CEO of the London Stock Exchange since 2015, and Ruth Wandhöfer, global head of regulatory, market and innovation strategy at Citi (pictured).

Against the motion were Antony Jenkins, former CEO of Barclays, who now heads 10X Banking, and Alderman Michael Mainelli, Chartered FCSI, executive chairman of Z/Yen.

- The entire debate is available for viewing on CISI TV. CISI members will receive 1.5 hours CPD for watching.

EDUCATION NEWS

The CISI has partnered with the City of London Corporation in the launch of a pilot project to deliver its level 2 qualification in Fundamentals of Financial Services to young learners.

The City of London Corporation is sponsoring places for up to 25 students from London schools to take this qualification at its prestigious premises at the London Guildhall, taught by CISI teaching and learning specialist Matthew Bolton.

Students taking part in the pilot programme will be invited to attend a CISI Insight Day. These days, held regularly by the CISI, give students the opportunity to interact with practitioners in the financial services sector and obtain an insight into the various roles available. Students will also have the opportunity to compete for work experience placements in July 2018.

• For further information on this project, contact the education development team at *educationdevelopment@cisi.org*

DISCIPLINARY ACTION

Gerald Rothwell – 21 December 2017

Following a notification that Mr Rothwell had been subject to disciplinary action by his employer, he was invited to appear before a CISI disciplinary panel. The panel, having considered the matter and the member's submissions, determined that Mr Rothwell was in breach of the CISI membership regulations and the CISI Code of Conduct, that he should receive a severe reprimand and that his Chartered status should be suspended for one year.

• Read the membership regulations at *cisi.org/regulations* and read the Code of Conduct at *cisi.org/codeofconduct*

Find more articles online

Have you checked out the digital edition of *The Review*?

The tablet and smartphone-friendly online issue is updated each week with features, opinions and analysis on hot industry topics, over and above what is in the quarterly *Review*. There is also an archive of articles from past print issues. View the digital edition and leave your comments on featured articles, or the issue as a whole, at *cisi.org/review*

Correction and apology

The previous 'In the know', published in the Q4 2017 edition, includes a question about the stamp duty charge for purchasing shares. On page 13 of the Q4 edition, the incorrect answer provided is option C: 0.75%. The correct answer is option B: 0.5%. The CISI apologises for the error.

IN THE KNOW

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

1. What is the basis for global anti-money laundering standards on which most developed countries' anti-money laundering laws are based?
A FATF 40 Recommendations
B EU Directives
C United Nations Resolutions
D Prevention and Suppression of Money Laundering and Terrorist Financing Law of 2007–2016

2. Which type of trading venue was introduced by the original Markets in Financial Instruments Directive?
A Multilateral trading facilities
B Organised trading facilities
C Regulated stock exchanges
D Recognised investment exchanges

3. Which of the following is the ISO 31000 definition of risk?
A The loss incurred from an uncovered exposure
B A situation involving an exposure to danger
C The possibility of harm or damage against which something is insured
D The effect of uncertainty on objectives

4. The aim of the ESMA Guidelines is to enhance investor protection by increasing the knowledge and competence of:
A Investment advisers only
B Information providers only
C Investment advisers and information providers
D Senior managers only

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

Financial planning news

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

We have a new financial planning executive on the team supporting Christopher Morris ACSI and I: Deanne Sinclair. I'm sure you'll all welcome her to the financial planning community. So far this year we have put into place some three-day CERTIFIED FINANCIAL PLANNER™ certification training courses to help those currently going through the CFP certification process. The training courses run in February and March and include an hour of mentoring outside of course time with the tutor. For those who have resolved to obtain their CFP designation this year, there's more good news. I am in the process of setting some dates and locations for four-day CFP certification training courses. The aim is to provide you with tutoring and support, time to work on your case study and also receive some post-course mentoring if required. These intensive courses will be held in several locations around the country, hopefully in Chester, Bristol and London, at regular times during the year. So watch your online bulletins for dates, locations and details on how to book.

Deanne Sinclair

REGIONAL EVENTS

I've been out and about recently attending a few financial planning events and have been very pleased to see so many new and old faces. All of our branches have financial planning representatives on them and they are working well with the regional committees to give a spread of technical, behavioural finance and financial planning skills sessions. We've sent emails asking for your views and suggestions for subject matter that you'd like to see. If you have some ideas about this, please contact me (*jacqueline.lockie@cisi.org*). If you'd like to put something back, as I know many of the planners are doing, then do get in touch. I can always find you something to do.

PROFESSIONAL REFRESHER AND CISI TV

I hope you've been keeping an eye on the helpful content we've been adding to your MyCISI accounts. We have a great video and information document on MiFID II just for financial planners, plus two great sessions looking at the technicalities and planning considerations when dealing with vulnerable clients. A CFP professional's perspective, combined with detailed information coming from the FCA, make for interesting and informative sessions. Look out for more in the coming months.

Financial planning content for *The Review* magazine

Twelve pages of financial planning content have been incorporated into this magazine since August 2016. The content for this and the online financial planning section is driven by the Financial Planning Editorial Panel, most of whom are CFP professionals. We are always on the lookout for new topics that can support the existing financial planning community and inform those who are attracted to the profession. Don't be shy, pass on your ideas.

SOME IMPORTANT DATES FOR YOUR DIARY

21 May 2018: ACCREDITED FINANCIAL PLANNING FIRMS CONFERENCE (for existing accredited firms only)
10–4pm; CISI offices, 20 Fenchurch Street, London

The Accredited Financial Planning Firms steering group is setting the content for this conference and will ensure it will be relevant and thought-provoking for you.

12-13 June 2018: PARAPLANNER CONFERENCE
Jury's Inn Hinckley Island Hotel, Hinckley, near Leicester

The Paraplanner Interest Group sets the content for this. We have exciting things planned to top the high bar we set at the superhero-themed conference in 2017. If you are a paraplanner reading this, keep an eye out for the booking information and twist a few arms to get yourself booked on. Otherwise you'll miss out on this fun and action-packed event.

1-2 October 2018: ANNUAL FINANCIAL PLANNING CONFERENCE
Hilton Birmingham Metropole, Birmingham

For those who have attended previous CISI or IFP Financial Planning Conferences, you'll know that there have been two full days of sessions spread over three days. But for many of you, three days is a long time out of the office. So we've consolidated it into two jam-packed days, 8.30am–6pm. Put the date in your diary and look out for the early-bird booking deals in your emails. The venue is great and I look forward to welcoming you to it in October.

- For more information visit *cisi.org/conferences*

ONLINE TRAINING ON INVESTMENT COMPANIES

To support advisers who want to brush up their investment trust knowledge while gaining structured continuing professional development (CPD), the Association of Investment Companies (AIC) has launched four 45-minute courses within its new online training centre, Learning Zone.

The CISI-endorsed courses can be taken at any time and in any order. CPD certificates are generated on successful completion of each 45-minute course.

It's free to access Learning Zone and take the courses. You'll need to be registered on the Financial Advisers centre of the AIC website (theaic.co.uk) – just look for the orange 'Financial Advisers' button at the top of the screen and create an account in less than one minute, if you don't have one already.

For those who are new to investment companies (investment trusts) the first course, 'An introduction to investment companies', is a logical place to start. Among other things, it explains the difference between 'investment trusts' and 'investment companies', terms that are often used interchangeably but in fact have distinct meanings.

Further courses dive into more detail on discounts and premiums, gearing, and the income features of investment companies. A fifth course on private equity investment companies is being released soon.

The AIC has launched these online courses to help train financial planners, paraplanners and wealth managers who would like training on investment companies, but who find it difficult to attend the AIC's face-to-face events around the country. Purchases of investment companies on adviser platforms now total more than £900m annually, a fourfold increase since pre-Retail Distribution Review days.

theaic.co.uk

+ 44 20 7282 5555

CISI FINANCIAL PLANNING CORPORATE SUPPORTERS Q1 2018

Gold

Royal London
www.adviser.royallondon.com

Corporate

Aegon
www.aegon.co.uk

AIC
www.theaic.co.uk

Dimensional Fund Advisors
www.dfauk.com

First Trust Global Portfolios
www.ftglobalportfolios.com

Just
www.justadviser.com

NS&I
www.nsandi.com

P1 Investment Management
www.p1-im.co.uk

Parmenion
www.parmenion.co.uk

Prestwood Software
www.prestwood-group.co.uk

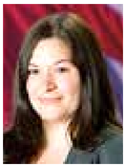
Schroders Investment Management
www.schroders.co.uk/adviser

Standard Life
www.standardlife.co.uk

Transact
www.transact-online.co.uk

Vanguard
www.vanguard.co.uk

ASK THE EXPERTS: WHAT'S HOT IN OPERATIONS REGULATION IN 2018?



Erica Borghi is chair of the International Securities Association for Institutional Trade Communication (ISITC) and vice president of fintech risk at Brown Brothers Harriman.

Nigel D Solkhon is CEO of ISITC Europe and director, regional head, execution to custody (E2C) EMEA at Citi. Watch CISI TV (by logging into MyCISI) for highlights of ISITC Europe's 2018 Conference.

How might financial services regulation affect the sector in the US and globally in the future?
Erica Borghi (EB): The key initiatives that ISITC is focusing on include the Markets in Financial Instruments Directive II (MiFID II); sanctions screening, as required by the New York Department of Financial Services; the European Markets Infrastructure Regulation (EMIR) reporting; then the European General Data Protection Regulation (GDPR) will be enforceable 25 May 2018.

The US Financial Crimes Enforcement Network Customer Due Diligence regulation takes effect 11 May 2018. Regarding the Foreign Accounts Tax Compliance Act (FATCA), ISITC monitors updates as they are issued, as well as developments in the Federal Trade Commission modernisation.

> "The appetite for moving to real-time settlement is low, but it could jump"

In 2018, we are focusing on technology solutions. Our members are still implementing operational improvements and investigating distributed ledger technology (DLT), artificial intelligence (AI), application programming interfaces (APIs) and machine learning.

Nigel Solkhon (NS): FATCA, although it is a US regulation, has impacted the European segment. MiFID II and the EMIR regulations are the other way around. Then there are things like T2S and T+2, the European securities settlement system. These are market forces that have a direct impact on the way in which we operate.

This year, what will be the big developments in settlements?
NS: In Europe, the deployment of DLT is being tested with things like cryptocurrencies. AI is about taking out the manual processing inside manager or broker organisations. AI has taken off and many providers are looking at how they can streamline some processes.

In Europe, and I'm sure in the US, it is about how we move from our current systems to the new world of shared information exchange. Many people are moving towards areas such as APIs that allow you to integrate directly into those data infrastructures, but not necessarily replace your own.

EB: We've also seen some success with machine learning in analysis, data quality and processing rate in the US. In terms of APIs, that's going to be a key component in getting us to where we need to be in accessing real-time data to support shortened settlement cycles.

What are the main disrupters that may impact your members' reconciliation processes?
EB: Limitations of technology, particularly when we're talking about intraday reconciliations. Currently, many organisations are batch-oriented. With reconciliation, your data comes overnight, and speeding that process up is a major disrupter. Also, when you use APIs to get data directly, it completely changes the process.

NS: The appetite for moving to real-time settlement is low, but it could jump. It's easy to move an internal settlement infrastructure to real-time settlement. It's easy to tokenise the assets so they can be moved and settled immediately, because it's internalisation. Once you push that out, and you've got other people in the chain of settlement and trading, that's where it becomes very much more complex.

How do you think messaging standards for collateral management and margining could be set to change in the future?
EB: ISITC's goal is to streamline all the derivative product types, creating similar workflows, so the buy-side and sell-side can more easily optimise their collateral. The sector has been focused on over the counter (OTC) bilateral workflows over the past three years, in preparation for the uncleared margin rule. Now it's time to leverage the market standard across other areas and products. Based on all the workflows, there may be an increased demand for adopting utilities in this space.

NS: My problem is that the orders can come in any shape and format. Most orders come via Financial Information Exchange messaging. But we also get Society for Worldwide Interbank Financial Telecommunication (SWIFT); also comma-separated values files; and some key in on their graphic user interface. Translating that information to process to a broker for execution, getting that information back and converting it into a SWIFT standard to send out to ourselves or a third party for settlement – that is a challenge.

What implications will the EU's Securities Financing Transactions Regulation (SFTR) reporting requirement have for members?
NS: SFTR extends reporting to previously unreported products, unfamiliar to existing reporting teams within banks and regulators. It introduces 153 reportable fields, requiring transaction and position-level data. Approximately half of the fields are not required under Markets in Financial Instruments Regulation (MiFIR) or EMIR and are totally new data points. Some fields will be different across instruments. A limited single-sided reporting regime for certain transactions will further complicate the reporting and lead to legal liability concerns.

Pick and mix

IT IS NOT SURPRISING THAT THINGS GO WRONG IN BRITISH COMPANIES – THE CONTINUED LACK OF DIVERSITY IN OUR BOARDROOMS IS LEADING TO 'GROUPTHINK'

ANTHONY HILTON FCSI(HON) JOHANNA WARD

It is increasingly understood in business that diverse teams are more creative and reach better decisions than groups from the same background and culture. A diverse group looks at a problem from a wider range of perspectives and with a wider spectrum of experience. The interaction of people from different cultures and backgrounds sparks new ways of thinking.

Senior management understands and generally sees it as desirable to put together diverse teams in the lower and middle parts of the group's operations, but it is much less willing to embrace diversity in the boardroom. Chairmen who will privately admit they worry about 'groupthink' claim to be unable to do anything about it. The only significant change in the composition of boards in recent years has been the emphasis on increasing the numbers of women.

The typical British-listed company remains light years away from what management guru Tom Peters – who wrote *In search of excellence* – thinks would be a perfectly comprised board. Anthony Fitzsimmons of Reputability, a consultancy specialising in governance and risk, currently has a blog on his website that describes what Peters, in one of his latest books, considers the ideal. Here is how it goes.

On a board that has ten members, including the chair, there should be no more than three people over 60, no more than three MBAs, at least three women, two people under 30, a brace of entrepreneurial types, a design guru, an IT superstar and a person of stature who seems weird – probably a rapper or an artist.

To this mix, Fitzsimmons would add at least one person who understands how people think and behave (a graduate in psychology, sociology or anthropology) and two others trained to deliver constructive challenge, such as academics, lawyers or journalists.

Peters' embrace of diversity is grounded in his view of what makes a successful business. One of his golden rules is that the four most important words uttered in any organisation are: "What do you think?" He believes that question conveys to the listener that they are seen as a person of value, who has an opinion that the questioner wants to hear. A huge amount of time and effort is spent talking about empowerment and engagement in organisations, without ever getting to the point where employees feel either empowered or engaged. What those disgruntled and disillusioned employees outside the board fail to realise is that the same dynamic often exists at the top of organisations. Boardrooms are also stuffed with people who feel the only opinion the chair wants to hear is their own. This is sometimes referred to as 'sucking up the oxygen'.

The point of such a diverse board is to make it impossible for one person to suck up all the oxygen, therefore making it more likely that there will be lively debate and engagement. With this in mind, Fitzsimmons mischievously decides to compare the Peters blueprint with the reality to be found among the non-executive directors in the boardrooms of large companies and their regulators.

Age data is incomplete, but where it is available it shows only 7% are under 50 and 55% are over 60. There are now more women on boards following the pressure from outside to hit a 30% target, but still almost no ethnic minorities. Only 1% of the non-executive directors are psychologists; only 2% have HR experience; only 7% are lawyers or academics, and the latter are usually chemists at pharma companies; only 9% know about IT and data, and they are clustered in media and telecoms.

But just under half of them have been directors elsewhere and many have 'C-suite experience'. They account for an overwhelming 94% of all directors.

It is not surprising that things go wrong. Thanks to modern technology and the speed of reporting, companies rarely get caught out by accounting mistakes or failures in financial controls – except in cases of fraud. Instead, the really serious problems are caused by the way people behave and interact with their colleagues. But as Fitzsimmons points out: "Non-executive directors with deep knowledge and skill in understanding how people really tick are rare."

Huge amounts of effort go into developing processes for corporate governance. It is tempting to think that much of it could be scrapped if we just put the right people on the boards in the first place.

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

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

MAN WITH A PLAN

Throughout his career, former Pensions Minister Sir Steve Webb has been nudging us towards a culture of saving and planning for retirement. So, are we nearly there yet?

EILA MADDEN CHARLIE SURBEY

When Steve Webb arrived at the Insitute for Fiscal Studies (IFS) as part of the new graduate intake in 1986, he expected to be working with industrial economist John Kay on a research project on privatisation. Instead, Kay left the IFS and he wound up working with economist and author Andrew Dilnot on tax and benefits.

That twist of fate has led to a 30-year career dedicated to helping people escape poverty through sensible financial planning and, in particular, preparing for retirement. Part of that time was spent in Parliament, where he made his mark as Pensions Minister in the Conservative-Liberal Democrat Coalition Government. In the 2017 New Years Honours list he was knighted for his services to politics and public service.

Some might see that as the culmination of a career, but not Sir Steve. Since losing his seat in 2015, he's been director of policy and external communications for pensions provider Royal London, where his priorities are to encourage a greater take-up of pensions and nudge people towards building a savings habit.

"What I love about pensions is every bit of your life shapes your pensions outcome – whether you're single or married, a renter or a homeowner, in good health or poor health," Steve says. "Therefore, you can't have sensible pensions policy without thinking of the houses we live in, the jobs we do and the families we make and break."

POLITICS AND AUTO-ENROLMENT

Steve became a regular media commentator on government policy on tax and benefits while at the IFS, but realised that sitting on the sidelines wasn't for him. "I was pretty clear I wanted to change things – not just talk about them," he remembers.

In 1997, he turned over an 11,000-vote Conservative majority to win the constituency of Northavon in south west England for the Liberal Democrats. His subsequent rise through the party eventually took him to the Department for Work and Pensions when the pensions auto-enrolment policy was being introduced. Under the scheme, workers aged 22 or older who earn £10,000 or more a year are now automatically enrolled into a contributory workplace pension.

Auto-enrolment has worked "massively, profoundly, quickly and dramatically," says Steve, adding that younger people face too many other financial pressures to start thinking about pensions in their 20s. "The priority has been to get them enrolled, get them up to a reasonable level of contribution and then leave them alone. When they're in their 40s and beyond and start getting interested in pensions, they'll actually have a serious amount of money to make some interesting choices with, but we just shouldn't expect your average twenty-something to be thinking about pensions. We're just pushing against the grain if we do."

NEW STATE PENSION

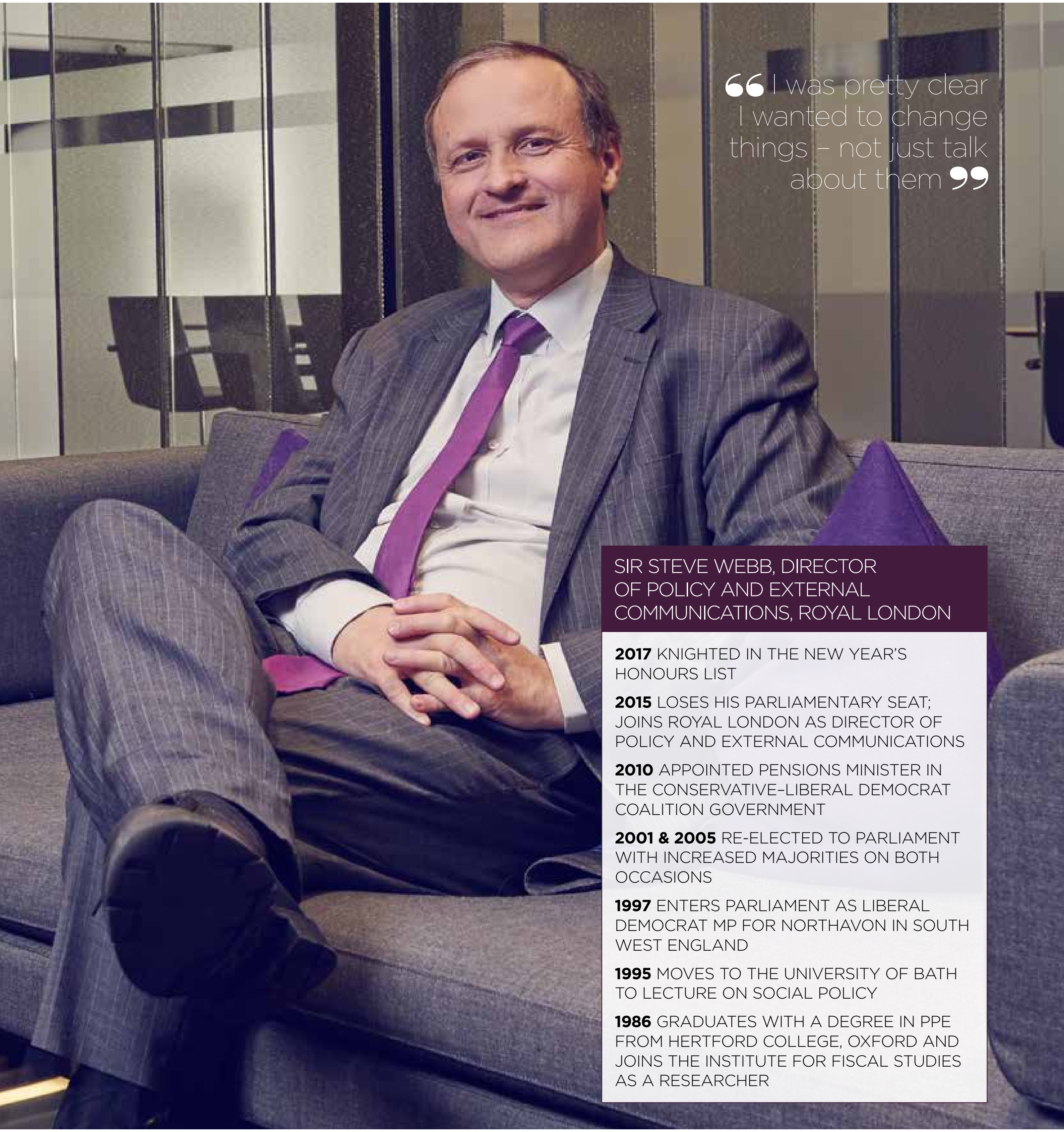
Although Steve played a part in delivering auto-enrolment, the change that wouldn't have happened without him was the introduction of the new state pension. Absent from any party manifesto in early 2010, he used the bargaining power the Coalition Government afforded the Liberal Democrats to get the new state pension onto the policy agenda. Steve argues that the system, applicable to everyone retiring after 6 April 2016, is simpler and fairer than its predecessor.

He says: "The importance of the new state pension won't be seen for a while, but it produces better outcomes for women and supports auto-enrolment by making saving pay. It will also simplify things massively so that people know what they will get from the government and that if they need more, they need to provide for themselves."

"Being able to set people free with their pensions was a very exciting thing to do"

Late on in Steve's time as Pensions Minister, he oversaw the introduction of pension freedoms, the brainchild of former Chancellor George Osborne. "Being able to set people free with their pensions was a very exciting thing to do and, although there are still policy refinements to be made, people come up to me and shake my hand and say: 'Thank you. That freedom gave me the ability to structure my retirement in the way I wanted to do'."

Fears that pensioners will blow their pension pot on luxury cars and holidays are not unfounded, says Steve, but definitely exaggerated. FCA research reveals most pensioners take 25% of their pot as a tax-free cash lump sum, as they have always done, and then invest the rest or use it to pay off debt. Steve thinks that makes sense



"I was pretty clear I wanted to change things – not just talk about them"

SIR STEVE WEBB, DIRECTOR OF POLICY AND EXTERNAL COMMUNICATIONS, ROYAL LONDON

2017 KNIGHTED IN THE NEW YEAR'S HONOURS LIST

2015 LOSES HIS PARLIAMENTARY SEAT; JOINS ROYAL LONDON AS DIRECTOR OF POLICY AND EXTERNAL COMMUNICATIONS

2010 APPOINTED PENSIONS MINISTER IN THE CONSERVATIVE–LIBERAL DEMOCRAT COALITION GOVERNMENT

2001 & 2005 RE-ELECTED TO PARLIAMENT WITH INCREASED MAJORITIES ON BOTH OCCASIONS

1997 ENTERS PARLIAMENT AS LIBERAL DEMOCRAT MP FOR NORTHAVON IN SOUTH WEST ENGLAND

1995 MOVES TO THE UNIVERSITY OF BATH TO LECTURE ON SOCIAL POLICY

1986 GRADUATES WITH A DEGREE IN PPE FROM HERTFORD COLLEGE, OXFORD AND JOINS THE INSTITUTE FOR FISCAL STUDIES AS A RESEARCHER

for some pensioners. A pension pot of £20,000, for example, might deliver a lifetime income of just £20 a week. In those circumstances, using the lump sum to pay off a mortgage or build a home extension to improve your quality of life might prove to be a better use of the money.

"Ironically, it's the excessively cautious I'm worried about, not the excessively reckless," says Steve. Many low-income pensioners, with little trust in the investment sector, are putting their freed-up pension pots into cash ISAs. "That feels like a safe thing to do but cash ISAs pay nought point not very much, and inflation is at 3%, so they're losing real money every year."

PROBLEM GROUP

All that said, research by the Resolution Foundation, a think tank, suggests we're worrying about the wrong people. The 'golden generation', currently retiring, are still comfortably enjoying defined benefit pension plans. And those in their 20s, now set up with auto-enrolment, the new state pension, pension freedoms and, potentially, a property to inherit from their parents, also have little to worry about long term – if, that is, the problem of the lack of affordable housing is fixed. If this generation is still paying rent in retirement, projected retirement incomes will have to rise. "But it seems to me the answer to that is a housing policy answer, hence my comment that everything matters," says Steve.

The big problem group is the one in the middle – the people who entered work after defined benefit schemes closed, who perhaps didn't join a pension scheme when they began working and who came to auto-enrolment too late to build up a meaningful pension pot. They are the people now in their 40s.

At the heart of the problem for all generations is the lack of value the public places on professional financial advice, even though the evidence suggests they are missing a trick. Research conducted by Royal London and the International Longevity Centre finds that people who took financial advice were, on average, £40,000 better off ten years later compared with those that didn't.

"Ironically, it's the excessively cautious I'm worried about, not the excessively reckless"

The issue, says Steve, is that financial advice is seen as an industry, not a profession. "We need people to understand they're dealing with a professional who can make a transformative difference to their quality of life." But the financial sector does need to meet savers half way. Product impartiality is key if advisers are to build public trust. And a lighter regulatory touch is needed to encourage financial advice firms to take on more business. "If we can't give advice firms the desire to expand, we'll always have an advice gap," he says.

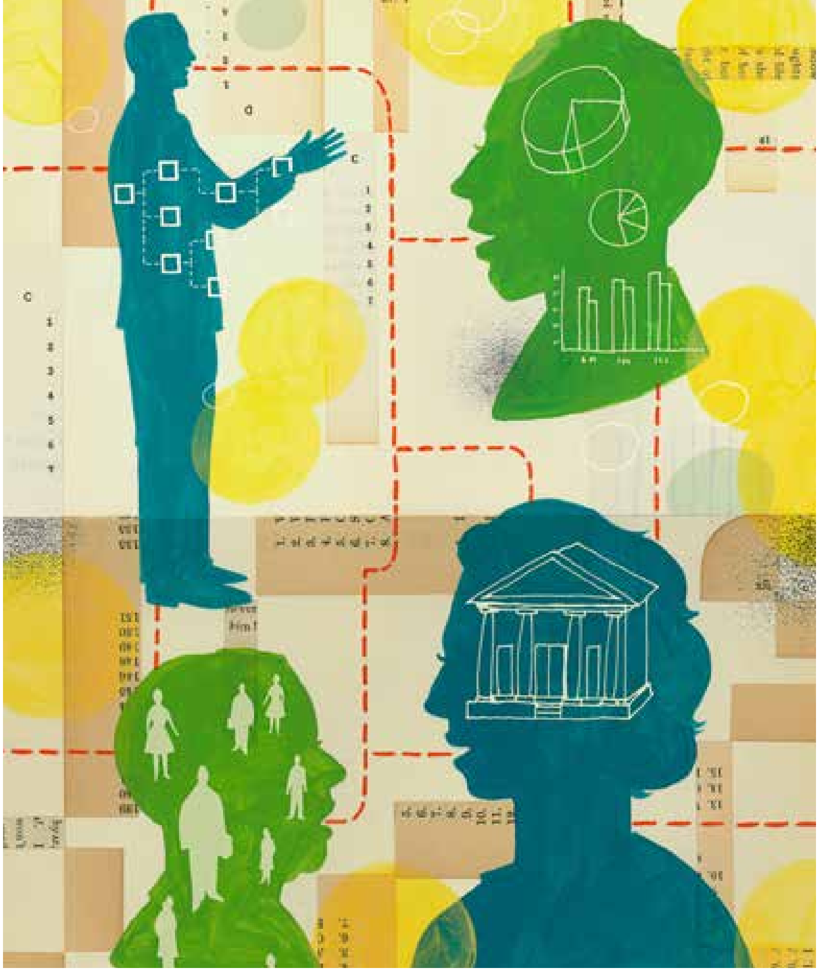
Steve saw the end of his political career as an opportunity to put the policies he had worked so hard to get through Parliament into practice. "I wanted to work for a firm that was serious about pensions," he says. "Having come from a public service role, I think the hard ridges of global capitalism were probably not quite me really, so working for Royal London – a mutual that is a serious, competitive business, but is ultimately answerable to its members – actually fits quite well with me."

Part of Steve's role at Royal London is helping ordinary people with the basics of budgeting and saving so that when they encounter some crisis, they have an emergency fund to dip into rather than turn to a doorstep lender.

Technology can help – particularly budgeting apps, which can have a transformational effect on people's behaviour. In research Royal London conducted with YouGov on the use of such apps, people cut back on spending of their own volition when they realised what they could do with the money they saved. "One guy used to buy a nice, expensive coffee at the train station everyday. He bought an expensive coffee maker so, instead of buying it, he made the nice coffee as he left the house and walked to the station with it. He saved himself £350 a year and nobody wagged a finger and made him feel bad; we put him in control of his own spending."

That control is a central pillar of the UK Financial Capability Strategy – a government-led initiative that seeks to improve people's ability to manage their money. Steve sits on the board of the initiative, which focuses on developing citizens' financial skills and knowledge, and improving their attitude and motivation towards saving. More still needs to be done to share best practice across the financial services sector – something, says Steve, the CISI can help with.

He believes a cultural shift is needed to make saving as normal as spending. It's a challenge not helped by one big elephant in the room – the present tax relief system, which is "broken and subject to too much change". If ministers can introduce stability to tax relief, and stop putting limits on how much we can put into our ISAs and pensions, savers will have a chance of providing for themselves in retirement, says Steve. "HMRC is terrified that someone is going to save too much and hoover up all the tax relief and we've got to find ways of taking a big deep breath and just chilling a bit." ●



OPEN FOR BUSINESS

Open banking presents new opportunities for the financial services sector beyond retail banking, but customers could be slow on the uptake

PAUL BRYANT IKON/LEIGH WELLS

The US is a runaway leader in the use of banking data for wealth management products and advice. Personal financial management (PFM) tools are used by over 30% of US consumers. These draw data from banks and other financial institutions to offer a view of credit card, bank, mortgage, investment and pension data within a single app. Budget tracking, expense analysis and overspending alerts are common features. Advisers use these tools to obtain an up-to-date picture of a client's financial situation and spending patterns.

Yodlee provides the technology for many of these apps, drawing data from over 16,000 institutions. Jason O'Shaughnessy, senior vice president EMEA/Australia at Yodlee, explains why US banks embrace data sharing: "It's a very competitive landscape. You've got thousands of banks. It's not like the UK, where eight banks and one building society make up 90% of the market.[US banks are] more innovative about sharing their data."

In the UK, the Competition and Markets Authority (CMA) has led an initiative to play catch-up, intensify banking competition and trigger a boom in financial services innovation.

It has compelled banks to make data available to third parties and to adopt a common technical standard for this data to be drawn through automated feeds. The initiative is called the Open Banking Standard.

WHAT IS OPEN BANKING?

A customer researching loans through a comparison site provides an example of how open banking works. They would be given an option to share relevant transactional banking data, directed to their bank site to grant the comparison site access, and then redirected back to the comparison site to receive their loan quotes.

These quotes should reflect a level of sophistication well beyond what is available today. The comparison site can interrogate eligibility criteria and exclude unsuitable loan providers. Loan providers can refine their offering, such as automatically conducting affordability checks and pricing more accurately.

The interface between the computers of the comparison site and the bank is called an application programming interface (API). This is not new technology. The most familiar application is the use of Facebook credentials to log in to another website.

STATE OF PLAY IN THE UK

The EU initiated the move towards open banking. The revised Payment Services Directive (PSD2) was transposed into member states' law in January 2018. It requires that all payment services providers allow authorised third parties to access customers' accounts to extract data or initiate payments, without having to use the banks' online services. It also sets standards for security measures. But the UK, through the CMA, has gone well beyond minimum requirements, demanding that the largest banks collaborate in their implementation process through an Open Banking Standard. PSD2 stops short of requiring common technical standards.

Momentum in the UK started to build in 2014 when the government commissioned the Open Data Institute and Fingleton Associates to investigate open banking. In the same year, the CMA launched an investigation into the supply of retail banking services to consumers and smaller businesses. Both investigations concluded that greater access to data should result in increased competition and innovation in banking and that banks should create standardised APIs, accessible by authorised third parties.

HM Treasury asked the Open Data Institute to outline a plan for the initiative. To do this, it set up the Open Banking Working Group (OBWG), comprising industry experts, and consumer and business representatives. Its mandate was "to explore how data could be used to help people transact, save, borrow, lend and invest their money, and to ensure a standard was put in place to protect privacy and ensure the data is secure." The result of this work is the Open Banking Standard that guides how open banking data should be created, shared and used.

The *CMA Retail banking market investigation: final report* of 2016 dictates the way forward. To manage the technical and governance aspects of the initiative, a new organisation called the Open Banking Implementation Entity was created. This is funded by eight UK banks and one building society and overseen by the CMA, FCA and HM Treasury. To kick-start innovation, Nesta, an innovation foundation, was mandated to identify and support 20 small technology companies to develop new services, apps and tools, using open banking functionality, that help UK small businesses.

> *"Where this logically ends is not just payment products, but savings, pensions and mortgages"*

Chris Gorst, fintech challenge prize lead at Nesta, says: "The UK version of open banking is really a progressive one. A risk with PSD2 is that you get fragmented solutions, with individual banks coming up with their own different ways of complying. With open banking in the UK, the banks have to agree a common standard. For developers wanting to develop new services, and ultimately for banking customers, that's really good news."

Banks are also playing their part to help new fintechs bring their innovations to market. A preferred route is to invite them to 'hackathons' – events where working prototypes of new apps and services can be built that interface with actual bank APIs in a 'test' environment.

And the scope of open banking is expanding. Since January 2018, consumer and small and medium enterprise current account transactional data has been accessible by authorised third parties. In his Autumn Budget 2017, Chancellor Philip Hammond announced that payment accounts such as credit cards and ewallets were also to be included in the initiative. Chris suggests: "Where this logically ends is not just payment products, but savings products, pensions, mortgages – an open ecosystem for all financial products. That would revolutionise people's ability to take control of their financial lives."

The CMA seems to be in agreement and has alluded to an expansion even further than the Chancellor's recent

OPEN BANKING PROGRESS IN THE UK

2007
EC publishes PSD1, introducing the concept of third-party participation in the payments sector

2012
Open Data Institute founded by Sirs Tim Berners-Lee and Nigel Shadbolt

2013
EC issues a proposal for PSD2 with timeline for transposition into national laws

2014
Open Data Institute and Fingleton publish report recommending open banking to stimulate banking competition

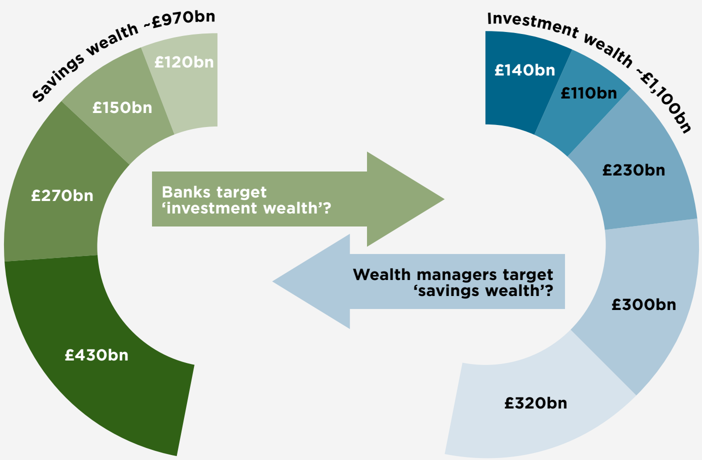
2014
CMA launches market investigation into the supply of retail banking services

2015
In the budget, HM Treasury commits to delivering open banking

2015
HM Treasury launches consultation with sector, consumer and business groups – many support open banking

2015
Open Banking Working Group (OBWG) formed to produce framework for design and delivery

WILL OPEN BANKING TRIGGER NEW BATTLES FOR 'SHARE OF WALLET'?



Current accounts
Fixed term bonds
Cash ISAs
Savings accounts

Other*
Unit/investment trusts
SIPPs
Shares
S&S ISAs

Source: ONS, HMRC, BBA
**including 'insurance' investment products, bonds and gilts*

announcement: "The applicability of these tools to savings products such as mortgages and other financial products like insurance – there are many who see this as a natural development. We did not express a view on this in our report, but we did say that we had tried to design these arrangements so that they could be reused for developing standards in other areas."

OPPORTUNITY FOR THE INVESTMENT SECTOR

Samantha Seaton, CEO of PFM company Moneyhub, says open banking will give wealth managers an entire view of clients' wallets, helping to clarify whether they should service their current client base further, or focus on attracting new clients. The prize is large for the investment sector if open banking can be used to switch a proportion of 'customer wallet' from banks' control (see infographic).

Tessa Lee, managing director of moneyinfo, sees another advantage: "Children of clients are not necessarily going to go to their mum and dad's regional adviser or wealth manager, but if that wealth manager connects with them on an ongoing basis and starts to build a relationship using technology, then when that wealth is passed on to the next generation, they've captured that audience already."

Financial advisers using moneyinfo cite additional benefits of improved client satisfaction from having access to their financial information at any time; more precise lifetime cashflow analysis from having accurate, not 'guesstimated' expenses; savings in staff time from a reduced paper reporting workload; and reduced costs of reports and postage.

However, Samantha says that the early adopters, and biggest beneficiaries to date, have been smaller advisers. Larger incumbents have been slow to seize this opportunity: "Most of the larger wealth businesses, until very recently, have not understood how PSD2 will be of benefit to them, but I think it is about to change due to PSD2 implementation in January 2018. I'm guessing that the workload from MiFID II, the General Data Protection Regulation and the impact of the recent FCA Asset Management Survey report has resulted in major league distraction as most of them have held the view that 'this is something for the banks, rather than the fund manager', yet this couldn't be further from the truth."

PACE OF ADOPTION UNCERTAIN

The OBWG sees big potential for investment products: it estimates that, should UK consumer uptake of PFMs reach US levels of circa 32%, it would suggest a £10–15m potential.

But Chris at Nesta cautions against expecting too much too soon: "If uptake is low, there will be some that say people don't want it because they are happy with the way things are. Others may say consumers haven't been using it because there hasn't been any education process. I think we are going to have that debate going on next year." ●

2015
EC publishes the requirements of PSD2 – transposition at national level to occur by Jan 2018

FEB 2016
CMA publishes final report, introducing open banking as a remedy to address lack of competition and innovation

FEB 2016
OBWG report recommends creating an open banking standard using an API

SEP 2016
Open Banking Implementation Entity (OBIE) formed to manage technical aspects and governance of the initiative

FEB 2017
Nesta introduces the Open-Up Challenge, a competition and support initiative

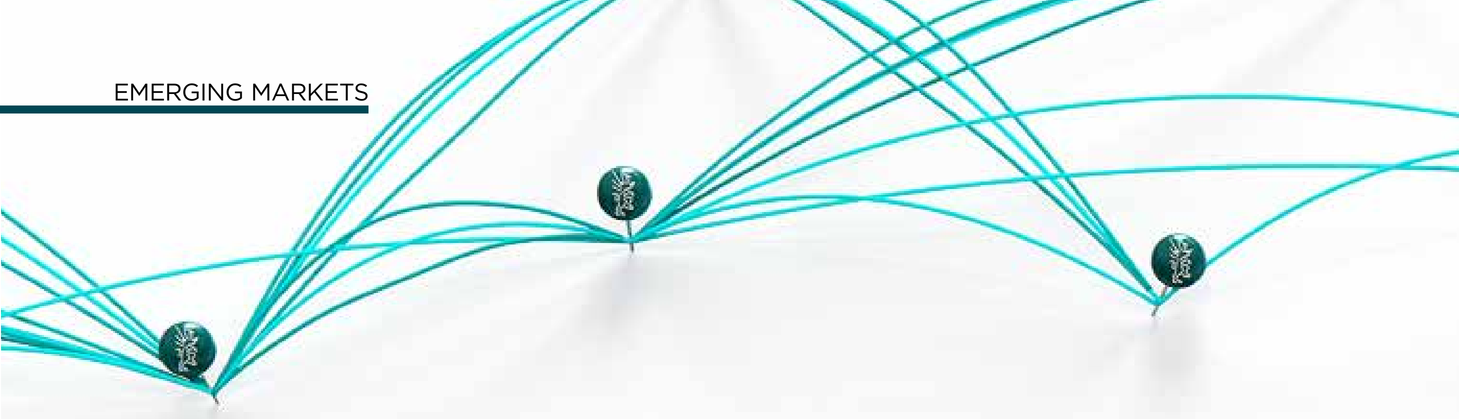
MAR 2017
Implementation of stage 1 of CMA remedies (APIs for branches, ATMs, personal and business current accounts, SME lending)

NOV 2017
Chancellor expands the scope of open banking

JAN 2018
PSD2 transposed into national law

JAN 2018
Implementation of stage 2 of CMA remedies (current account transactional data)

JAN 2018
NESTA Open-Up Challenge stage 2 applications open



CISI teams worldwide are working with emerging financial markets to promote professionalism in knowledge, skills and behaviour

NEIL JENSEN PETER CROWTHER

Building global standards

When the global economy tipped into crisis in 2008, the hopes of the world shifted to the so-called BRIC (Brazil, Russia, India and China) nations. One by one, the sustainability of these countries has been tested, but there can be little dispute that population and middle-class growth in places like India and China are creating a new dynamic and edging these countries into the mainstream. As the societies in emerging economies become more sophisticated, the growth of domestic financial markets and the desire to integrate with the broader economic community has become an imperative. Indeed, the interconnectedness of the global economy means that there is a degree of commitment to ensuring all parts of the network – emerging and developed – have the chance to prosper. If one domino falls, there are repercussions for many. This is where the work of the CISI in emerging markets comes into view.

The CISI has recognition for over 45 jurisdictions, including nations in Africa

The CISI started looking overseas some 15 years ago as part of its strategic review at that time, explains Simon Culhane, Chartered FCSI, chief executive officer of the Institute. "Many of our major banking customers were expanding their operations and wanted to ensure their international staff had the same high education standards as in the UK. We started our international strategy by focusing on the major hubs where our UK banks were growing, notably in places like India and Singapore. Once we were established, we worked with local and regional banks."

Today the Institute has formal links with many countries that could be viewed as 'emerging'. Kevin Moore, Chartered MCSI, CISI director of global business development, says: "We are talking about a group of countries across the world that are very different from each other, but they do have many things in common, such as a potential talent pool of exceptionally bright people who have an eagerness to learn, build their career and experience the international community," he says. "Part of our job is to assist them in achieving their aspirations."

The CISI helps to build a framework to enable this, which usually comprises two or more modules: one focused on the unique legal framework of the country while the others are more generic technical skills. This brings the essential knowledge needed to enhance the credibility and professionalism of the local market. The CISI has recognition for over 45 jurisdictions, including nations in Africa, the Middle East and Asia. "It's partly about raising standards," says Kevin. "One of the things that defines a country on an upward trajectory is the introduction of a professional and more competitive financial landscape. In order to achieve that, the workforce has to have the required skill set and awareness that will allow the country to enter the international financial market. Our examinations help to facilitate that process."

The CISI's offering covers risk and compliance, corporate finance, management and careers, capital markets, wealth management, wholesale, integrity

Going global

MALAN ALEXIS
INVESTMENT MANAGER, GROFIN MANAGERS, IVORY COAST

Malan is an investment manager with GroFin Managers, a fund manager focusing on the finance and business support of small and medium-sized enterprises (SMEs) in Africa. *Capital Finance International* magazine recently awarded the company a prize for SME Social Impact Finance, Africa.

Malan's role is to serve entrepreneurs in the SME sector with risk capital and business support, helping them to realise their full potential and achieve long-term success. "My daily activities require me to be familiar with financial analysis, business valuation and other topics in corporate finance, including regulatory aspects," says Malan.

He turned to the CISI when he decided to reinforce his academic background in finance, notably in corporate finance. "The CISI certificate was the best choice since I considered that the syllabus would help me make better informed recommendations around investments," he recalls.

Malan says that there is a big demand for training and expertise in finance in the Ivory Coast, particularly as Africa, as a continent, represents the next frontier. "Young people are aware of the possibilities of jobs with major international banks, so they need qualifications that can help them become more professional – the CISI can help them achieve that."

He recently passed unit 2 of the CISI Certificate in Corporate Finance (Corporate Finance Technical Foundations). "This allowed me to acquire essential knowledge for business valuation and choosing the best capital structure for private company financing," he says.

As in all frontier markets, regulation is of paramount importance in the Ivory Coast and Malan is currently self studying unit 1 of the CISI Certificate in Corporate Finance (Corporate Finance Regulation). "The CISI is the only institution that provides both technical and regulatory qualifications at the same time. These qualifications not only facilitate career progression, but also provide the confidence you need to interact with stakeholders across the business and financial community."

KAMUNYU NJOROGE ACSI
MANAGER, INVESTOR EDUCATION AND PUBLIC AWARENESS, CAPITAL MARKETS AUTHORITY, KENYA

Kamunyu is a manager for investor education and public awareness at the Capital Markets Authority (CMA) Kenya. He presided over the introduction of CISI certification in the Kenyan market, under the leadership of the CMA's CEO, Paul Muthaura.

"I have seen the programme grow from its inception, with the signing of a Memorandum of Understanding between the CMA and the CISI, to the domestication of the International Introduction to Securities and Investment to include Kenyan content and the development of Regulations and Market Practice, Kenya," says Kamunyu.

Kamunyu has also been instrumental in the development of a continuing professional development programme, which will be deployed by the CMA in 2018.

"I am excited that the CMA and the broader Kenyan capital markets have been able to achieve this very important milestone that will position Kenya as a premier investment destination by guaranteeing professionalism in service delivery," he adds.

The CISI provides Kenya with internationally recognised qualifications, which have been well received by most market practitioners."The CMA is leading the way in ensuring that its staff members undertake programmes of this type," says Kamunyu.

"I have taken and passed stage one (International Introduction to Securities and Investment, Kenya), stage two (Regulations and Market Practice, Kenya) and a third optional module, Global Securities."

Kamunyu is proud of his ACSI membership of the CISI. "The CISI programme in Kenya has had an immense influence on my career and I look forward to continuing that relationship."

> **“** The CISI programme in Kenya has had an immense influence on my career **”**

DUBAI
The CISI has partnered with the University of Dubai and its Center of Executive Development to provide internationally recognised financial qualifications to students. The university was the first educational institution in the UAE to partner with the CISI.

KUWAIT
The CISI has a contract with the Kuwait Capital Markets Authority to establish an integrated programme for securities practitioners in the local capital markets. The programme includes international and bespoke Kuwaiti qualifications in both English and Arabic.

NIGERIA
Working with the Chartered Institute of Stockbrokers of Nigeria, the CISI focuses on integrity and continuing professional development. This allows the members to keep up to date with sector developments, maintain regulatory compliance and demonstrate continuous learning.

KENYA
In 2014, the CISI signed a Memorandum of Understanding with the Kenyan Capital Markets Authority and CISI exams are now mandated as part of the Kenya Capital Markets Programme for Certification and Licensing. Around 600 people have engaged with the CISI through this programme.

SOUTH AFRICA
The CISI has a special relationship with the University of Johannesburg, underlined by the signing of a Memorandum of Understanding for cooperation. The partnership allows some of the CISI’s international vocational qualifications to be built into undergraduate programmes at the university.

INDIA

The CISI has had a presence in India for ten years, offering examinations at Christ University and Jain University in Bangalore. In 2016, over 2,000 exams were taken in the country.

CHINA

The CISI has a partnership with Qingdao to introduce wealth management exams in the city, with the Shanghai University of Finance and Economics providing face-to-face training. The Institute hopes to have 300 people taking its examinations in 2018.

PHILIPPINES

The CISI has been mandated to provide financial literacy courses and exams in colleges and universities across the Philippines.

SRI LANKA

The CISI's exams have been taken by over 5,000 students in Sri Lanka, thanks to a partnership deal with the University of Sri Jayewardenepura, one of Sri Lanka's largest state-owned universities, to promote recognised professional qualifications.

FAROUK ABDULLAH ALWYNI ACSI
CEO, ALWYNI INTERNATIONAL CONSULTING, INDONESIA

Farouk is an Islamic finance practitioner and a lecturer based in Kuala Lumpar. He spent most of his Islamic finance career in the Jeddah-based Islamic Development Bank Headquarters, handling trade finance operations in many Asian and Commonwealth of Independent States countries.

"As a CISI-accredited training partner, I am compelled to keep updating my areas of expertise," he says. "But I am happy to share my financial experience and knowledge with other professionals through the CISI platform, preparing them to pass their own CISI exams."

Indonesia is going through a period of change. "The current trends in Indonesia are the

YERNUR RYSMAGAMBETOV
HEAD OF THE BUREAU OF CONTINUING PROFESSIONAL DEVELOPMENT, ASTANA INTERNATIONAL FINANCIAL CENTRE, KAZAKHSTAN

Kazakhstan is a rising economy, highly dependent on the oil industry and contributing around 50% of the GDP of central Asia.

Yernur stresses the importance of having access to CISI qualifications in an ambitious and focused environment. Employees at the Astana International Financial Centre, for example, have an average age of just over 32 and a large percentage are studying, including undertaking CISI examinations.

"There is limited trust in local qualifications, so not only do we have the CISI structure, but in Kazakhstan we are also drawing on the experience of the UK legal system. We are also forming partnerships across Europe, Asia and the US, such as our stock exchange link up with Nasdaq and the Shanghai exchange," says Yernur, who has worked with JPMorgan Chase in New York and Wilshire Associates in California, and studied in London.

These external partnerships have been encouraged at the highest level and are a signal of the determination in the country to elevate the economy and make Kazakhstan a destination of choice for investors. "We are also developing a regulatory environment based on the principles of English common law, with some features similar to the FCA, in order to send the right messages to the global community," says Yernur.

Kazakhstan, in the short term, will embark on a privatisation programme (70% of the economy is state-run) and, in the medium term, many people expect the country to benefit from China's 'Silk Road' initiative, which will create trade links between Asia and Europe. For the longer term, Kazakhstan is expected to become a regional financial services hub, especially as it has some of the lowest labour costs in the world.

development of infrastructure and the growth of ecommerce. The Indonesia National Development Planning Agency estimates that, up until 2019, the country will need around $350bn to meet its infrastructure development target," says Farouk.

This is all happening against a backdrop of regulatory change. The central bank has issued regulations pertaining to fintech, requiring all service providers to register their business.

The OJK, Indonesia's financial service authority, wants to strike a balance between growth and customer protection.

This makes for an exciting environment for young professionals, particularly for those who possess the entrepreneurial spirit.

"Financial technology helps them market their products and removes the need for them to be highly extroverted or to be a sales person," Farouk says.

He sees Indonesia as a dynamic economy, citing a prediction from eCommerce consultancy PFS that "Indonesia could be one of the fastest-growing markets in Asia Pacific in 2018, with transaction values reaching $11bn.

"I hope that I can harness my training and consulting business to good effect," Farouk concludes.

AUNG THEIN TUN
CHARTERED MCSI, DIRECTOR, INSTITUTE OF BUSINESS AND INVESTMENT MANAGEMENT, MYANMAR

Aung is from Myanmar, where the financial services sector is growing steadily. Until 2015, there wasn't a stock exchange in Myanmar, although the Securities Exchange Law was enacted in 2013. "The capital markets in Myanmar are at a very young stage," says Aung. "The launch of the Yangon Stock Exchange (YSX), and development of financial services, encourages young people to get into the sector."

He admits that the sector needs local qualified professionals and investor education to enable the capital markets to perform well, alongside well defined sector standards.

Aung is the first CISI trainer in Myanmar and is a director of the Institute of Business and Investment Management, which is an active CISI-accredited training partner. "Studying CISI qualifications helped our students to get into the sector quickly when the capital market was launched, and some of them played a key role in newly established stockbrokers in Myanmar."

The quality of CISI training has impressed sector regulators, participants and students. The CISI has gained a strong reputation within a relatively short time frame. According to a survey conducted among securities companies and YSX, 57% of job applications are from candidates with CISI qualifications. On average, 42.5% of total employees are CISI qualification holders in those companies.

Aung says: "Learning CISI qualifications helps the younger generation to get into the sector in a quick and practical way, while helping the country's capacity for development."

and ethics, operations, fintech and financial planning. Over 400 specialists contribute to exam panels, review workbooks, write items and refine elearning offerings. It has taken the CISI 25 years to get to this stage of its development.

WORKING WITH DOMESTIC AUTHORITIES

While there is considerable enthusiasm from aspiring professionals in developing economies, the Institute does encounter hurdles in taking that expertise to the domestic authorities. “Understandably, there is sometimes resistance to a ‘foreign’ solution,” says Kevin. “However, when people see that collaboration is the order of the day, and that the CISI relies on local training businesses and works with local institutions, relationships become much warmer. Being a not-for profit organisation helps as well – making it easier to build relationships with regulators and other official bodies.”

Simon underlines that the CISI is well equipped to deal with the problems it may come across in these markets. “Issues involving integrity and professionalism are global and are certainly not limited to emerging markets. A major part of our work involves tackling these problems head on. People know that building trust is critical, and they are keen to work with us. We are, effectively, the only professional body in the world that requires its members to take and pass an integrity test before being accepted for membership.”

Helena Green, Chartered MCSI, CISI assistant director of strategy, says that the Institute leads the way in driving this educational process and also in working with regulators and partners over the past few years. “We always aim to collaborate rather than compete with local partners.”

SUCCESS IN KENYA

One very tangible case study that highlights how the CISI works with local bodies to help establish momentum and provide expertise along the way is in Kenya, where it has partnered with the Capital Markets Authority (CMA).

Kevin says: “Kenya wants to increase access to raising long-term financing through the capital markets and wants to make the country the investment destination of choice. The CMA’s willingness to work with us and encourage people to take our exams is a strong sign of the energy in Kenya. They have a great chance to steer away from some of the problems we’ve seen in more mature markets.”

The relationship with the CMA in Kenya has been a success story; an opinion shared by its chief executive, Paul Muthaura. “Kenya, at 80%, has one of the highest pass rates for the Introduction to Securities and Investments, a certification that is one of the initiatives under the Memorandum of Understanding we have with the CISI,” says Paul.

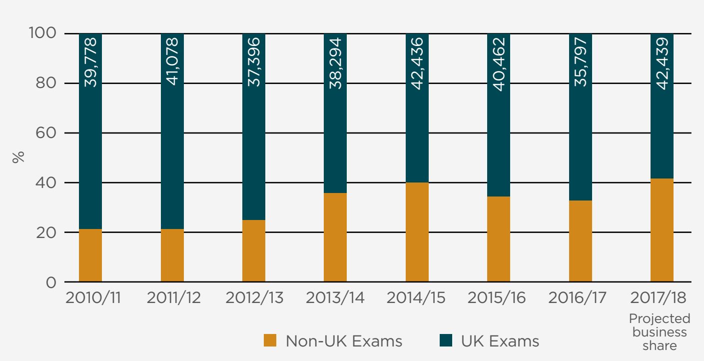
He adds that the capital markets sector in Kenya has strongly supported the introduction of international certification standards in tandem with the launch of more diversified products, with the aim of making Kenya a competitive and attractive destination for international fund flows. “This is complemented by ongoing efforts to introduce CISI certification standards within the wider East African community, built on a recognition that capital markets are increasingly operating across different sectors,” says Paul.

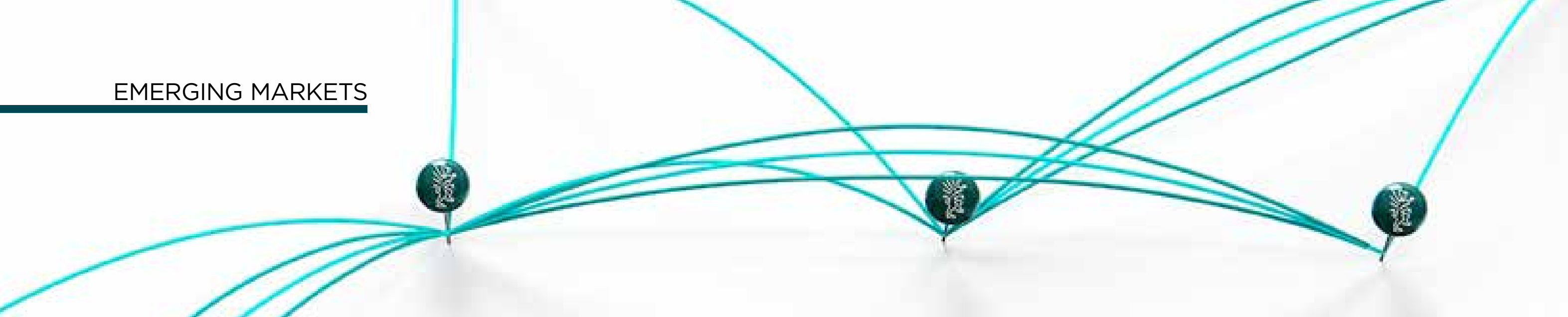
“People know building trust is critical, and they are keen to work with us”

He is upbeat about what this means for the financial services community in Kenya. “It is envisaged that the certification programme will create a highly skilled talent pool in line with the Capital Market Master Plan and Vision 2030 national ambition for the country to become a regional and international finance centre,” he says.

Simon believes that emerging markets can show a new way forward as well as adopting legacy processes. “It would be a mistake to see the traditional markets as always the leaders in terms of trends. Just consider the September 2017 McKinsey report, *Mobile financial services in Africa: winning the battle for the customer*, which describes Africa as the global leader in mobile money. In some areas, you have emerging markets ahead of traditional markets, largely due to the fintech revolution.”

CISI EXAM NUMBERS





The pace of change in the global economy and the way that technology is influencing that transformation means that the CISI has to reach out to potential young professionals as well as those already working in the sector. It has been successfully linking up with business schools and universities, notably in China and India.

FRUITFUL PARTNERSHIPS

The CISI has partnered with the Shanghai University for Finance and Economics (SUFE) to drive an initiative to establish a wealth management hub in the Chinese city of Qingdao, a growing centre of some ten million people. SUFE will lead the courses, with prospective candidates and a pilot group of 30 students completing their training in January. With full and active support from the regional government and the UK Foreign Office, there are hopes for at least 300 people to take the examination in 2018. “Our qualification’s broad focus on wealth and investment makes it suitable for a wide audience, from new entrants to financial services to professionals already working in the sector who may be interested in diversifying,” says Hayley Brown, Chartered MCSI, CISI senior international manager in London, who is coordinating the project.

Lynn Xie, executive director at the Center of International Professional Qualification at SUFE, echoes that sentiment, adding: “The qualification provides a pathway to learn advanced wealth management concepts as well as skills and behaviour to help promote professionalism in the sector.” This is highly appreciated by the Qingdao government, which introduced SUFE to the CISI and subsequently offered to subsidise the programme, dependent on results. “They also encouraged the programme partners to cooperate with each other and let the market test the content to see if practitioners will take to it,” says Lynn.

“I am always struck by the desire for learning that you see in these markets”

Simon adds: “Our work in China provides a perfect example of how the CISI operates as it is based on collaboration, blending our own expertise with local knowledge. In this case, we are delighted to be working with the full support of the municipal government of Qingdao.”

Lynn notes enthusiasm for the course in China: “Young people in China are eager to take examinations and it is therefore relatively easy to reach out to professionals from banks, securities firms, fund managers and investment companies.”

It’s a similar story in India, where the CISI has partnered with Christ University in Bangalore.

One very important element in the relationship is the CISI’s Integrity at Work workshop, which focuses on the challenges posed by real-life ethical dilemmas relevant to the financial services professions. There’s great enthusiasm for the examinations in India, where CISI has been present for 11 years. The link-up with Christ University has proved to be successful, and in 2017, over 300 students took the CISI International Introduction to Securities and Investment exam, all securing, at least, a 70% pass rate.

There’s comparable traction in the Middle East, where financial services professionals took 4,190 examinations in 2016–17 – an increase of around 32% since 2010–11, when 3,171 examinations were taken. The forecast for the year ending March 2018 is 4,300 – a further 3% increase. The CISI set up an office in Dubai to work with its strategic partner, the Emirates Commodities Authority, but since its establishment, the CISI now works with most of the regulators across the region.

Matthew Cowan, Chartered MCSI, CISI regional director for the Middle East, India and Sri Lanka, says the Middle East is the fastest growing area in financial services worldwide. There’s also a big appetite for fintechs, which underlines that change is being embraced. “Regulatory qualification regimes are a relatively new introduction to the Middle East finance sector and unlike markets such as the UK, there is no continuing professional development culture. As these markets develop away from frontier status, professionalising the industry becomes a higher priority,” he says.

The CISI’s task is clear, he adds. “As part of our vision, we aim to shape the future of the financial sector by working with educational institutions to train the students to become the next generation of finance professionals.”

A KEY CONTRIBUTION

Simon is naturally proud of the CISI’s role in adding significant value to emerging markets. As well as providing a qualification framework that introduces a ready-made structure for regulators, the CISI works closely with the academic community and helps people working in financial services gain the knowledge necessary to work in a frontier market. Simon says: “I am always struck by the desire for learning that you see in these markets. I think people there see a more direct link between their education and their future. But our work is not simply about benchmarking standards; it is also about providing consumer protection in markets where savings and pensions are still growing, but where knowledge and understanding associated risks are often limited. Across all disciplines, we are making a key contribution to market evolution.” ●

Find out what you can learn from Africa’s mobile banking revolution at cisi.org/mobilebanking

BIG DATA DREAMS

Chinese companies outside the financial services sector have been buying overseas banks. What is the motivation behind these eye-catching acquisitions?

DAVID ROBINSON

In September 2017, Legend Holdings paid $1.8bn for a 90% stake in Banque Internationale à Luxembourg (BIL). It will be the largest takeover of a European financial institution by a Chinese company once the deal is completed. The acquisition follows hot on the heels of Geely's purchase in May 2017 of almost one-third of Denmark's Saxo Bank.

In May 2017, HNA Group raised its stake in Deutsche Bank to nearly 10% – making the Chinese conglomerate the biggest single investor in the German banking giant – and Fosun International has increased its holding in Portuguese bank Millennium BCP to 25%.

Chinese interests have been snapping up a variety of foreign assets in recent years, but these deals represent a new phenomenon: Chinese companies outside the financial services sector acquiring overseas banks.

An investment holding company, Legend operates in a host of other sectors, including technology. Its subsidiaries include Lenovo, the world's biggest personal computer maker. Geely owns Swedish carmaker Volvo. Fosun, another investment holding company, owns Wolverhampton Wanderers football club and has a stake in Cirque du Soleil; and HNA began life as a two-jet regional airline.

What is the motivation for these eye-catching acquisitions and why are they happening now?

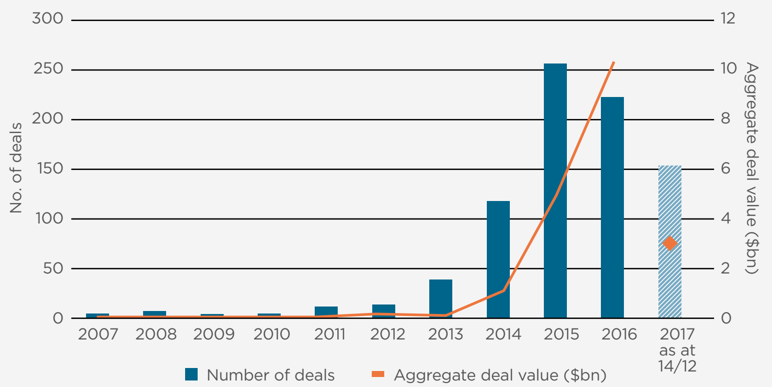
THE FINTECH BOOM

"This trend needs to be seen in the context of the fintech boom in China," says James Kynge, emerging markets editor at the *Financial Times* and author of *China shakes the world*. "It is shaping a lot of the bets on the future of the Chinese economy."

Internet-enabled technologies have been disrupting traditional banking around the world, but the far-reaching changes that innovations such as predictive analytics, peer-to-peer lending and big data represent to the financial services sector are particularly apparent in the world's most populous nation.

The value of venture capital-backed fintech deals in China surged from $4.7bn in 2015 to $10.1bn in 2016, according to data organisation Preqin. The value of venture capital-backed fintech deals in the US in 2016 was $6.1bn (down from $9.9bn in 2015).

VENTURE CAPITAL-BACKED FINTECH DEALS IN CHINA



Source: Preqin

Driving this growth is the world's largest and most developed ecommerce market, accounting for 47% of global digital retail sales, according to research company eMarketer.

According to management consultant McKinsey, 68% of China's internet users made mobile payments in 2016, amounting to a total value of $790bn – 11 times that of the US.

China's three internet giants have been creating all-encompassing platforms

This rapid uptake has been spurred by a huge digital-savvy population in a closed digital economy. The government's 'great firewall' around the internet not only restricts information, it also helps protect Chinese firms from international competition, allowing the leading domestic tech companies to adopt the latest innovations and corner huge swathes of the domestic market.

China's three giant internet companies (Baidu, Alibaba and Tencent) have been aggressively creating all-encompassing platforms – such as Tencent's WeChat app and Alibaba's mobile wallet Alipay – to embed their services into every aspect of customers' lives.

"The average consumer in China makes most of their purchases throughout the day – from visiting a convenience store to hiring a taxi to seeing a doctor – via direct transfers on their smartphone," says Benjamin Cavender, a Shanghai-based analyst at the China Market Research Group. "People do not really use cash any more."

Baidu, Alibaba and Tencent have invested heavily in emerging technologies – such as blockchain and artificial intelligence – to support the development of financial services.

Alibaba's fintech affiliate Ant Financial – which provides online banking, fund management and other financial services – has been valued at more than $70bn and controls more than half of China's fast-growing $5.5tn mobile payments market. Tencent's investments, meanwhile, include online lenders, investment banks and payment systems.

Fintech revenues – including insuretech premiums – in China are set to grow a whopping 39% year-on-year and hit $75bn by 2019, according to estimates by Bernstein Research, which predicts soaring growth in online payment systems.

"Chinese consumers have few reservations about sharing personal information and are ready to embrace fintech offerings, creating opportunities for fintech firms and incumbents willing to take on digital transformation," writes accountancy firm EY in *The rise of fintech in China* – a report compiled with DBS Bank.

Technology platforms that can provide financial services are hot property in China and it is therefore not surprising that Chinese conglomerates such as Geely and Legend are snapping up fintech-supporting lenders like Saxo and BIL, which have a background in digital start-ups.

"Fintech is going to be huge in China and an important part of that will be the application of fintech in industry," says Jue Wang, a China specialist at think tank Chatham House.

GOVERNMENT AMBITIONS

The mechanics of the levers of power in China's one-party system are not always transparent, but it is likely that Geely and Legend's acquisitions have, to an extent, been influenced by the Chinese Government's industrial strategy.

About 30% of Legend is owned by the Chinese Academy of Sciences, a state institution.

The country's economic rise has been built on low-end manufacturing, but as wages rise and competition from other Asian countries increases, the Beijing Government has set out a plan – Made in China 2025 – to reboot the economy towards innovative higher value, advanced manufacturing led by automation, robotics, big data and cloud computing.

"China operates like no major economy elsewhere in the world in that industrial policy is set to the nth degree by government," says the *FT*'s James. The big-picture goal is to become a world leader in cutting-edge manufacturing – and fintech has a big role to play in executing this plan.

In order to flourish in China, a company must stay on the right side of the government. "By buying overseas companies that directly support China's attempts to become the world's most innovative manufacturing country, they are effectively scoring brownie points with the Communist Party," James says.

UNLOCKING DIGITAL PAYMENTS

Big data has the potential to overhaul every area of industry. The internet of things – the interconnection of everyday objects via the web – could allow companies to harvest huge amounts of data on individual customers, allowing them to cross-sell whole suites of tailored, personalised products and services.

"The average consumer in China makes most of their purchases via their smartphones"

The proactive use of big data is likely to be central to Geely and Legend's long-term strategies for Saxo Bank and BIL, analysts say.

Fintech could, for example, help Geely offer digital auto loans on Volvo cars on an unsecured basis by using algorithms to predict which customers might default, significantly reducing delinquencies. It could also apply big data to car insurance premiums to predict who might miss payments or make claims.

As for Legend, which manufactures Lenovo smartphones, fintech could potentially help it launch its own mobile payments platform via further tie-ups.

"It's quite possible a mobile phone manufacturer – like Lenovo – could move downstream into online payments," says James. "The digital payments market is dominated by the big internet giants, but there are still lots of smaller payments companies it could acquire."

It is unlikely that the acquired European lenders will be able to establish Chinese banking operations as part of these deals. The typical Chinese model is to take the technology back to China, but not necessarily use the acquired foreign asset as an operating company. However, additional tie-ups may develop as a result. Following Fosun's acquisition, Millennium BCP signed an agreement in November to develop business ties with Chinese electronic payments clearing system UnionPay.

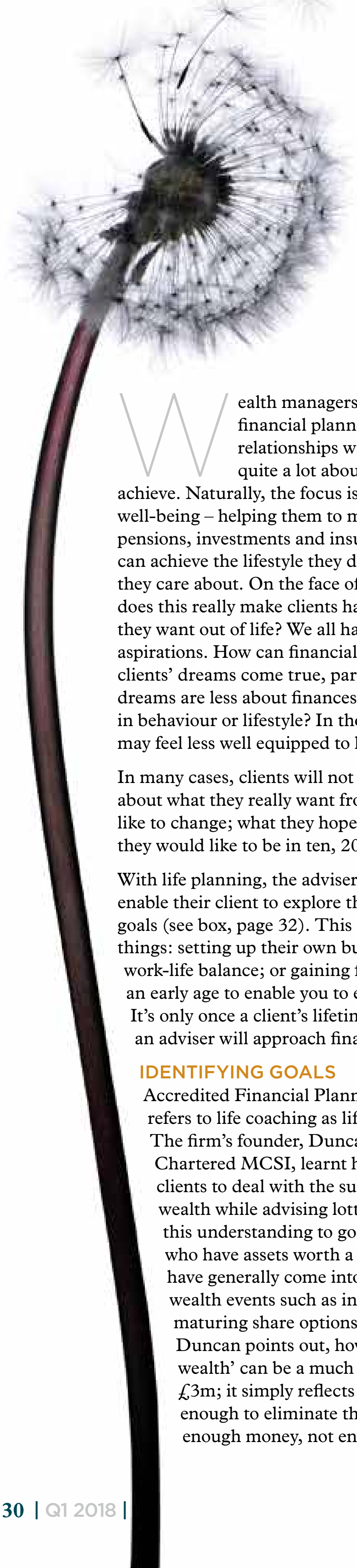
"Chinese consumers have few reservations about sharing personal information"

HNA, meanwhile, may have additional motivations for raising its stake in Deutsche Bank. The conglomerate's debt-fuelled recent acquisition spree – which includes hotels, golf clubs, cruise lines and logistics groups – has left it struggling to secure domestic credit and made foreign lenders wary. The Deutsche Bank stake may be an effort to address this problem. It is, however, a side issue to China's central ambition: to become the most innovative manufacturing country in the world.

ACQUISITIONS OF OVERSEAS FINANCIAL SERVICES COMPANIES BY NON-FINANCIAL SERVICES CHINESE FIRMS: MOST RECENT TOP TEN DEALS BY VALUE

Target	Target nation	Acquirer	Acquirer macro industry	Deal value ($m)	Date announced	Status
Banque Internationale à Luxembourg	Luxembourg	Beyond Leap (parent company: Legend Holdings Corp)	Financials (parent company: investment holdings)	1,768.082	September 2017	Pending
UDC Finance	New Zealand	HNA Group Co	Industrials	461.274	January 2017	Pending
Banco Comercial Portugues SA	Portugal	Chiado (Luxembourg) SARL (parent company: Fosun Interntional Hldgs)	Financials (parent company: investment holdings)	195.007	July 2016	Completed
Sheng Xin Holdings Pte	Singapore	Singapore Dasin Coml Hldg Pte (parent company: Dasin Retail Trust)	Real estate	177.675	January 2017	Completed
Project Bond Holdco	United Kingdom	Project Quartz Bidco	Materials	128.099	February 2017	Completed
Guide Investimentos SA	Brazil	Fosun Property Holdings	Real estate	93.470	September 2017	Pending
Felio Malta	Malta	Shanghai Feilo Acoustics Co	Telecommunications	41.062	December 2017	Completed
Starlight Legend Invest	United States	Starlight Culture Ent Grp	Media and entertainment	25.459	September 2017	Pending
Atlantic Gateway SGPS Lda	Portugal	Hainan Airlines Holding Co	Industrials	21.151	September 2017	Pending
Vado Investment BV	Netherlands	Qingdao Port International Co	Industrials	19.153	October 2016	Pending

Source: Thomson Reuters (data accurate as at 5 January 2018)



A PLAN FOR LIFE

Helping a client to identify and meet their life goals can win financial planners much more than a loyal client, it can win them a true ambassador

JILL INSLEY ISTOCK

Wealth managers, financial advisers and financial planners have good relationships with their clients and know quite a lot about what they want to achieve. Naturally, the focus is on their clients' financial well-being – helping them to manage some or all of their pensions, investments and insurance needs so that they can achieve the lifestyle they desire and protect those they care about. On the face of it, this looks fine. But does this really make clients happy and get them what they want out of life? We all have dreams and aspirations. How can financial planners make their clients' dreams come true, particularly when those dreams are less about finances and more about changes in behaviour or lifestyle? In those instances, planners may feel less well equipped to help.

In many cases, clients will not have thought in depth about what they really want from life: what they would like to change; what they hope to achieve; and where they would like to be in ten, 20, 30 or 40 years' time.

With life planning, the adviser uses life coaching to enable their client to explore their non-financial lifetime goals (see box, page 32). This could include many things: setting up their own business; achieving a good work-life balance; or gaining financial independence at an early age to enable you to enjoy more time travelling. It's only once a client's lifetime goals are identified that an adviser will approach financial planning or advice.

IDENTIFYING GOALS

Accredited Financial Planning Firm™ Wealthflow refers to life coaching as life transition coaching. The firm's founder, Duncan Glassey CFP™ Chartered MCSI, learnt how difficult it can be for clients to deal with the sudden acquisition of huge wealth while advising lottery winners. He has put this understanding to good use with his clients, who have assets worth a minimum of £3m and have generally come into money through sudden wealth events such as inheritance, divorce, maturing share options or selling a business. Duncan points out, however, that 'sudden wealth' can be a much smaller amount than £3m; it simply reflects a sum of money large enough to eliminate the age old excuse of 'not enough money, not enough time'.

New clients are encouraged to meet Wealthflow's life transition coach, Moa Diseborn, who is internationally certified by the International Coach Federation. They can meet individually and with their partners or spouses, to discuss their lives and what they want to achieve.

Wealthflow offers this type of coaching alongside investment management and financial planning services. These latter services can often involve a client making significant changes in their life, such as taking on new investments or introducing new savings habits. Through life transition coaching, Moa helps clients to identify their values and life intentions and use these as a compass by which to make decisions and follow new directions. Typical questions that Moa might ask include: "What would be important for me to know about you?" and "What's the worst thing about your current situation?" The responses help Moa to establish what is truly important to a client as, psychologically, our fears and worries are a reflection of this, Moa explains.

In many cases, clients will not have thought in depth about what they really want from life

During the conversation, Moa will adjust her demeanour to one that suits the client and the nature of the conversation. Coaching the parents of a disabled child receiving a substantial medical negligence settlement might require her to take a more gentle and sensitive approach than she would when coaching an entrepreneur selling their business for tens of millions of pounds.

This process allows clients to identify areas that they may choose to further develop, says Duncan. Ambitions range from writing a book to singing in a choir to being politically active. Most people excuse themselves from significant life change through lack of time or money, but following receipt of a significant capital sum, they have the funds to allow them more control over their time.

Moa does not give financial advice. Instead, she encourages clients to talk about themselves. "Most people are uncomfortable about doing this to start with," she says. "I assure them that they have the answers and that I am there just to support them in that process. The sessions are confidential – I do not pass on the results to Duncan unless the client asks me to do so."

Once life transition coaching has helped the client identify their goals, Duncan creates a financial plan for them, carrying out detailed cashflow analysis stretching over several decades to ensure the client's capital will support their planned expenditure.

TARGETING NEW CLIENTS

Duncan and Moa also use life planning techniques to help families and individuals who have special care needs as a result of medical negligence or catastrophic injury. Cashflow modelling is particularly helpful for family members who are scared that a compensation award may run out. "We can show them that it is OK to buy an electric wheelchair or take that much-needed holiday as a family," Duncan says.

One child – Kieran (not his real name) – received a £6m settlement after medical negligence left him with severe cerebral palsy. He is wheelchair bound with no upper body control and requires extensive support.

Duncan says: "Although Kieran's parents had anticipated the financial settlement, the receipt of the funds shocked them. They felt unprepared and didn't know where to begin. Our initial advice was to take some time, recover from the legal proceedings and not make any rushed decisions."

Life and financial planning spilled over into the parents' lives because of a very fine line between family life and Kieran's life needs. Duncan says: "It can be difficult to separate, although necessary from a financial management perspective, as the money received is to support Kieran and not other family members."

Moa supported the parents with career changes, early retirement and the establishment of a new business selling support aid for families with specialist care needs. She also helped address the emotional impact of having professional carers within the family home, and the potentially negative impact on family life and privacy.

The real value that Moa was able to bring was to help Kieran's parents isolate what they really wanted emotionally. Often, when faced with a problem, clients will try to solve it too quickly, but fears and doubts will blind them to the best solution. Moa helped Kieran's parents to identify that, as their son faced the prospect of full-time care, they feared the loss of privacy in their own home. Importantly, as Moa is not able to offer financial advice, she could divorce money considerations from the conversation and this enabled Kieran's parents to identify their true fears and goals.

Kieran's money was invested in a globally diversified portfolio, with 30% in growth assets and 70% in defensive assets, the investment objective being to outperform inflation, net of charges. The combination of life and financial planning enabled the family to construct a new purpose-built home with a hydrotherapy pool and sensory room, confident they were doing

HOWARD AND DIANE'S STORY

Howard, a civil servant, and his wife Diane, a primary school teacher (not their real names), led active lives raising their three children. Things changed suddenly and dramatically when Howard was involved in a road traffic accident. He had been cycling, was hit by a car and suffered catastrophic injuries. When Duncan Glassey CFP™ Chartered MCSI, of Wealthflow, and life coach Moa Diseborn first met Howard, his legal case for compensation had completed and he had received a settlement sum of £7.5m.

The impact of the accident on their lives, physically and emotionally, led Howard and Diane to participate in Wealthflow's Life Transitions Coaching service. Until then, Diane, in her role as wife and parent, was taking on the responsibility of ensuring their lives ran smoothly. The pressures on her were, and still are, substantial. She lacked the confidence to make time for herself – something that Howard was aware of and wanted to support her to do.

Receiving one-to-one support from Moa helped Diane to relax and create more space for her own life. This led to Howard relaxing, less fearful of the impact the daily stresses were having on his wife. Since working with Moa, Howard and Diane have gained renewed strength and confidence from which the whole family has benefitted.

From the outset it was clear Howard and Diane's financial planning goals were linked to their family life. Their priority was to regain as much as possible of the lifestyle they had prior to the accident. They knew they would need to make changes to their physical surroundings immediately with the purchase of an adapted car, indoor and outdoor wheelchairs and extensive home adaptations. What they didn't know is whether they could afford to do so while maintaining a substantial portion of the settlement to provide for Howard's long-term care.

Establishing a flexible lifetime spending plan is one of the most important parts of the financial planning process. It gave Howard and Diane the opportunity to determine whether their initial spending plans were realistic and, long term, helped them to establish a level of care costs that were achievable while providing the help Howard needs.

As a C6/7 tetraplegic, Howard needs extensive personal care and, as a couple, they agreed Diane would not take on the role of primary caregiver. Howard established and runs a care management plan, employing professional care workers and specialist therapists, the funding of which is facilitated by drawing a regular monthly sum from the settlement funds to cover all associated costs.

"The relationship we have with Duncan and Moa is very important to us," says Diane. "We know our finances are being taken care of but more than that, we feel supported. The life coaching isn't something we would have considered before but it has helped us enormously and has given us reassurance about our family's future."

the right thing for Kieran now while ensuring sufficient capital remained to provide continued support throughout his lifetime. The original court reports suggest Kieran might survive until the age of 45, but his parents hope that these facilities will make him happier and potentially extend his life.

Through life transition coaching, Moa provided Kieran's parents with the space and support to think through what their son really needed from this new building and reach their own conclusions, free of financial considerations. While a financial planner could help them to enact their plans, they couldn't help to formulate the right plans to meet their emotional and life needs.

THE IMPORTANCE OF LISTENING

Chris Budd ACSI, founder of Bristol-based independent financial adviser Ovation Finance, qualified as a business coach with the European Mentoring and Coaching Council. He says the skills he has learnt in that role are equally useful for life planning. He uses them to engage in regular, structured conversations with his clients to help them identify their objectives. It also helps to enhance their awareness, skills and behaviour.

He took three sessions of business coaching himself, which changed his life. "It gave me time to think and talk about myself for the first time," he says. "I realised I was depressed and that the thing I wasn't doing, and that was important to me, was writing novels."

Chris started taking Wednesdays off to write, and his depression lifted within six months. He has now completed three books. Coaching skills are now embedded into Ovation's advice model, with all of its advisers trained in business coaching to some degree.

Life coaching is groundbreaking for clients, but it is transformational for their advisers too

One of Chris's techniques in an initial meeting with a client is to keep quiet. "Even when the client is not talking, I will not say anything. I sit there and smile encouragingly. Initially people say what they think you want to hear. But if you keep quiet, their real thoughts and desires start to emerge."

Chris then asks: "If that happens, what will happen then?" This makes the client challenge their assumptions about what they want to achieve. He cites the example of one couple who thought that because they liked going to London to see art, they should buy a flat in the capital and invest in art of their own. When Chris asked what would happen then, they realised their ambition would result in them having to look at the same paintings every day. Instead they decided to spend money on city breaks to visit galleries around the world.

LEARNING LIFE PLANNING

Tony McMenamin, a financial life planner with Serenity Financial Planning in Burley in Wharfedale, West Yorkshire, has worked in the finance sector since 1995, previously for a fund management company, a life and pensions provider and an investment platform. He is now at the beginning of his life planning career, having completed a life planning course at the Kinder Institute. The Institute provides workshops, intensive training and consulting services to financial advisers worldwide.

While many clients who are attracted to life planning are in their mid to late middle age and beginning to wonder if there should be more to life, some of Tony's clients are younger. "A professional couple in their 30s came to see me because they had just moved in together and had a spare property that they were renting out. The initial reason for the meeting was to sort out their finances, but as we talked it came out that they wanted to start a family and they were on the second course of IVF."

The couple felt uncomfortable discussing these difficulties with friends and family, but found it easy to bring them up as part of a life planning meeting. Tony enabled them to talk about what they would do if the IVF treatment was unsuccessful, and this gave them insight into what each thought about this.

"Neither of them had discussed this in detail before, but we discovered that if the IVF didn't work this time, they would prefer to adopt two children or become foster parents. They both found out things about their partner's views that wouldn't have been discussed in the detail that we covered, or at all, in their busy day-to-day lives," says Tony. Life planning has given them a clear path to follow and they are confident that the decisions they may have to make in the future are right for both of them.

Life coaching as part of the financial planning process is clearly groundbreaking for clients, but it is also transformational for their advisers too. Neither Duncan nor Chris have lost a life-planning client yet.

Chris says: "If you sell someone a product, you have a client for a short period. If you give them planning around their objectives, you have a loyal client. But if you provide life coaching so they can plan a future they didn't think possible, you have an ambassador."

THE DIFFERENCE BETWEEN LIFE PLANNING AND LIFE COACHING

Life planning: The Kinder Institute of Life planning defines life planning as a process that "connects the dots between our financial realities and lives we long to live".

Life coaching: According to the Life Coach Directory, life coaching helps an individual to make, meet and exceed his or her personal and professional goals. This could include excelling in the workplace or being happy and fulfilled at home. Life coaches help their clients to confidently face difficult situations and push past emotional barriers. They will never tell a client what to do. Instead, they will give clients the tools to help themselves.

The implications of GDPR for financial services firms

The new regulation will come into force on 25 May 2018. All firms should be assessing their interactions with customers' personal data now

RITCHIE BANN GETTY/ANDREW BAKER

Many a regulatory acronym has landed on the financial services sector in recent years, but complying with the General Data Protection Regulation (GDPR) promises to be one of the most exacting undertakings of all. And the clock is ticking.

GDPR, which comes into force on 25 May 2018, is all about giving individuals control of their data. The new rules apply to all companies across the EU – and potentially beyond – that process personal data, but financial services firms will be especially affected as they hold so much highly confidential customer information.

And data is very often the cornerstone of their service, enabling them to offer tailored products to their customers based on recent purchases or financial history.

"GDPR has upped the ante for financial services firms," says Oliver Bray, a partner at law firm RPC.

WHAT GDPR CHANGES

Under GDPR, individuals will be able to control how their data is used, know where it is stored and have a right to transfer or, in some circumstances, erase it. In instances of misuse, individuals will have increased rights to legal recourse alongside existing rights to claim compensation.

"Data portability is one of the big GDPR issues," says Oliver, who is also chairman of the City of London Law Society's Commercial Law Committee. "Firms will need to ensure individuals can take their data from one bank and plug it into another bank without fuss.

GDPR, DPA, PECR AND ePRIVACY EXPLAINED

	1998 Data Protection Act	2016 General Data Protection Regulation	2003 Privacy and Electronic Communications Regulation	2017 ePrivacy Regulation
How does it define personal data?	Information that relates to an identifiable individual and is processed, wholly or partly, by automatic means or by non-automated processing within a filing system	Extends the range of information covered by the DPA to include genetic and biometric data, as well as online identifiers such as IP addresses	Same as DPA	Same as GDPR
How does it benefit individuals?	Individuals benefit from controls imposed on how their personal data is used by data controllers. Controllers must adhere to the 'data protection principles' which are detailed in the DPA. For a list of the principles, visit: *ico.org.uk/for-organisations/guide-to-data-protection/data-protection-principles/*	Individuals will be able to control how their data is used, know where it is stored and have a right to transfer or, in some circumstances, erase it. In instances of misuse, individuals will have increased rights to legal recourse alongside existing rights to claim compensation	Individuals are given specific privacy rights in relation to electronic communications, including marketing communications, and in relation to the use of cookies	Individuals will enjoy sufficient protection against unauthorised access or alteration to electronic communications data and confidential and safe transmission
How does it affect companies?	Companies may only process data in accordance with the 'data protection principles', and must allow individuals to exercise certain rights over their personal data	Companies that process personal data must have robust policies and procedures in place to comply, and demonstrate compliance, with the GDPR from 25 May 2018. Processing must only be performed with the appropriate consent or in reliance on another legal basis. Companies must have policies in place to allow data subjects to exercise their rights under GDPR. Both data controllers and data processors are subject to the GDPR, though the obligations on processors are more limited	Companies must ensure they have the necessary consents to electronic direct marketing. The requirements are different depending on the form of electronic communication. A company must also obtain consent for any cookies 'dropped'	Companies will need to review their consent mechanisms and any reliance on cookies for marketing, to ensure that the business can continue to communicate with consumers in the way that it wants to. The requirements are stricter than in the PECR
Penalties for non-compliance	Maximum fine of £500,000	Maximum fine of 4% of annual global turnover or €20m, whichever is higher	Maximum fine of £500,000	Maximum fine of 4% of annual global turnover or €20m, whichever is higher
Territorial scope	DPA applies to data controllers established in the UK, which are processing data in the context of that establishment; or where the controller is established outside the UK/EEA, but is processing data using equipment in the UK otherwise than for transit	GDPR will apply to the processing of personal data by businesses established within the EEA, and to controllers or processors established outside the EEA that are conducting processing activities related to the offering of goods or services to individuals within the EEA, or monitoring the behaviour of individuals within the EEA	PECR does not have extraterritorial effect, so organisations outside the EEA are not subject to its obligations	ePrivacy will apply to entities anywhere in the world that provide electronic communications services to, or gather information related to the terminal equipment of, end users within the EEA

Source: RPC

"Subject access requests are also a risk. Currently, it costs £10 under the 1998 Data Protection Act to obtain all the information a company holds on you. Digging out all that information can be expensive if systems aren't set up correctly. Under GDPR, these requests will be free. So, there could well be an avalanche of new requests. And if you can't locate this data quickly enough, you will be in breach of GDPR."

The definition of data has been expanded under GDPR to include genetic and biometric data, as well as online identifiers such as IP addresses. The 1998 Data Protection Act (DPA), currently in force, defines personal data as information that relates to an identifiable individual and is processed, wholly or partly, by automatic means or by non-automated processing within a filing system. The range of that information is broad and includes details such as name, address, place of work and telephone number, and even descriptive details – such as an individual's appearance, the car they drive or the pet they own – anything that can lead to identification.

GDPR will supersede all national UK laws relating to data protection, including the DPA. However, the EU's 2003 Privacy and Electronic Communications Regulation (PECR), which sets out additional rules for electronic communications, remains in force and will do so until it is replaced by the upcoming ePrivacy Regulation (see table above).

COSTS OF NON-COMPLIANCE

"Everyone is running around in a bit of a panic," says RPC's Oliver. "Firms need to understand where all their customer data is, who is using it, who else is processing it and whether it is going across borders. If it's going outside the European Economic Area, then they will also need to sort out international data transfer agreements."

GDPR non-compliance can lead to fines for firms of up to 4% of annual global turnover or €20m, whichever is greater. Under the DPA, the current maximum fine in the UK is £500,000. And Brexit or no Brexit, GDPR is here to stay. In *Brexit and data protection*, a House of Commons briefing paper published in October 2017, the UK government confirms that it will bring GDPR into UK law regardless of any Brexit settlement.

GDPR fines will also be meted out following a cyber attack if a firm that has been hacked hasn't taken appropriate steps to protect customer data. Any data breach must also be reported within 72 hours. The financial services sector is already the most attacked by cyber criminals, according to the IBM X-Force Threat Intelligence Index.

"GDPR and cyber crime are closely linked," says Oliver. "It all comes down to the central idea of knowing where your data is and knowing what your systems are to protect it."

CONFLICTING LEGISLATION

A further problem for financial service firms is the arrival of another piece of legislation – the revised Payment Services Directive (PSD2) – which appears to be pulling in an opposite direction to GDPR (see page 17 for more).

As a way of encouraging more competition, PSD2 requires banks to open their payments infrastructure and customer data assets to grant third parties access to this information on behalf of customers.

"This open banking style promised with PSD2 must surely increase the chances of a breach, which is a sobering prospect given that GDPR will be in the background with its risk of substantial fines and increased reputational risk," says Oliver.

A HEAD START

Following the global financial crisis, financial services firms were forced to tighten up their technology and compliance systems. For larger organisations especially, the advent of GDPR may not pose as many complications. A PwC study from November 2017 finds that financial services firms are leading the way on GDPR readiness, although this shouldn't be a reason for complacency.

"Building and maintaining consumer trust is already a core aim for large banks, insurance companies and related organisations," says David Longford, chief executive of DataGuidance, which advises firms on data protection. "Therefore, while GDPR will require many changes for the UK financial services sector, the leading firms will likely be in a good position to make those changes.

The financial services sector is already the most attacked by cyber criminals

"There will, however, be challenges. It will be difficult, for instance, to adapt and embed several principles of GDPR on day one, such as data portability and profiling. And the huge volume of clients that these organisations have – both B2B and B2C – means that renegotiating and issuing vendor contracts before 25 May will be a big piece of work, too."

Yet, not all GDPR legislation is set in stone.

"The problem is, we're still awaiting much of the guidance from the regulators," Oliver points out. "For firms, it's hard to future-proof systems when they haven't got clear guidance."

THE TRUE COST OF GDPR

Research by Veritas, the *2017 Veritas GDPR report*, finds that seven-figure investments are the norm for firms to become GDPR ready. And a 2017 report by Consult Hyperion – *GDPR: banks, breaches and billion dollar fines* – forecasts that GDPR will cost banks €4.7bn in fines over the next three years, with financial institutions expected to experience 384 data breaches, and tier one banks facing fines as high as €260m per breach.

"There is also a growing litigation culture in the UK," adds Oliver. "We've already seen class action claims for damages for data breaches. This is the other side of the risk coin, and some of these actions may dwarf the fines imposed by the regulators.

"You should think of GDPR as being a complete compliance and infrastructure overhaul. Hopefully, it will mean a refresh of how processes are run internally. But the whole issue has certainly brought data to the very top of the risk agenda." ●

THE ROAD TO GDPR COMPLIANCE

JANUARY 2012
The European Commission publishes initial proposal for updated data protection regulation

MARCH 2014
European Parliament approves first reading of GDPR regulation

JUNE 2015
Council of the European Union approves first reading of GDPR

DECEMBER 2015
European Parliament and Council come to agreement on GDPR

APRIL 2016
GDPR finally adopted by both the European Parliament and Council. Regulation given two-year post-adoption grace period, becoming law on 25 May 2018, and will apply directly to each member state without the need of local law

25 MAY 2018
After almost seven years of negotiations in Brussels and beyond, GDPR will finally come into force in the UK and across the EU

Financial planning's gold standard

Becoming an Accredited Financial Planning Firm™ can help you to raise standards and demonstrate the transformative power of financial planning

JAKE MATTHEWS

For decades, the financial advice, and latterly the investment management world, have been put under the microscope by the regulator, Pensions Ombudsman and others. We've had pensions misselling from the financial advice world and a spotlight placed on fees and services. Recently, the FCA closed consultation on the investment management sector and the updated Markets in Financial Instruments Directive (MiFID II) now requires transparency of all costs. With so many different pieces of regulation now in play, there is potential for advice from financial planners and investment managers to sometimes be contradictory and confusing for clients.

How does the public know what good looks like? Clients need look no further than an Accredited Financial Planning Firm™ (AFPF), a flagship for all financial planning firms. Accredited firms give comprehensive financial planning advice to the public – and they don't scrimp on service and are fully transparent on all costs. They work alongside their clients to get them where they want to go, not where the adviser thinks they should go.

Accredited firms give comprehensive financial planning advice to the public

"Financial planning can transform someone's life," says Craig Palfrey CFP™ Chartered MCSI, a managing partner at Penguin and Get Financial Advice, and a founding member of the CISI Financial Planning Forum Committee. An AFPF can help to demonstrate that transformative potential to the outside world.

Accredited firms have a defined process that meets the global Financial Planning Standards Board's six-step financial planning process. As part of their service, they must:

1. Establish and define the relationship with the client
2. Establish the client's goals and objectives.
3. Analyse and assess the client's financial information.
4. Develop the financial planning recommendations and present them to the client.
5. Implement the client's financial planning recommendations.
6. Regularly review the client's situation.

THE ROAD TO ACCREDITATION

Upon application to become accredited, no less than half of any company's FCA-registered advisers must be a CERTIFIED FINANCIAL PLANNER™ professional.

Then, the following must be demonstrated:

- That a full financial planning service, including cashflow modelling, is offered by default.
- That the financial planning proposition is clearly communicated and promoted to clients in marketing materials.
- That policies and procedures are consistent with the CISI's Code of Conduct.
- A business structure that reflects a clear fiduciary responsibility to clients.
- A clear and consistent fee structure.
- An understandable and visible investment philosophy.
- Company-wide awareness of the financial planning service and how it differs from financial advice.
- A majority of advisers with a level 6 financial planning qualification.

These components, together, show the public what good looks like. The public can have confidence in firms that go the extra mile to demonstrate this, alongside their ongoing commitment to improving their clients' lives. Being able to demonstrate the application of their technical knowledge, coupled with cashflow planning, adds the most value possible to clients.

It helps clients define what they want out of life, and shows them how they can get there by being guided through a financial plan.

Duncan Hannay Robertson CFP™ Chartered MCSI, a private client adviser at Cambridge-based Hannay Robertson Financial Planning, says the accreditation process pushes standards even higher and reminds him of the power of processes. "The CISI holds you accountable," he continues. "There's no hiding. The Institute says: 'Show us you've got a great financial planning business that doesn't just have the badge, and that you genuinely implement accurate and inspiring financial plans for your clients'."

Accreditation does this and much more. It reduces compliance and regulatory risks, aids in attracting and retaining clients, and helps a firm become part of a community of like-minded contemporaries in the UK in which ideas are readily shared.

This community is not limited to the UK, however. One of the criteria to becoming an AFPF is to have CFP™ professionals involved in the business at director level. Being a CFP professional gives you access to over 170,000 others across the world. Cross-border advice is increasing and planners can find like-minded CFP professionals in other countries to help their clients.

Accredited firms gain greater consumer and professional recognition with the CISI's help

SUPPORT FROM THE CISI

The CISI supports accredited firms in a number of ways. These include:

- helping consumers identify firms that focus on providing a full and effective financial planning service and establishing accredited firms as leaders in the profession by profiling them online at *cisi.org/findaplanner*
- building a community of financial planning businesses that consistently demonstrate excellence in professional standards and service in financial planning via the gala awards at the CISI's annual Financial Planning Conference
- actively supporting the development of these firms and driving the financial planning profession forward – for example, every AFPF is encouraged to partake in Financial Planning Week.

Accredited firms will also gain greater consumer and professional recognition with the CISI's help. For example, public relations are supported and brand awareness built. This could be via PR campaigns with resulting media engagement; centred on the AFPF register; or the provision of regional or national promotional materials (see boxout top right).

Rebecca Taylor CFP™ Chartered FCSI, managing director at Peterborough-based Aurea Financial Planning and CISI Board member, helped to write the initial accreditation criteria. She describes the accreditation as a 'gold stamp' that's different from individual qualifications. Accredited status is an indicator of good financial planning, and shows that the firm as a whole has a thorough financial planning process to ensure the client will benefit from a holistic view of what they're doing.

With support from the CISI, which is committed to encouraging the growth and development of integrated financial planning as a solid and respected discipline, achieving this benchmark can only be good for your firm. Jonathan Gibson CFP™ Chartered MCSI, managing director of Dundee's Wells Gibson, believes it is vital for his firm to be associated with a professional body that is the largest and most widely respected for those who work in the securities and investment sector in the UK. For him, the accreditation and related association with the CISI are both important differentiators in his competitive local market in east Scotland.

The CISI's economies of scale also provide the financial planning community with the support it needs to enable it to continue to grow.

CONTINUOUS IMPROVEMENT

Becoming accredited isn't the end, though. The improvement should be constant. Planners need to think about how they translate the standard into a great client experience and, as a group, they also need to spend more time on the message to the outside world and on helping the consumer to understand why financial planning works for them. "If we do that successfully," says Craig, "then the transformative power of financial planning becomes a self-perpetuating circle." In fact, the CISI has announced that it will be auditing accredited firms to ensure that they still do what they say. This, in turn, will add to the public confidence of the Accredited Financial Planning Firm brand. ●

For more information on how to become an accredited financial planning firm, read our fact sheet, *Setting the standard in financial planning*, at *cisi.org/afpf-factsheet*, or contact the CISI's financial planning team on *financial.planning@cisi.org*

HOW THE CISI PROMOTES AFPFs

The CISI promotes AFPFs on a micro and macro level.

For example, online and print advertising campaigns in *The Telegraph*, *Law Society Gazette* and *AB* magazine have targeted larger swathes of firms' target market and planners' core, professional audience – accountants and legal professionals.

Press releases are also submitted on completion of the process, placing the firm in the spotlight.

WINNING IN WIMBLEDON

"Financial planning is about more than money," says Gareth Rees CFP™ Chartered MCSI, partner and Chartered Wealth Manager at Gem & Co Financial Services

When did you become an accredited firm? What has happened since?
July 2014. It was a natural transition for our company once I qualified as a level 6 CERTIFIED FINANCIAL PLANNER™ professional.

Becoming accredited involved a short but thorough process to ensure we met stringent principles and standards. We believe that we are a better quality firm because of obtaining and maintaining our accreditations. It shows our commitment and professionalism to our clients.

We are proud to stand as the only accredited firm in Wimbledon and this sets us apart from other financial planning firms.

What has accredited firm status brought to your firm and why should others seek to become accredited?
It has provided kudos amongst existing professional connections and opened the door to new ones. Financial planning firms should become accredited to receive acknowledgement that they are delivering excellence in financial planning, and to safeguard the reputation of true financial planning.

In addition, clients can feel confident that they are dealing with genuine and respected professionals.

Gareth Rees CFP™ Chartered MCSI
Committed to and passionate about the financial planning profession, Gareth is both a Chartered Wealth Manager and CERTIFIED FINANCIAL PLANNER™ professional – two of the highest designations achievable for wealth managers and financial planners.

Gareth delivers cutting-edge financial strategies to help individuals and families maximise their financial resources so that they can live the life they choose and enjoy what is important to them.

Gareth co-founded Gem & Co in May 1999, after a successful career in financial services, which started in 1986. A busy father of triplets, Gareth knows how difficult it is to strike the right balance between work, family and self. He has a passion for rugby and every weekend you will find him coaching the junior section of Old Rutlishians' Rugby Club in Surrey.

What other accolades and awards has the firm picked up in recent times?
I'm proud to say that we've won local Chamber of Commerce, Merton Best Business awards for four years in a row. In 2014 we came top in The Extra Mile category – which highlights businesses that give something back to their community. We did this by supporting local schools with work experience programmes. In 2015 we won the Best Service Excellence award and in 2016 we were runner-up for this category.

This year, we were delighted once again to be recognised for our success at the Merton Best Business awards with the runner-up award in Best Business Under 50 Employees category.

What sort of business is it and what services does it offer? What's your USP?
Our core values of putting clients at the heart of our business and always doing the right thing for them is what sets us apart. This is reflected not only through our business growth, but also most importantly, in our clients' feedback and testimonials.

We provide a comprehensive financial planning service, working with clients who are doing well and want to ensure they are making the best decisions about their money.

In a nutshell: we get people organised with their finances and provide them with peace of mind; we work closely with our clients to find out what is important to them and then we create smart financial strategies that deliver results; and we monitor and maintain clients' financial plans to ensure they meet their financial goals.

How did you get into financial planning?
I started GEM & Co Financial Services with two friends in 1999. We were all working in large blue chip financial organisations and wanted to branch out on our own and to provide truly independent financial advice. At first our business provided both mortgage and investment advice.

We joined the Institute of Financial Planning (IFP) in 2011 because we wanted to develop our knowledge and understanding of financial services.

Then in 2013, we decided to come out of the mortgage business to concentrate on our investment business.

The Gem & Co team at the Merton Best Business Awards 2017

We engaged with Brett Davidson, a business consultant who showed us how we could use our skills and qualifications to better effect than simply processing transactional advice. It was a game changer!

In 2014 we continued our education by attending master classes held by Paul Etheridge CFP™ Chartered FCSI, founder of the IFP. Following the IFP merger with the CISI, we were introduced to like-minded people in the financial planning community who gave up their time to point us in the right direction when we got stuck. Events such as continuing professional development (CPD) days, branch meetings and the annual conference all really helped.

We are small in terms of staff numbers. However, having taken advantage of all the above resources, we have been able to develop a robust business plan that has seen our business grow exponentially over the years through referrals from existing clients, new clients and reputable professionals.

We are a better quality firm because of obtaining and maintaining our accreditations

Our business has achieved several milestones over the past year. We have moved into new premises, which are more conveniently located for our clients in the heart of Wimbledon, and we have expanded our client services team to further enhance the quality of service and client experience.

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

Being actively engaged in the process of turning a financial plan into a client's reality, and seeing clients accomplish their desired lifestyle and life goals with our help.

Financial planning is about more than money. Our goal is to help our clients live the life they have always dreamed of – to live their 'happy ever after'!

Our advisers and the supporting client services team are passionate about what we do – all members of the team are committed to the same goals and values of putting the client at the heart of our business.

What do you like about the CISI?

I like the engagement of the new senior team and the links the CISI has forged with the Institute of Chartered Accountants in England and Wales, plus the new CPD system, which makes my life much easier!

You were involved in Financial Planning Week 2017. What did you do?

As we have done for several years now, we held pro-bono surgeries and helped around half a dozen people get back on track by introducing them to the financial planning process.

It still amazes me how few people set financial goals before implementing stuff, which can get them into a financial pickle!

What does a typical day look like?

It starts with the school run, which is a good opportunity to find out what is going on in my teenage triplets' lives. At the office I begin by setting the day's priorities in my action planner, which are drawn from my 90-day and 30-day goals. I also check emails and check in with the team, then get on with client work or business development. No day at the office is the same for me, but I always finish my workday by reviewing my goals to ensure I'm on track and then I hit the gym!

What are your key tips for other planners?

- Keep focused on clients' goals and always do the right thing by your client.
- Provide clients with consistent engagement and honest, open communication to show how your firm will deliver the financial plan.
- Don't be afraid to get outside help and work with top business consultants. They are worth every penny!

INTELLIGENT GIFTING

THE BRIEF

Bob and Betty set up their housebuilding company in 1974. Having grown the company substantially over the years, they made a partial exit in 2016 by selling a minority share to a private equity house with a plan to fully exit the company in 2019–2020.

The couple gifted £100,000 to each of their four siblings and may wish to gift more to help them in the future, but as Bob was more cautious about this than Betty, they both agreed to delay further gifting for a while.

They also wished to provide this help to their children in the future without spoiling them. Bob and Betty were concerned about the impact their wealth may have on their children, aged 29 and 27, and were unsure of the best way to transfer wealth to them.

They also needed investment advice, having limited their investments in the past to property, with only a relatively small amount going into pooled investment and pensions.

As well as needing advice to invest capital initially, they needed a longer-term plan to take into account the additional wealth that they would come into in 2019. In addition, they would also clearly benefit from a structure being in place to ensure that their wider financial affairs were put in order.

They approached Fiscal Engineers to help them establish a structured and disciplined plan for their wealth.

Kevin Bunting, Chartered MCSI, helps his clients pass on wealth and financial knowledge to their children through the setup of a Family Investment Company

KEVIN BUNTING ISTOCK

Betty, who looks after the couple's personal finances, said that until fairly recently, she had often needed to transfer funds between accounts to pay bills due at different times of the month, but they now have "more money than they will ever need".

They had never given their personal investment affairs any real attention before they came to see us, saying that they were time poor.

We spent time in the initial stages educating them to improve their understanding of portfolio construction and why getting the right asset allocation is critical. Financial modelling suggested that the capital Bob and Betty had available initially, without the potential further exit monies expected in 2019–2020, should be sufficient to enable them to maintain their standard of living for the rest of their lives.

A coordinated, tax efficient structure was put in place to implement an investment portfolio for the new capital as well as to integrate advice on their current investments. Given that Bob and Betty were additional rate taxpayers, part of the structure looked at maximising tax efficiency.

They had never given their personal investment affairs any real attention before

While investment bonds were considered, once we'd looked beneath the surface, we felt it appropriate to introduce Bob and Betty to a trusted tax adviser and a lawyer (part of our expert network). Following several meetings, a Family Investment Company (FIC) was put in place.

This enabled Bob and Betty to invest part of their capital in the FIC by way of a loan and use the company to provide a means to pass wealth on to the children over time in a controlled manner. The plan is that in the future, the children will be made directors and shareholders in the company. This will engage them in the running of the FIC and will allow them to get used to managing the sort of wealth that they will ultimately need to manage, but in a controlled and supportive manner. Bob and Betty's shares will retain voting rights so they can help the children make good investment decisions and ensure they don't squander their wealth.

With regard to estate planning, Bob and Betty had very basic wills and no Lasting Powers of Attorney (LPA), so as part of the introduction to the lawyer, new wills were drafted and LPAs were put in place. A review is now taking place of their existing life cover to consider additional protection against inheritance tax (IHT).

Following several meetings, a Family Investment Company was put in place

While we were in discussions with Bob and Betty, their son announced his engagement, which furthered our conversations around ensuring their wealth passed down the generations efficiently. We introduced them to a solicitor who specialises in family law to discuss the protection of the family's wealth, and specifically, the use of prenuptial and living together agreements. Their son and his fiancée have now begun establishing a prenuptial agreement.

Finally, as part of the discovery process, we found that Bob and Betty's home insurance was shortly due for renewal and that Betty was struggling to balance all of the insurances they have for their homes in Leicester, London and Majorca, cars (Bob has a collection of 20), motorbikes, boats, motor home and helicopter. We therefore introduced Betty to a specialist insurance brokerage, which was able to not only simplify their affairs, but also improve the cover and lower the overall cost.

THE OUTCOME

Bob and Betty now have a robust structure in place for their finances that they can trust and have confidence in. They have clarity and a properly thought-out plan for their future that caters for the additional wealth that they will receive in the next two to three years. By adopting a family office approach and coordinating our expert network of professionals required to meet the needs of the clients, we have helped Bob and Betty achieve their ideal money/life balance. ●

KEVIN BUNTING, CHARTERED MCSI

Kevin joined Fiscal Engineers in March 2016, having moved from HSBC Private Bank.

With 25 years' experience of financial planning, Kevin is one of the Chartered Wealth Managers at Fiscal Engineers, a multi-award winning boutique wealth management firm.

Kevin is passionate about supporting clients through the key financial moments in their lives. Empowering clients, giving them real clarity of their future and helping them to make good decisions is as important as constructing a well thought out investment portfolio. Having a true relationship with the client rather than just their money is key to delivering the best outcomes for them.

WHAT HAPPENED NEXT

Having fully implemented the investments into the FIC, Bob and Betty have now moved on to address their IHT position further and we are currently discussing joint life, second death Whole of Life cover, written on a maximum cover basis to address their IHT liability in a cost-effective manner. Bob and Betty will then have a ten-year planning window to allow them to establish their gifting schedule once they have fully exited their business.

In addition, we have also used our financial organisation service to reorganise their home filing system and have ensured that it is properly arranged in a way that suits Bob and Betty.

GOLD DIGGER

Financial adviser Karlie is worried that her client is being taken advantage of. To what extent, if any, should she intervene?

GETTY/CURVABEZIER

Karlie is a financial adviser who had advised George for many years. George and his wife Jan had separate investments, and Jan had her own adviser. Jan ran a successful business but decided to retire early following a brain haemorrhage. George told Karlie that, thankfully, Jan made a full recovery following a successful operation, but decided to retire to pursue a quieter life and enjoy other hobbies.

One day, Karlie is informed that George has passed away. Over the next few weeks, Karlie helps with the transfer of George's investments to Jan, the sole beneficiary of his estate, and during this time Jan informs Karlie that her own adviser is considering retirement. Karlie is invited to several meetings to present her firm's services to Jan and her retiring adviser, and is eventually appointed as Jan's new adviser.

Karlie builds a trusting relationship with Jan over several years. Jan is a wealthy woman, with substantial investments, her own pension and a widow's pension. She could, in theory, afford to take some risks with her investments, but she is risk-averse and wants to ensure that she has money available for probable future healthcare. Neither Jan nor George had close family, but Jan is keen that money is left to provide for both sets of relatives on her death. Karlie has a copy of Jan's will, with listed beneficiaries, stored in her file.

It becomes apparent that Jan is lonely, but she mentions regularly that she is wary of gold-diggers. Eventually, however, Jan tells Karlie that she has met someone through a dating app: Paul Goldman, who is more than ten years younger than her. Jan confides that she has already received several marriage proposals from him, even though they have not been together long, which makes Karlie wary of Paul's motives. However, she does not feel as though it is her place to say anything about the relationship.

Jan could, in theory, afford to take some risks with her investments, but she is risk-averse

After six months, Paul sells his property and moves into Jan's house. With Jan's consent, he starts attending review meetings. The couple express an interest in travel – something Jan has not brought up before – and ask Karlie to invest some of Jan's money in investments with higher returns so they have more available funds to spend on this hobby. Karlie is concerned about this change in approach, but the amounts of money involved are not large, and she feels she would be overstepping her professional relationship if she were to express an opinion on this.

At their next meeting, Jan explains that she wants to leave something to Paul on her death, and Karlie suggests that her pension drawdown might be appropriate. This is agreed, and the paperwork is completed. Jan seems a little forgetful and confused during this meeting, but Karlie cannot determine whether she is simply tired and a bit stressed, or whether this is as a result of the brain haemorrhage that Jan suffered (and recovered from) more than five years ago.

Jan and Paul leave to go on holiday, and very soon afterwards Karlie is surprised to hear from Jan's pension provider that her access to Jan's pension information has been removed. Karlie calls Jan, who explains she and Paul are to marry before passing the phone to him. Paul, rather brusquely, informs Karlie that further discussion can wait until he and Jan return in several weeks.

Jan has met someone though a dating app who is more than ten years younger

Karlie is worried that Paul is taking advantage of Jan, and wonders what to do. She does not want to damage her relationship with Jan, because (as well as liking her as a person) she is a valuable client, and Karlie has been well-remunerated while advising her over the years. On the other hand, Karlie wonders if this means that she has more of a responsibility to try and resolve the tricky situation Jan is in.

WHAT, IF ANYTHING, SHOULD KARLIE DO?

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

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

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

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

WHAT WOULD YOU ADVISE?

Visit *cisi.org/golddigger* and let us know your favoured option. The survey results and CISI's opinion will appear in the Q2 print edition of *The Review.*

TRUST IN CONFLICT: THE VERDICT

This 'Grey matter', published in the Q4 2017 print edition of *The Review*, raises a relatable dilemma which highlights conflicts created when the interests of an aging relative and younger generations collide. There were many in depth and well-considered comments, for which we thank you. A selection of these will be published at *cisi.org/conflictverdict* Options offered and results are as follows:

A. This is now a family matter. He has drawn their attention to the situation and it is now up to them to decide on a course of action. (12 responses)

B. Regardless of the actual legal relationship between Philip and the trustees (Eileen's children), he has a moral responsibility to protect Eileen's interests. (22 responses)

C. His duty of care to the trustees means he should consider the position of the remaindermen as well as Eileen, the life tenant, even though the remaindermen are also trustees. (88 responses)

D. He should step down as a trustee. (11 responses)

While C is the most popular option (88/133 votes), respondents in the comments are evenly split over whether Philip's moral duty to Eileen should outweigh his duties to the trustees. Roughly half the respondents argue that care for Eileen is paramount, while others note that his role as trustee means he has a duty of care to all beneficiaries from the trust.

What is likely to be the key determinant of Philip's role is the terms of the trust. Philip's duty of care is to uphold the purpose of the trust, and should the trust dictate that the interests of Eileen are paramount, Philip should face the difficult conversation with her children about the need to diminish the value of the fund to pay for Eileen's ongoing care.

Respondents are also split about whether Philip should step down as trustee. For some, his role as adviser and trustee represents an insurmountable conflict, yet others say that he was appointed as a trustee by virtue of his independence and expertise. In fact, he is the least conflicted as the remaining trustees are also family members. He is the only trustee that is likely to fully understand the responsibilities that come with that position. Principle 5 of the CISI Code of Conduct requires Philip to manage a conflict of interest fairly and effectively, and so long as he declares any conflict and is honest, open, transparent and fair with all parties, there is no reason why Philip needs to step down as trustee.

He should consider the position of the remaindermen as well as Eileen, but abide by the terms of the trust and the spirit in which it was set up. For this reason, option C is the CISI's preferred option.

THE DAWN OF BRITAIN'S NEW REGULATORY CLIMATE

The long-awaited Senior Managers and Certification Regime will bring its share of challenges – for firms and regulators alike – says David Morrey of Grant Thornton

DAVID MORREY

On 26 July 2017, the FCA published its long-awaited consultation paper on extending the Senior Managers and Certification Regime (SMCR) – already applied to deposit takers and insurance firms since March 2016 – across about 47,000 solo regulated firms. The proposed regulations represent a profound change in the UK regulatory structure and will have a material effect on all regulated firms, in their relationship with the regulator, in the way they operate, and in their relationship with those who work for them.

THE WAY AHEAD – WHAT TO WATCH OUT FOR

The FCA's original plan was for this second wave of the SMCR – essentially covering all solo regulated firms, while also extending the Certification Regime to insurers – to come into force in 2018. However, a series of delays has meant that the consultation paper (CP) was published at the end of July, rather than in Q1 as originally intended, and final rules are now not due to be made until summer 2018. Given the likely scale of the work demanded by Brexit (and the updated Markets in Financial Instruments Directive, et al) and the expected demands the SMCR will make of the FCA's authorisation function, we believe it is now unlikely the new regimes will substantively come into effect until the UK leaves the EU in March 2019.

These delays were probably prompted by the difficulties of designing a regime that could be applied across the FCA's regulated population of organisations – from firms such as BlackRock at one end to dentists and vets at the other – with some credible degree of proportionality. Given the requirements of the legislation (for example, that all firms should be subject to the Certification Regime), the FCA has probably gone as far as it can in tailoring the SMCR for different sizes and complexity of firm. However, all but the largest firms are likely to find it a significant drain on their administrative resources, and not just in the set up. The other cause for delay in the CP's publication was of course the General Election, and it would be unwise not to assume that there may be other twists to what has always, from its origins, been a very political narrative. One obvious example is the likely impact the publication of the FCA's first SMCR enforcement cases will have.

The proposed regulations represent a profound change in the UK regulatory structure

LONG-TERM CULTURAL IMPACT OF SMCR

Although we believe implementation is not likely until 2019, we would advise firms to start thinking now about its implications for them, both directly and in their future relationship with the regulator. This is not primarily for the usual reason of needing to ensure the necessary changes to business systems and processes are completed in good time. Rather, it is because the long-term cultural impact of the SMCR is likely to be significant for many firms and there is a risk of creating unwanted incentives and consequences if sufficient thinking is not done up front. There are two main reasons for this. The first is that the SMCR was originally targeted only at the biggest banks, and extending it to all regulated firms has major implications for both the scale and uncertain nature of its impact. The second is that, despite its various detailed requirements, the SMCR is, in its philosophy, the antithesis of tick box regulation. As such, it will affect the behaviour of all those subject to it. Despite the title, this will include (because of the reach of the Certification Regime and the individual conduct rules) all your staff apart from those in a defined set of ancillary roles.

> *There are further questions of diversity and groupthink that regulators haven't yet resolved*

WHAT'S REALLY DIFFERENT?

Very little in regulation, as in other aspects of life, is truly new, and so it is worth taking a look at what the Approved Persons Regime (APER) was meant to be about when it was introduced and what were the significant cracks that became apparent over time. Back in 2000, the FSA, the newly-formed regulator, produced its manifesto for the future of regulation: *A new regulator for the new millennium*. In this document it states: "Vetting at entry aims to allow firms and individuals who satisfy the necessary criteria (including honesty, competence, and financial soundness) to engage in regulated activity."

While the tone is more measured, the original purpose of the APER was similar to that of the SMCR. It is true that the latter catches fewer people in senior manager functions (SMFs) than APER did in controlled functions (CFs), but it more than makes up for this by introducing the Certification Regime, which all firms must administer and police themselves. How this will play out in terms of giving the SMCR a sharper focus than its predecessor will only reveal itself with time. We see six areas where the effectiveness and impact of the SMCR will be determined. Whether the government and the FCA ultimately conclude that the SMCR has been a success will largely be driven by how well the regulator handles these challenges:

- **Enforceability**: Despite the rhetoric, it is not clear how much easier it will be in the new regime to hold individuals to account for the kind of failures that helped cause and then exacerbate the financial crisis.
- **Barrier to entry**: Individuals in role will almost all be 'converted' into SMFs, but as they move on the regulators will face the question of whether they want to raise standards, and, if so, in what way.
- **Talent pool**: Related to this is the question of whether there are enough suitably qualified people to perform SMFs, and whether the existence of the SMCR may deter even the good candidates from signing up. And within this there are further questions of diversity and groupthink that regulators haven't yet resolved.
- **Resourcing**: Authorisation is at the volume end of regulation and it is not clear that the SMCR will make fewer demands on it. In fact, the requirements around policing statements of responsibility and regulatory references may require more resources than the APER.
- **Enforcement**: The Prudential Regulation Authority (PRA) will have a major interest, but in reality the FCA is the regulator with the large enforcement function, and both the nature and outcomes of the first major SMCR cases it brings will set the tone and precedents for what follows. The regulatory appetite for losing important cases is inevitably low and individual cases must meet a higher legal test than corporate ones. The APER proved hard to enforce against, so will the SMCR prove stronger in practice?
- **Priorities**: Regulators' agendas are as busy as ever, partly imposed and partly by choice. Over time, the APER became less of a priority, the pre-approval of Paul Flowers as chair of Co-operative Bank being the most obvious example. In a world of finite and increasingly flat resourcing, there is a significant risk that the SMCR could meet the same fate. If so, it will herald some unpredictable consequences for firms. One of the key differences, though it will only apply formally to those firms that are in the enhanced regime, is the concept embodied in a 'responsibilities map', that the senior managers of a firm should between them cover all its activities. In contrast, the core regime reverts to the APER idea that the activities which matter will be covered by the key SMFs. This dilution is a key element of the SMCR that the FCA has introduced in order to make it more proportionate for smaller firms, and it will be interesting to see the wider reaction if a core firm collapses and senior manager accountability is perceived to have fallen through the cracks.

Another key difference is the requirement on holders of SMFs to take "reasonable steps" to prevent or minimise a breach of regulatory requirements. Defining and documenting these, particularly in the heat of dealing with such a breach, may become the subject of considerable soul-searching for all concerned, including the regulators trying to make after-the-fact assessments. The other differences worth noting at this stage are the requirements around the annual renewal of certifications and the provision of regulatory references to future employers. Both of these are likely to alter the relationships between firms and their employees and to create significant new layers of administration. ●

About the author

David Morrey is a partner in Grant Thornton, specialising in regulation. He is head of investment management at the firm. David appears on the first of our 2018 series of 'Ask the experts' on SMCR, on CISI TV in February 2018. *david.morrey@uk.gt.com*

Enduring challenges

Affiliate member Suzanne Price has a marathon tale of endurance to tell

LORA BENSON

Suzanne's proud collection of finisher's shirts, race numbers and medals

Endurance has a different meaning, depending on who you are. We all have our limitations, but some of us can go just that little bit further. Although a self-confessed plodder, Suzanne Price's can-do approach to running since turning 50 has enabled her to complete the Abbott World Marathon Majors challenge.

This challenge consists of a series of six of the world's most renowned marathons: London; Berlin; Chicago; New York; Tokyo; and Boston. A medal for completing these, known as the Six Star Finisher medal, was introduced in 2016. Suzanne says: "For elite athletes, their motivation is for the massive prize money. For me it's more for the experience, an amazing Six Star medal and the kudos, as fewer than 3,000 people in the world have earned the title of the Six Star Finisher to date." Just nine people in the UK have completed the challenge within a year and, among those, Suzanne is the only woman.

For Suzanne, 2016 was a lucky year, and she has the probability ratios to prove it: "I was lucky to get marathon places in the regular ballots for London in April (1:17 chance); Berlin in September (1:2 chance); Chicago in October (1:3 chance); and New York in November (1:19 chance). I was then able, via a sports tour company, to sign up for the Tokyo marathon in February 2017 and the Boston marathon in April 2017. Only two other people in the UK achieved all six World Marathon Majors that year!"

STAYING FIT

Staying injury and illness free was one of Suzanne's biggest tests during this time: "The ultimate finale for me was being presented with my Six Star medal at the end of the Boston marathon last year. I had done it! It felt so very special."

Suzanne started running at the age of 17 as a way of keeping fit – six-mile runs after an hour's aerobic session. "I joined a ladies' running club, and played football for a local women's football team. I was running a half marathon in the morning and playing a football match in the afternoon!

"I gave up football at the age of 23 to train for the London Marathon, my first ever, which I ran in 1988. I was sponsored by my stockbroking employers Henderson Crosthwaite and raised over £2,000 for charity – a lot of money in those days. Back then you didn't have all the technology, gear and gels that we have today. It was trainers, cotton t-shirts, water at the drinks stations and a finish time that also included how long it took you to get over the start line with the others – no chip timing! I ran it in about five hours; it was amazing but tough. The training and recovery time was immense. It put me off running for a while."

Following the 1988 marathon, Suzanne entered the odd 10k race every couple of years. "But in 2013 I decided that I should run on a regular basis to try to lose weight!"

KEEPING MOTIVATED

With two young sons and a full-time job as a strategy manager for Capita Financial Software Services in Cheltenham, Suzanne found her return to training for the Paris Marathon in 2013 extremely challenging: "I followed a rigorous training plan which worked, and I finished in just over five hours. I then helped to establish a local running club, which kept me motivated and introduced me to an assortment of other running events."

Her family have supported her running challenges. "I had the pleasure of running the Brighton marathon with my son last year. It was one of the highlights of all my marathons."

Suzanne tries to run three times a week. She switched from a high-carbohydrate to a high-fat diet for the Berlin marathon. "The body runs out of carbs at mile 20 (when you hit the wall), but on a low carb diet you burn fat, so can run for longer. This worked, as I ran the second half of the Berlin marathon faster than the first half!

Running keeps me healthy and it has a great social aspect. I get satisfaction coaching others. Inspiring people to do something they never thought they could do is a great feeling." ●

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

SUZANNE'S SIX STAR FINISHER TIMES

2017	05:25:28	2016	05:42:29
2017	05:46:33	2016	05:31:13
2016	05:16:33	2016	05:32:08

Help for last-time buyers

The much-derided bungalow has an important role to play in tackling the financial challenges posed by an aging population and an impoverished younger generation

ANDREW DAVIS JOHANNA WARD

Any day now, building work will finish on a UK development of 30 bungalows in the village of Wymondham on the A11, a few miles south west of Norwich. Unremarkable as this might sound, their developer, the retirement homes specialist McCarthy & Stone, was sufficiently excited to make a point of announcing the imminent delivery of its first 100% bungalow project in its latest financial results.

McCarthy & Stone's excitement becomes more understandable when you consider just how endangered a species bungalows have become. According to the National House Building Council, just 2,210 new bungalows were registered in the UK in 2016. Thirty years earlier, in 1986, the total was 26,408. As McCarthy & Stone points out, that represents a drop from one in six new homes to one in 63 in the space of a single generation.

The cheapest way to release equity is to sell and downsize

Although to some, bungalows might appear irredeemably naff – their rapid decline reflecting nothing more than a welcome outbreak of good taste among the British public – there are more powerful forces at work here than a change of fashion. The most obvious is the impact of big increases in the price of land for housing over the past 30 years, especially in the south of England. Being single-storey homes, bungalows are land-hungry and therefore less profitable per square foot of floor area than multi-storey dwellings. As a result, developers naturally favour other property types that maximise the density of their projects, ensuring the highest possible return on investment.

However, it is not only developers that have reinforced the trend away from bungalows. Councils also have an impact through planning policies, which specify development densities that make flats and houses the only viable options.

In other words, there are reasons to believe McCarthy & Stone's assertion that the decline of the bungalow has far more to do with a lack of supply than the disappearance of demand among buyers. Consider the question from another angle. In 1975, Stannah manufactured its first stairlift and by 1985 had become the global leader – in 2011 it invited the Prince of Wales to help celebrate the production of its 500,000th stairlift.

Over the same period, in which the bungalow all but died out, hundreds of thousands of stairlifts were fitted in British homes to allow mainly older residents to enjoy the key advantage of a single-storey dwelling without having to move into one. For many of those Stannah customers, staying in their existing home was the overriding priority. But had some of them been able to find an affordable bungalow, it is a fair bet they would have moved home rather than adapt the one they already had.

This matters, both from the perspective of consumer choice and because, if people are unable to move into the later-life properties they want, the housing market will become even less liquid than it is already. It will, therefore, function less well for everybody, no matter what age they are.

There has been increasing discussion in recent years of equity release as a way for older people to realise some of the wealth they have accumulated in their homes, for their own purposes as well as to pass to younger generations. These products clearly have a role to play and are becoming justifiably popular. But it is equally clear that the cheapest and most efficient way to release equity from your home is to sell it and downsize. Making that easier for older homeowners to accomplish would increase the options for younger buyers looking to move up, and should therefore be an explicit aim of government housing policy. But the sorry tale of the bungalow's steady decline shows how far we remain from unblocking our dysfunctional housing market.

Viewed from this angle, equity release mortgages start to look like the financial services equivalent of the stairlift: a way of letting people stay in their own homes when other options – were they available – might offer an even more satisfactory outcome, both financially and practically.

The mini-renaissance of the bungalow is encouraging

Back in Wymondham, McCarthy & Stone says it is experiencing strong demand for its new bungalows, and this is not the only place where it is planning to build them. In all, the company has more than 200 in the pipeline, which will sell for between £300,000 and £450,000. Most of them will form part of mixed developments on larger sites, alongside its mainstay blocks of retirement apartments.

CONCERTED EFFORTS

Given the scale of population aging that Britain faces, these early signs of a mini-renaissance of the bungalow are encouraging, but should not be overplayed. The Wymondham development came about only because the seller of the land stipulated that it had to be used for single-storey development. Without much more concerted efforts to make this kind of development financially viable, the market will never deliver the choice of housing, with wider access to truly efficient equity release, that 'last-time buyers' need.

CHANGE: REGULATORY UPDATE

CHRISTOPHER BOND, CHARTERED MCSI, EDITOR

FROM THE EDITOR

2017 was a regulatory year dominated for senior managers in many firms by the extraordinary efforts necessary to prepare for the start of the updated Markets in Financial Instruments Directive (MiFID II) on 3 January. A stepchange in EU securities law introducing the first ever detailed conduct rulebook which overshadows the FCA Handbook and which makes significant changes to it. Firms ready for the date should congratulate themselves.

2018 will see the start of the next 'elephant' – the General Data Protection Regulation in May. This transforms the way firms collect, store and use existing and new personal data and applies to wholesale as well as retail firms, such as signatory lists.

Preparation for the Senior Managers and Certification Regime is likely towards the end of the year too. Add to those the shadow of Brexit – there is no possibility of firms reducing the regulatory budget just yet – perhaps the reverse. We do indeed live in challenging regulatory times.

Here are some other interesting themes that senior managers should be aware of so they can ask pertinent questions of compliance.

1. THE FCA's NEW MISSION STATEMENT

This is well worth reading since it bears the imprint of the new CEO Andrew Bailey. It emphasises that retail and wholesale firms treating customers fairly is the first objective but that clean and transparent markets, firms taking action to reduce financial crime and the FCA promoting competition through new entrants and innovation, are also priorities. Given the reduced power of the FCA to make new rules under EU directives and regulations, it must make the most of how these rules are applied in the UK. To this end, the FCA plans to issue a series of discussion papers describing its current internal policies and processes on how it authorises and supervises firms, whether and how the Handbook can be simplified and reduced in length, and how it enforces the rules. It asks specific questions on these and welcomes more general comments.

It is hard to say how intently the FCA is listening but it is a promising start. The first discussion paper on authorisation has already been published. Answers and comments are due by March.

2. MiFID II

In late 2017 the FCA accepted that firms may not be fully compliant by 3 January 2018 – the only clear red lines are in transaction reporting, market status and best execution – but the FCA expects firms to tell them if they are not ready in any significant area. If so, you are not alone – the unpreparedness of some EU states and their firms for MiFID II can be seen in the EU taking action against 19 states for late law adoption.

Senior managers may wish to ask their compliance team or MiFID II project team to take them through the project timetable to see the current status of actions – at best to give management confidence, at worst to prioritise action for uncompleted tasks.

3. BREXIT

There is a deadline of March 2018 for some firms to know the future relationship with the EU before starting to trigger contingency plans – for some EU licences that may be too late already (Frankfurt is allegedly too full for new banking applications). They may be delayed by the FCA's expectation that the EU passport will continue during a transitional period. The December 2017 Brexit initial agreement covers EU nationals coming to the UK during a transitional period (although there has already been a reduction in EU nationals coming to the UK from July 2016 to June 2017 – down 54,000 from 284,000 in the year before the Brexit vote to 230,000, and an increase in EU nationals leaving, up 28,000 from 95,000 to 123,000.

OTHER BREXIT DEVELOPMENTS

- There are separate UK Government proposals on a new visa scheme after Brexit for EU workers in the UK, and apparent UK Government unity on a two- or three-year transitional period, but the EU wants a shorter one.
- The London Stock Exchange/London Clearing House accepts the case for stronger European Commission supervision over euro clearing.
- EU banks have sold €350bn (17%) of UK tied assets because of Brexit uncertainty.
- There is German/French pressure for a more federal Europe with greater powers to EU financial regulators.

4. FINANCIAL CRIME

The National Crime Agency estimates that as much as £90bn is laundered through the UK each year. The Government's strategy calls for a new Minister for Economic Crime and a new national economic crime centre which will have representatives from all crime fighting bodies, such as the FCA. It will have six priorities, including reducing corruption, law enforcement and financial transparency. The Serious Fraud Office survives as a separate agency but under the supervision of the centre.

Financial crime is a current priority of the FCA, which has launched many skilled persons reviews of firms under section 166 of the Financial Services Act. Firms' cyber policies are another priority – under the General Data Protection Regulation, firms can be fined heavily by the Information Commissioner's Office for data breaches. The Securities and Exchange Commission has warned that half of US asset managers do not regularly test their vulnerabilities – is this representative of the UK too ? This level of protection costs firms huge amounts of money. For example, HSBC employs nearly 8,000 staff in compliance.

OTHER FINANCIAL CRIME CONCERNS

- A lesser known consequence of MiFID II will be to give the regulators more market data to find market abuse.
- There are concerns about Kremlin influence on Kaspersky antivirus software, which is widely used in the financial sector.

5. SENIOR MANAGERS AND CERTIFICATION REGIME

Non-bank firms continue to fret about the Senior Managers and Certification Regime (SMCR) extension to them in late 2018/early 2019. Those firms subject to the full enhanced regime are particularly concerned about the personal responsibility of senior managers, including directors, and about changes to their business structure under the prescribed overall responsibility maps resulting from identifying the decision-maker for each activity or function in the map. Members of independent financial adviser networks are hoping to be outside the regime because they are not directly authorised. The FCA continues to emphasise its hope that the SMCR will lead to better behaviour and that the SMCR will be the principal approach it will use to holding managers to account for problems in their areas, and all staff for personal breaches. However, it will be proportionate in its expectations of smaller or less risky firms so that they do not need to reinvent their business models or structures because of the SMCR. All eyes are on the response of the FCA to the many comments on its consultation paper on the SMCR – expected Q1/2 2018.

6. THE RISE OF SECTOR CODES

The FCA has published a paper on its support of financial services sector codes in unregulated markets. This is spurred by the London interbank offered rate (LIBOR) scandal and by the desire to support the Bank of England and the FICC Markets Standards Board's (FMSB's) work on codes for particular unregulated markets, such as spot FX or indices. The FCA says it will either formally recognise these (for example the new FX Code) – in which case there is no 'safe harbour' for firms complying with them, but compliance "tends to indicate" proper standards of market conduct – or will not recognise them (in which case they have no formal status but the FCA may use them as evidence of standards in enforcement proceedings). What is equally important is the apparent acceptance by the FCA that it should give financial services sectors (often led by trade bodies) space to establish codes or guidance on the practical application of many of its rules, for example, under MiFID II, even without FCA endorsement.

7. CORPORATE GOVERNANCE

There have been significant developments here – applying to both public and private financial firms. The European Securities and Markets Authority has issued detailed guidelines on corporate governance for all MiFID firms which limit the number of directorships a board member can hold (normally one executive and one non-executive director (NED) role or four NED roles). The guidelines define specific duties for the board in remunerating employees, implementing its strategy, risk strategy, and other factors such as the integrity of its accounting and reporting. Boards are strongly advised to conduct a gap analysis to fill and document the gaps.

The Financial Reporting Council is proposing to tighten the UK Corporate Governance Code for listed companies, including limiting all directors, including the chair, to nine years (19 FTSE 100 chairmen to go). The Government's plans to tighten company law in this area have been diluted – no employees on company boards and no binding shareholder vote on executives' pay. The survivor is the requirement to publish the ratio between the highest paid and average employee.

Separately, Mark Carney, governor of the Bank of England, has indicated the UK may abolish the cap on bankers' bonuses under EU law post-Brexit.

8. ENFORCEMENT

In 2017, fines against firms rose ten times as much as in 2016, to £229m. The number of actions against individuals reduced. Is this showing the return of the 'light touch' or the calm before the SMCR is extended to non-banks in 2018/19? Certainly the mood music from the top of the FCA indicates the importance of individual responsibility under the SMCR.

The SMCR has been in force for banks since March 2016. However, apart from a tougher approval process for senior managers, and rumours that the FCA is studying specific examples of making senior managers responsible for breaches in their areas, there has been little visible enforcement action of the SMCR.

9. CHANGES IN FINANCIAL SERVICES COMPENSATION SCHEME PAYMENTS BY FIRMS

The FCA is consulting on big changes to the funding of the Financial Services Compensation Scheme (FSCS) by firms, in particular:

1. By changing the individual classes of firms so that, for example, fund managers pay more and financial intermediaries including brokers pay less. (This would take a heavy toll on firms' profits. Firms' budgeting is difficult – witness the latest recent interim call on firms.)
2. By considering requiring risky firms to pay more and conservative product firms less.
3. By tightening up the requirements for firms' professional negligence policies so more compensation is paid by insurers or firms with wide PI exclusions. (Over 2016/17 the FSCS paid out £375m in respect of 37,000 claims. It has apologised for making many mistakes in calculating investors' Arch Cru compensation.)

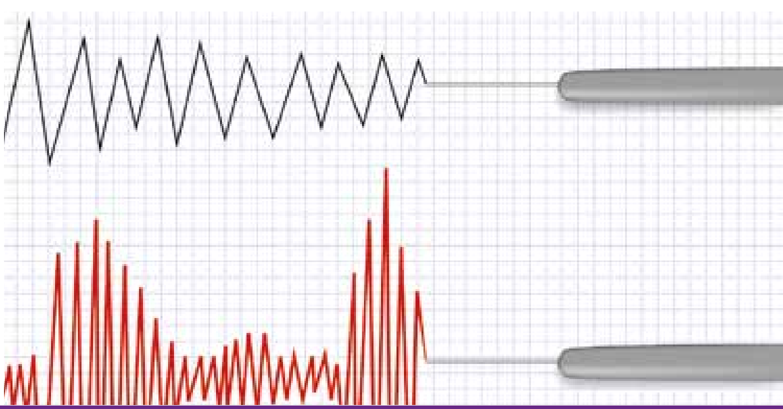
Separately, the Financial Ombudsman Service (FOS) has warned that its funding model under which most firm levies and case fees have been frozen for the past six years is no longer sustainable, and these will need to increase. Currently the FOS operates at a loss of £60m a year; the payment protection insurance (PPI) deadline is pushing up fees and costs.

10. THE FINANCIAL SERVICES REGISTER AND THE ABUSE OF PROFESSIONAL QUALIFICATIONS

The FCA was clearly surprised by the volume of criticism it received over its abolition of its public Register of Certified Persons when the SMCR comes into force. It is now considering alternatives, such as requiring firms to publish these lists or itself to publish them as received from firms. However, it sees problems in each. For example, in lists being inaccurate, out of date or vulnerable to scams.

The CISI is willing to provide a channel for replacing the Register and giving the public free access (see cisi.org/cpregister). There would need to be legal protections to the provider – equivalent to those of the FCA. Firms would also need to provide their information to it. The role of advisers (and the public's ability to find out about the FCA's actions against some of them) in the Tata Steel Pension Scheme reform has added vigour to this debate.

Separately, a review by Unbiased has found that many retail advisers were wrongly claiming to have CISI qualifications. The CISI has threatened to take action against such advisers. It is unclear whether the FCA will also do so – or will leave this to professional bodies. It is clearly a risk to the public.



The following articles are drawn from the Winter 2018 edition of the *Investment Management Review* (*IMR*). For access to the full issue please visit cisi.org/imrmagazine

ARJUNA SITTAMPALAM, CHARTERED MCSI, EDITOR

INVESTMENT MANAGEMENT REVIEW

US ADVISORY SYSTEM IN BETTER SHAPE THAN MiFID II-DRIVEN EUROPE

EDITOR'S INTRODUCTION

The investment advisory regulatory systems are in a state of flux on both sides of the Atlantic. In the US, the new fiduciary rule introduced in 2016 was expected to trigger the biggest shake-up in the advisory system for more than a generation, but its ultimate fate is now uncertain under the new administration.

The Markets in Financial Instruments Directive (MiFID) II in Europe is making fund managers, advisers and other distributors scratch their heads as to how the distribution system will operate.

Notwithstanding any Trump era developments, on current evidence it looks as if the US system has the better chance of evolving to become a role model globally compared with MiFID II facing ongoing structural problems and the relatively rigid Retail Distribution Review (RDR) in the UK.

US FIDUCIARY RULE SURVIVES TRUMP BUT WITH UNCERTAIN FUTURE

The Trump administration was expected to abolish the new fiduciary rule requiring independent advisers to put clients' interests ahead of theirs as legislated under President Obama. However, outright withdrawal has proved to be too hard a nut to crack. The Department of Labor has announced that it will delay the final compliance deadline to 1 July 2019,[1] pending reevaluation of the regulation. It is widely expected that the rule will be subject to significant revisions. This rule, announced in April 2016, was described at the time as set to cause the most radical transformation seen in the US financial advisory sector for decades.

The aim of the rule is to end conflicts of interest by imposing the fiduciary standard already applicable to registered investment advisers and fee-only planners on all who advise on retirement savings.[2] Brokers can continue to rely on commission structures, but subject to various provisions. When advising on retirement plans, they can only charge reasonable compensation, and in selecting investments they must serve their clients' best interests. These stricter criteria contrast with the current standard which has encouraged some to advise investing in vehicles that offer high commission rates regardless of clients' interests.

The Department of Labor is considering a flexible system for compliance. It will consider a more streamlined exemption system for firms, encouraging investor-friendly products posing low conflicts of interest. It is suggested that on the whole the rule might survive the review but without some of its most important enforcement clauses.

Though commissions can still be charged, because of conditions such as the need to show reasonableness, it is expected that the rule will encourage and accelerate the shift to charging fees already well underway.

The review is not all. The Securities and Exchange Commission has also intervened in an endeavour to encourage the Department of Labor to work with it, drawing upon its decades of experience.[3] Legislators are putting forward bills to amend the rule. But perhaps the most important development is that the Fifth Circuit of Appeals at the federal level is hearing arguments to abolish the fiduciary rule altogether on the grounds that the Labor Department exceeded its statutory authority in putting forward the rule, which introduces another layer of uncertainty.[4]

FIDUCIARY RULE BENEFITS TOP WALL STREET FIRMS

Some of the largest and most influential brokerages belonging to top Wall Street firms, even prior to the new fiduciary rule, had been shifting towards fee-based systems, as the latter are more lucrative than the commission-based approach.

The benefit to the top players from the new regulation is already visible. Bank of America's global wealth units, including Merrill Lynch fee-based assets, increased by 19% to just under $1tn in the second quarter of 2017 compared with one year earlier, amounting to 38% of client assets.[5]

Morgan Stanley has adopted a different approach. It has reduced commission charges to comply with the rule's 'reasonable compensation' standard. It is also establishing a new computer-based robo-advisory tool. Its fee-based assets went up by 17% to more than $950bn from a year earlier in the second quarter. Pruzan ascribes some of the move to the fee-based system to the new fiduciary requirement.

SUCCESSFUL FUND MANAGERS HIT BY THE FIDUCIARY RULE

Extra compliance burdens imposed by the fiduciary rule are causing quite a bit of dislocation in the distribution system for US mutual funds, having adverse effects even on some of the successful ones. The large brokerages have been making available thousands of mutual funds to their clients. The sheer number of such funds is now posing difficulties, considering the due diligence and documentation required on investments recommended by advisers. Litigation risks have become a strong consideration.

Unsurprisingly, the brokerage firms are aiming to remove some funds, including those with higher charges or those seen as too risky, both of which might require justification if offered to clients.

Matt McGrew, chief operations officer of USA Financial, a financial services firm in Michigan, expects that his firm will eliminate more than 350 sales arrangements covering mutual funds, variable annuities, alternative investments and fund managers, leaving fewer than 150.[6]

There is now the worry that fund costs may be the key measure in the choice of funds, ignoring the issue of overall return, including costs. Some advisers are also worried that funds they have recommended to clients for years may no longer be available for reasons given below.

COMMISSION-BASED VERSUS FEE-BASED

The move away from commission-based systems is not always to the benefit of even affluent clients who have no problem in paying fees. Though advisers can be biased by high commissions, fee-based systems are not free of conflict either, and in some cases clients would be better off paying commission.[7]

To avoid the typical 1% fee plus another 1% or more for an actively managed fund, they automatically put clients into index funds. Ben Johnson, director of global exchange-traded fund (ETF) research at Morningstar, feels that this approach is having an impact because of the pressure to keep down the total cost of the adviser relationship.

The following is an example of how the commission-based model can be cheaper for some. Consider paying 5.75% for A-share class of the American Funds Fundamental Investors fund with a relatively small 0.6% expense ratio. If this charge of 5.75% is spread out at 1% per annum over 5.75 years, then the overall charge becomes 1.61% per annum for 5.75 years dropping to 0.61% per annum thereafter. On the other hand, if a fee-based adviser uses an exchange-traded fund (ETF) such as iShares Core S&P 500 ETF with a 0.04% expense ratio, when added to the 1% fee will be 1.04% per annum – 0.57% per annum cheaper than for the active fund for the first six years but 0.43% more expensive after that.

Barron's points out that not using the American fund above would have been bad as its performance over 15 years of 10.3% exceeded the S&P 500's 9% and also beat 96% of other funds in its category. But investors have fled for the above reason, with the fund suffering nearly $2bn in outflows over the year. Similar top performing load funds from Franklin Templeton and BlackRock are also suffering,

even great no-load active funds such as Fidelity Contrafund, a perennial success, have lost out. Thus, paying commission rather than fees can be to the benefit of long-term buy and hold investors regardless of wealth levels.

Of course, fee-based advice means ongoing payments and continuing service whereas commission-based advisers have no incentive to advise further for buy and hold customers. Also, remember that very few funds outperform consistently.

Other conflicts arise when fees are charged. For an adviser, the more assets the client has for investment, the better. Thus, the adviser could argue against paying off a mortgage or investing in areas such as business, which will leave less in his/her advice spot.

Furthermore, many advisers are not passive but actively trade ETFs in a dubious attempt to beat the market. Research from the Financial Planning Association finds that percentage of advisers exclusively passive fell from 25% to 15% from 2014 to 2017, during which time ETF use increased from 80% to 88%.

According to Michael Kitces, director of wealth management at Pinnacle Advisory Group, most advisers don't publish returns. His feeling is that not wanting to publish performance indicates lack of good results. Also, these advisers are not as experienced and skilled with support as portfolio managers at fund companies. So, they are unlikely to outperform active funds.

UNCERTAIN MiFID II SHAKE-UP CONFUSING BANKS AND INVESTMENT ADVISERS

Banks' fund managers and distribution platforms are faced with uncertainty concerning the new rules covering fund distribution and advice in Europe, and in many cases are still needing clarification. The problem is much more acute on the continent of Europe, where, unlike in the UK, banks and distribution platforms dominate the advisory and distribution scene.[8]

Research by Platforum, a consultancy, shows that at least 80% of distribution comes from banks in many countries. MiFID II is demanding that distributors have to perform product reviews, should supply more information on sales and charges as well as need to understand and collect data on their target markets for funds. The idea here is that they need to establish that funds are reaching the target markets they are designed for.

It is expected that this will cause banks offering fewer third-party funds to limit the burden. According to Diana Mackay, CEO of Mackay Williams, a highly regarded expert on retail distribution, it makes sense for banks to reduce the number of fund management partners they deal with. Benjamin Quinlan, CEO of the consulting firm Quinlan and Associates, agrees that the banks could offer fewer funds from external managers. A paper by Deloitte in 2016 forecasts that MiFID II could lead to fewer third-party funds on offer by banks to the retail public to keep cost down, thus reducing choice.

But Mackay feels that it could be difficult for those banks that boasted of choosing the best external funds for their customers, to now focus on in-house products only. She feels that some may continue to make available third-party funds through their own label, including fund of funds, reducing the level of due diligence required.

Allfunds, the largest fund platform in Europe, does not expect platforms to reduce the number of offerings as they need to add value to clients. Marta Oñoro, global head of legal at Allfunds, believes that MiFID II will actually boost open architecture.

The situation is different yet again in the independent advisory sector. Mackay predicts consolidation in Europe as independent financial advisers (IFAs) are forced to become larger to reduce the new compliance burdens and pressure on fees. Even in the UK, knock-on effects will occur for IFAs as MiFID II changes the definition of independent advice. But Rodolfo Crespo, senior analyst at Platforum, predicts that independent advice will still grow especially in France, Germany and Spain.

Overall, there is no clear agreement on how MiFID II will shake up European distribution. Mackay points out that many areas are subject to uncertainty. Different distribution structures in the various countries will lead to local interpretation of MiFID II by the national regulators and result in patchwork of rules without any consistency. She says that the ideal of unifying Europe in a single set of regulatory requirements has moved further away.

EDITOR'S COMMENT

MiFID II is introducing measures across the board, some controversial and some applauded. But in the area of investment advisers and distribution, its stipulations leave much to be desired in terms of clarity and clear direction, leaving its potential impact very much suspect. A patchwork of rules across Europe is not an enticing prospect.

Dr Wolfgang Mansfeld, former president of the European Fund and Asset Management Association (EFAMA) writing in the Autumn 2017 edition of *Investment Management Review*, expressed scepticism whether MiFID II could deliver a satisfactory outcome for European distribution and suggested the possibility of the EU moving to the US approach of a fiduciary rule or a UK-style commission ban in a couple of years.

Compared with the US and the UK, distribution in Europe and much of the world remains backward, dominated as it is by the big banks. Over time this is bound to change. The evolving US system received a fillip from the fiduciary rule, but its total abolition is not likely to halt the gradual evolution towards a very flexible approach, minimising conflicts of interest. The fact that this rule is actually benefiting these big players points to their lobbying power and influence, ensuring that some professional version of the rule will come into being.

It looks as if, despite initial expectations, the authorities are adopting a constructive approach to revision, which appears to be not politically motivated on a blanket basis, as widely felt at the outset of the Trump administration.

Some of the arguments on commission versus fees highlighted in the US are valid universally and may be relevant in the long term in the UK as well, when charges come down under pressure of passive fund management and digital disruption.

Much of the world needs to get away from archaic and potentially biased retail bank dominated fund distribution. Despite Trump regime uncertainties, on current form, the US system looks most likely to evolve towards a globally copied model rather than the nationally fragmented system in the EU or the more rigid RDR in the UK.

1. 'Delay for fiduciary deadline', Lisa Beilfuss, *The Wall Street Journal*, 31.08.2017.

2. 'Guard on retirement savings likely to lose bite', Lisa Beilfuss, *The Wall Street Journal*, 10.07.2017.

3. 'Recent developments on DOL fiduciary rule', Victoria A Bruno, *National Law Review*, 22.08.2017.

4. 'A fiduciary rule reckoning', *The Wall Street Journal*, 01.08.2017.

5. 'Wall Street gains on fiduciary rule after objecting to it', Lisa Beilfuss, *The Wall Street Journal*, 14.08.2017.

6. 'Retirement rule casualty: brokers' mutual-fund offerings', Daisy Maxey, *The Wall Street Journal*, 15.08.2017.

7. 'The great fund fee shuffle', Lewis Braham, *Barron's*, 14.08.2017.

8. 'MiFID II scrambles distribution of funds in Europe', Alice Ross, *FTfm*, 02.10.2017.

STRONG ATTACK ON INVESTING FOR THE LONGER TERM

EDITOR'S INTRODUCTION

Investing for the longer term is highly desirable and conversely, short-termism is deplorable,. This has virtually become a paradigm. This belief is strongly challenged by columnists in the *Financial Times* and *Wall Street Journal*. The validity of their case is examined below.

LONG-TERMISM CAN DAMAGE INVESTORS

Andrew Haldane, the chief economist of the Bank of England, in a seminar paper on the virtues of patience in finance, referred to many studies that show the link between growth and patience, while attacking the converse connection between impatience and shortfalls in savings with a poor impact on long-term investments and growth.

Many authoritative investors and academics concur with Haldane's critique of short-termism. Part of the blame is attributed to public companies having to publish results quarterly rather than annually, which shifts investors' focus away from long-term investments that enhance productivity.

In rebuttal, Izabella Kaminska, the *Financial Times* columnist, pointed to tech-based businesses such as Uber, Tesla and Snap which exist because of investors' forgiving long-termism despite their being loss making or having low profits.[9] While admitting that excessive short-termism has negative effects, she argues that long-termist thinking has serious negative consequences. More investors are too forbearing and potentially gullible. Second, idealistic long-term thinking can disconnect markets from reality.

She argues that long-term thinkers uncritically accepting fanciful stories and investor fashions can pose dangers. Investment decisions are then driven by 'the grandeur of futuristic visions appealing to entrenched biases, belief systems or desires'.

WHICH IS MORE SPECULATIVE: LONG-TERM OR SHORT-TERM?

From a different perspective of the long-term, the prominent and regular *Wall Street Journal* columnist James Mackintosh differentiates between investors and speculators. In practice, the two activities are distinguished by time horizon. Speculators trade frequently in the belief that others will enable them to close the deal and thereby make a profit. Investors, on the other hand, are going for the longer term, betting on improvements in fundamentals. Many speculators are considered to be no more than gamblers betting on horses.[10]

Speculation is described as anticipating market psychology, while investors focus on forecasting returns over the entire life of an asset. According to this understanding, speculation relies on a favourable change in the valuation basis, while investors rely on improvement in fundamentals.

Mackintosh quotes a paper published in the *Journal of Portfolio Management* that turns these conventional ideas upside down.[11] This study by Joseph Kushner, an associate at Goldman Sachs Asset Management, finds that short-term momentum traders tend to make their money when fundamentals improve, while value investors, generally considered fundamental, profit most when market prices go up without any commensurate change in earnings or book value.

The analysis looks at the past 30 years and analyses the returns from value and momentum strategies, according to contributions from changes in valuation and business improvements. Though value is associated with fundamentals and not considered speculation, the study finds that the value approach based on buying companies that are considered cheap on the basis of the ratio price to book value derives its gains from a rising valuation without the companies showing any fundamental improvement.

On the opposite side of the coin, it finds that the short-termist approach of momentum holding stocks for just a month typically is beneficial when there are improvements in fundamentals while valuations are actually falling. Overall, contrary to conventional wisdom, the paper indicates that it is the longer-term orientated value investors who are speculative, while the shorter-term momentum players are betting on fundamentals.

Both strategies are routed in human nature. Value investors exploit the fact that investors in general overreact to bad news, leaving companies too cheap on the assumption that they are abysmal. Momentum bets on rising stock prices attracting investors on the basis that they will continue to rise further.

EDITOR'S COMMENT

It is true that long-term investments can turn out to be duds, but it is not generally true. Note that Amazon was making losses for many years after inception and has turned out to be a winner.

Visionary endeavours cannot be dismissed as just grandeur. Microsoft, Google, Facebook and Amazon would not exist today without patient and forbearing investors at inception. Some long horizon investments can pay off in spades and those who stay with them patiently must be congratulated, not just for the fortunes made, but also for their contribution to these behemoths who have changed the face of society.

Kaminska has a point, however. The chance of the average investor spotting a future Google is near zero, and it's far more likely that they will lose out in the way that she suggests. The problem here is that the retail public suffers from a paucity of access to professionally managed long-term vehicles in a suitable range of sectors, a situation screaming for more attention from the authorities.

The basis on which value investing earns returns needs comment. Often, companies that are cyclical in nature are pushed down in market downturns, when a business cycle is moving south or when disaster strikes. It does not need an immediate enhancement in the company's fundamentals for the valuation to improve from exceptionally low levels. Any hint of the economy turning upwards or the evidence that matters cannot get any worse for the company and can only improve can be signals for a boost to valuations, even years before the actual results come through.

The statistical methodology of the paper does not allow for these scenarios which often occur in real life. Contrary to the paper's findings, value investors do bet on fundamentals and make money from them. But often they come in early and must wait patiently till their expectations are realised, and they exit not when the profits come through, but earlier when the market becomes convinced of it. So, the statistics will just show that they came in and went out without any quantifiable change in business results.

The momentum arguments in the paper are also misplaced. The key issue here is new announcements. In general, markets don't react instantly and fully to new developments, and after an initial jump, the trend continues for a while. Momentum investors tend to come in when the trend is clearly underway and are gambling on its continuation and not betting on fundamentals, contrary to a key conclusion of the paper. They rely on getting out before the music stops. Overall, the value and momentum analysis in the prestigious *Journal of Portfolio Management* paper does not support its contention that long-term value investing is a gamble, regardless of fundamentals, while short-term momentum plays represent bets on business improvements.

There are genuine problems in indiscriminate backing of the long term. Outright losers need to be distinguished from potential winners. There is no systematic science that allows this. How long should investors wait and how do they assess that eventually things will turn out OK? Performance measurements can become subjective whichever metric is used, whether share price, revenue or any other variable.

Some trends, however, can provide compelling evidence, such as Facebook's penetration of the global population in terms of proportion covered. But, even here, at the time of Facebook's initial public offering there was much pessimism about its future prospects, given its saturation of the world. What was missed was its spotting correctly the expansion in mobile, which gave it a new powerful boost.

What is long term or short term depends on the investor's perspective. For many pension funds, 25–50 years is the norm. For an 80-year old, perhaps ten years is long, and 60 years is more appropriate at age 20.

Another important angle pertinent to Haldane's comment above is what happens in the real economy. How long is needed for a capital investment to pay off and hence, be justified? In the pre-digital era, a minimum of five years was typical, and 10–20 years is more common. Note that private equity investments used to have 5–7-year time horizons without much exception. Many buyout offerings are now available over a 10–20 year term in response to institutional investor demand driven heavily by pension considerations.

Matters may be different in a digitally disrupted world. The long term has become more difficult to predict, and a careful analysis of social trends becomes more important. For instance, consider increasing urbanisation and the possible shortage of food. These are perhaps among the more reliable developments in the next few decades insufficiently recognised by investors.

What about the perspective of society? Speculators and short-term investors add value in arbitraging and keeping prices liquid and efficient and perform a social function, while long-term investors looking at underlying factors help to keep speculation within bounds and curb the formation of bubbles building up.

The Wall Street Journal and *Financial Time*s, notwithstanding some misplaced arguments, have served to highlight dangers of uncritical acceptance of long termism and what it stands for. However, the argument for long-termism remains strong in spite of problems.

A key here is to back developments with strong economic or societal rationale. Monitoring of short-term developments by professionals is also important for their potential impact on the long term.

9. 'Cultish long-termism can hobble investors', Izabella Kaminska, *Financial Times*, 13.09.2017.

10. 'Long-term vs. short: which is a gamble?', James Mackintosh, *The Wall Street Journal*, 22.08.2017.

11. 'Two types of factors: a return decomposition for factor portfolios', Joseph Kushner, *The Journal of Portfolio Management*, Summer 2017.

CONFLICT BETWEEN US AND MiFID II RESEARCH RULES

The Markets in Financial Instruments Directive (MiFID) II rules on research are in serious conflict with US law and regulations governing research over there. As a temporary measure, the Securities and Exchange Commission (SEC) has introduced an effective suspension of the US rules for a limited time but the problem would still need to be resolved by the end of this period.

This clash puts global fund managers in a quandary. European fund management firms investing worldwide need to buy research from US banks. As the matter stands, to obtain this research they will then face the Hobson's choice of violating either European or US rules.

US legislation currently forbids broker-dealer banks from taking specific payments for research. It is precisely what the new EU rules are insisting on by ruling out bundling together payments for research and execution in the cost of investment deals, and instead demanding that research should be paid for separately.

The rationale for the US legislation conflicting with the MiFID II rules is that broker-dealer banks taking specific payments for research could result in them being classified as investment advisers by the SEC and having to register as such. This status would restrict their ability to trade in their own right as a principal or market-maker, an issue of particular importance in fixed income markets.

The EU rule is in direct opposition to the US stipulation. Investment managers need to make research payments either from their own money or from specifically identified research payment accounts funded by their clients. In either case, specific payments are made for research, directly violating US requirements.

US broker dealers, under the Investors Advisers Act 1940, are exempt from regulation if they have received no special compensation for advice. Unfortunately, MiFID II payments come under the category of special compensation. In another piece of legislation, the Exchange Act of 1934, even if an adviser uses client commission to pay a broker dealer, a safe harbour is provided by the act allowing the adviser to carry on.

MiFID II had introduced the new rule in order to avoid conflicts of interest, giving investors more transparency. The aim was to incentivise providers to enhance their research and allow investors to trade with banks at the best execution price rather than being influenced by the 'free' research provided.

In the absence of a resolution of the problem, US asset managers were concerned that they would be stopped from sharing US analyst research with their European operations paid for through trading commissions from global operations. The largest asset managers run global portfolios investing worldwide and relying on research generated throughout the day in different time zones.

European asset managers were facing the prospect of access to research on mainly stocks and financial instruments sharply cut down because the US sell-side dominates the global sector. It is estimated that the continuation of the conflict would render 75% of the world's analysts out of reach to European fund managers.

Because of the conflict, the FCA clarified some of the rules it wrote in May: that European fund managers delegating key decisions to US managers must ensure that their American counterparts follow MiFID II on research. The FCA's stance was particularly important because it is responsible for enforcing MiFID II rules in the UK which has the world's second largest asset management industry including some of the sector's biggest international names.

In the few months to October 2017, two trade bodies on both sides of the Atlantic had been appealing to the SEC not to charge US managers under the rule, should they comply with MiFID II.

In the UK, 40 of the world's largest asset managers and banks, including BlackRock, Vanguard, JP Morgan, and Schroders, had an emergency summit with the FCA in September to clarify new rules threatening their global operations. They were assured that the FCA, the SEC, and the EC, together had the highest calibre people working on the problem.

It was considered that any action by the SEC would be a rare occurrence of US regulators adapting to foreign laws rather than what they are accustomed to do, imposing their rules on the rest of the world as they did with taxes and market legislation.

On 26 October 2017, the SEC finally obliged. It announced temporary relief due to last for 30 months from 3 January 2018, the implantation date for MiFID II. It did not come up with a new interpretation of the law. In effect it just said that it will not enforce the law against US institutions that violated it in compliance with MiFID II rules for this temporary period so that it can assess the evolution of actual practice and take final decisions as necessary. It gave effect to this decision through three letters which do not represent a change in the law but merely a promise of non-enforcement.

The first letter says that broker dealers can receive research payments from hard dollars or advisory client's research payment accounts. The second letter allows money managers to continue to aggregate orders from mutual funds and other clients, while the third permits the fund managers to continue relying on existing safe-harbour rules while paying broker dealers for research and brokerage.

Joe Clayton, chairman of the SEC, stated that it acted after input from market participants and the move was also welcomed by top executives at the EC and the FCA.

EDITOR'S COMMENT

MiFID II research rules could lead to unintended consequences. Currently, some leading managers have decided to pay for research out of their own pocket. A pertinent question is how much they will pay. Concern has been expressed that there might be a race to the bottom in establishing a market price. When a product has high fixed and low marginal costs, then the choice of the price becomes a matter of business strategy, as in the case of written research, as distinct from analysts' and salespeople's phone calls. The written material could eventually be given away under the same competitive considerations at a nominal fee.

If, however, the charges remain at a high level, the giant firms can easily absorb them, but not so the smaller fry. This is not in the long-term interest of the sector, which has thrived on the dynamism of new entrants. Furthermore, a primary motivation appears to prevent conflicts of interest in dealing at higher prices than justified. This is something that most fund managers would tend to avoid any way as their career prospects depend on their performance.

This is even more true in fixed income. MiFID II has not recognised this while even the French regulator has.

It is understandable, therefore, why the SEC has not jumped to agree with MiFID's logic and is adopting a 'wait and see' approach.

Sage & Hermes Research

The articles you have seen in the preceding pages have been taken from the Winter 2018 edition of the *Investment Management Review (IMR)*. Some of them might appear in the magazine in a more expanded and detailed version. In this digest they don't appear in this way. To access the full version please visit

cisi.org/imrmagazine

TOP US WEALTH MANAGERS PROFIT FROM FAST-GROWING REVENUE SOURCE

In the face of considerable concern that their clients are put at serious risk, they remain complacent about the dangers from a market downturn.

FRANKFURT OBJECTION TO POST-BREXIT LONDON BUSINESS

While all major European cities are scrambling for business from Brexit, there is unexpected opposition in Frankfurt.

ROBO-ADVISORY APPROACHES AND TARGET-DATE RETIREMENT SCHEMES UNDERGO EVOLUTION

The implications for asset managers, advisers and their clients are reviewed.

NEW DIFFERING PATHS OF BLACKROCK, VANGUARD AND FIDELITY PROVIDE STRONG INDICATORS OF INDUSTRY PROSPECTS

The actual actions of the three giant groups in their pole position with a panoramic view of the world speak much louder on the future of fund management than the multitude of conferences on the issue.

LEADING FUND MANAGERS EXPLOIT INNOVATIVE SOURCES OF RESEARCH THROUGH DIGITAL CHANNELS

Much of the industry, however, remains backward for understandable reasons.

NEW SYSTEM PLANNED TO BOOST GERMAN RETIREMENT SAVINGS

The outcome could lead to the German defined contribution system for individuals comparing favourably with what the UK public enjoys at present.

PLANS TO ABOLISH SCANDAL-RIDDEN LIBOR

While the UK authorities have signalled the termination of the traditional benchmark, it will not be easy. Many millions of contracts worldwide will need to be revised, taking a few years. Some predict that the benchmark will survive. The strongest replacements and the chances of LIBOR lasting are reviewed.

THE IPO SYSTEM FOR OBTAINING PUBLIC QUOTATIONS DECAYING

The all-important US equity market has been shrinking, partly attributed to the reduced attractiveness of the traditional initial public offering. Several new approaches have been introduced, including the use of crypto currencies. One method is very promising and fast-growing, but others are dubious.

THE HYPE, THE HOPE AND THE REALITY UNDERLYING BLOCKCHAIN'S TRANSFORMATIVE POTENTIAL

Exaggerated predictions surrounding distributed ledger technology are rife. Investment managers are not enthusiastic en masse, but concrete progress is visible in areas of direct concern to them. The big questions are how widespread and over what timescales might the technology be used in asset management.

To access the full version please visit
cisi.org/imrmagazine

INSIDE THIS ISSUE

The rise and rise of sustainable investment

Sustainable investment, once the province of the do-gooder, has entered the investment mainstream. From pension fund pitches to exchange-traded fund launches, 'green finance' has emerged over the past two years as a common ingredient of much successful fund marketing. A new collection of essays on this theme – '*The perfect storm: navigating the sustainable energy transition*' – has become required reading beyond firms' environmental, social, and governance teams. Its team of lead authors and editors speaks to the confluence of professional, political and academic thinking: Alexander Van de Putte, professor of Strategic Foresight at IE Business School, one of Europe's top academies; Dr Keirat Kelimbetov, governor of the Astana International Financial Centre (and a former deputy Prime Minister of his country); and Ann Holder, chief editor at the Sustainable Foresight Institute.

The term 'green finance' is used to refer to financial instruments, services or activity which result in positive change for the environment and society over the long term. Often this is linked to positive changes to greenhouse gas emissions. Marissa Blankenship of Allianz and Richard Burrett from Cambridge University, two of Professor Van de Putte's chief collaborators on the book, assess some key issues overleaf.

The drive to green finance is being driven by investor demand; ambitious societal objectives (such as the Paris agreement and the Sustainable Development Goals); the rise of new financial instruments (such as green bonds); and improved understanding of risk through enhanced analytics and reporting.

But how big is it, how big will it become? The team behind the long-standing Global Financial Centres Index is now building a Global Green Finance Index (GGFI) in an initiative from Long Finance in association with Finance Watch and the Mava Foundation. The GGFI is designed to shine a light on green finance activity by ranking the world's financial centres on the quality and depth of their green finance offerings. The index is being constructed using a number of existing indices in combination with a survey of senior sector figures from around the world.

The intention behind the GGFI is to:

- Define green financing and green finance criteria.
- Enable financial centres to enhance the range and depth of their offerings.
- Showcase and share best practice in green financing.
- Create a 'race to the top' which will catalyse the growth of green finance, improve policymakers' and other stakeholders' understanding of what makes a financial centre 'green' and shape the financial system to support sustainability goals.

This initiative is being conducted under the leadership of Professor Michael Mainelli, Chartered FCSI, Executive Chairman of Z/Yen. For further information on the project, please contact his colleague Mark Wardle at **mike_wardle@zyen.com**

Managing uncertainty

The CISI is delighted to be involved in a major long-term project with Britain's Open University and the University of Regensburg in Germany, on how financial professionals can best organise their learning strategies in times of uncertainty. The project is investigating the workplace learning strategies of finance professionals faced with unprecedented levels of economic, market, and political unknowns. For many reasons, including but not limited to the post-Brexit landscape, the financial sector in the UK faces more significant uncertainties than at any time in its history. Despite the uncertainties and ambiguities, though, the financial sector considers the knowledge and skills of people as its most valued asset.

Key project questions

- How do finance professionals shape their work in uncertain times?
- What is the nature of uncertainties faced by finance professionals?
- How can active work behaviour in the finance sector be measured on the individual level?
- How can technology be used to scaffold professional learning activities during times of uncertainty?

This work is part of a larger research partnership involving The University of Regensberg (Prof Dr Regina Mulder and Ms Leonie Beatrice Jacob) and The Open University (Professor Allison Littlejohn and Ms Vasudha Chaudhari). To get involved or find out more, contact Ms Chaudhari – see page 70.

The year of economic crime

Governments, law enforcement agencies and regulators around the globe are zeroing in on economic crime: market abuse; money laundering; tax evasion. Exchanges of bank account data between almost all countries have multiplied in the past year under the common disclosure rules. Regulators in Europe – including Britain's FCA – have given clear indications that, with the onslaught of regulation in our sector, MiFID II, GDPR, et al, they will try to be in listening mode for the rest of 2018 when it comes to minor infringements. But on crime they will be most robust in their approach.

The programme for this year's Cambridge International Symposium on Economic Crime – the 36th, and now the biggest gathering of its kind in the world – has a special focus designed by and for financial services professionals, including anti-financial crime, compliance, legal, audit, information security and risk management staff, regulators, law enforcement and other professionals. See *crimesymposium.org* for further information.

The Symposium exemplifies the convening of professionals and academics to mutual benefit – as is, on a smaller but no less significant scale, the paper starting overleaf, co-written by a distinguished financial services professional and an eminent Cambridge University Fellow. The next issue of *Review of Financial Markets* will have a special feature on the changing approach to economic crime. As ever, comments and suggestions are most welcome.

George Littlejohn MCSI, editor, *Review of Financial Markets*

george.littlejohn@cisi.org

UNIVERSITY OF CAMBRIDGE

FINANCING THE SUSTAINABLE ENERGY TRANSITION[1]

Marissa Blankenship, vice president ESG Research, Allianz Global Investors
marissablankenship@gmail.com

Richard Burrett, partner, Earth Capital Partners and Fellow, Cambridge Institute for Sustainability Leadership, University of Cambridge
richard.burrett@cisl.cam.ac.uk

The year 2016 was a tremendous one for the commitment to sustainable finance following the success of the Paris Agreement Conference of Parties 21 (COP21) 2015 and the launch of the Sustainable Development Goals (SDGs).

While the green financial system is in its nascent stages, the combination of government guidelines and commitments as well as interest from issuers and investors demonstrates a willingness to create the financial infrastructure necessary to fund the transition to a low-carbon economy. A range of initiatives from public and private sources have launched which should support the shift from niche to mainstream financing, including China's *Guidelines for establishing a green financial system*, France's commitment to issue a sovereign green bond, recommendations from the G20 Green Finance Study Group to scale up capital for green investment, and the development of green stock exchange platforms. Green finance infrastructure, however, will not be enough as it currently stands to deliver the 70%–80% of the financing supply that will be required from the private sector.

This paper investigates the risks and limitations of the current approach to financing the transition to a sustainable energy future and proposes alternatives, which include a differentiated cost of capital for low- versus high-carbon industries.

Market momentum is growing

The ability to transition to a less resource-intensive global economy is dependent upon green finance instruments. Green finance involves efforts to internalise environmental externalities and adjust risk perceptions to boost investments that will aid the transition to a low-carbon economy and mitigate the risks from climate change.[1] Green financing, in particular green bonds, has strong support from the public sector. It is estimated that the total green bond market size at the end of the 2016 was $192bn, however the majority is publicly funded.[2] To make the transition to a low-carbon economy, substantial investment is needed to sustain the momentum from 2016 to finance renewable energy, energy efficiency and clean technology.

Decarbonising by changing the world's energy system and adapting infrastructure are the largest financing hurdles. Estimates by the United Nations Environment Programme – Finance Initiative (UNEP FI) suggest that $35tn is needed between now and 2050 to finance the sustainable energy transition.[3] While the Global Commission on Energy and Climate estimates that $90tn in investment is needed to adapt both man-made infrastructure and natural infrastructure over the next 15 years and to meet this challenge the pace of infrastructure investment needs to double to an average of $6bn per year by 2030.[4] Furthermore, the risks due to climate change are not isolated to transition, physical and liability risks but investment will also be needed to address the disruption to social systems.

Carbon markets have expanded since the EU introduced the Emissions Trading Scheme in 2005. This caps the total amount of carbon dioxide, nitrous oxide and perfluorocarbons and limits emissions from 11,000 heavy industries and airlines in 31 countries. By 2020, emissions from covered sectors should be 20% lower than in 2005 and 30% lower by 2030.[5] Other national and regional schemes existing or under development include those in China, California, and Japan, but through Article 6 of the Paris Agreement a more ambitious international market mechanism could come into force. According to the Organisation for Economic Cooperation and Development (OECD), carbon prices are about 80% lower than required to protect the climate, and in their analysis of six industries in 41 countries, emission costs through fuel taxes or trading systems need to rise to at least $34 a metric ton. Currently, 90% of global emissions are taxed or priced below $34 and 60% of emissions are not priced at all.[6]

Clean technology is a fragmented market with each technology attempting to respond to the challenge of creating a clean future but at varied stages of adoption. Bloomberg New Energy Finance counted, as of 2015, more than 600 publicly-held companies worldwide in the clean energy value chain, with at least moderate corporate exposure to renewable energy or smart technologies.[7] This transformation has led to new installations of renewable energy overtaking conventional power for the first time in 2015 to 153 gigawatts (GW), or 55% of new installed capacity, thus exceeding coal for the first time.[8] Investment in renewable energy sources such as wind, solar and other clean technologies such as smart grids, storage and electric vehicles is expected to represent about 5% of global GDP for 2016, or approximately $3.8tn.

Global green bond issuance topped $100bn in 2017 surpassing the issuance volume of 2016. Poland issued the first sovereign green bond in December 2016 but during 2017, France became the second nation to issue a sovereign green bond with a €7bn issue in January, and Fiji emerged as first Pacific Island nation and emerging economy to issue a sovereign green bond. Nigeria became the fourth country globally and the first African nation to issue a sovereign green bond in December 2017. The issuer universe continued to grow but market insiders see much more potential for banks and corporates to lift green issuance. In response to Paris Agreement commitments, perhaps there has been increasing focus on green city bonds, resilient infrastructure and alignment with national climate targets.

The role of financial institutions

Financial institutions represent only about 4% of total outstanding green bond issuances and this picked up ahead of COP21. Banks have primarily focused on financing renewables and green buildings; however, there is a significant challenge in data management and project reporting, thus reinforcing the need for governments and investors to agree on common standards for green bonds and other financing tools. Financial institutions are in competition with development banks such as the European Investment Bank (EIB) and KFW (German Development Bank), which have attractive financing facilities for green activities, and which may undermine the attractiveness of funding through green bonds.

1. http://unepinquiry.org/wp-content/uploads/2016/09/Synthesis_Report_Full_EN.pdf.
2. Orith Azoulay et al., 'Green bonds 3.0: quality check,' 2017.
3. http://www.unepfi.org/climate-change/climate-change/
4. http://newclimateeconomy.report/2016/wp-content/uploads/sites/4/2016/08/NCE_2016_Exec_ summary.pdf.
5. https://ec.europa.eu/clima/policies/ets_en.
6. http://www.oecd.org/tax/carbon-pricing-efforts-are-falling-short-but-even-modest-collective-action-can-deliver-significant-progress.htm.
7. https://data.bloomberglp.com/bnef/sites/4/2016/01/Clean_Energy_Investment_ Factpack.pdf.
8. https://www.iea.org/newsroom/news/2016/october/medium-term-renewable-energy-market-report-2016.html.

Reprinted by permission from A. Van de Putte, K. Kelimbetov, & A. Holder (eds.), *The perfect storm: navigating the sustainable energy transition* (2nd edition, pp. 73–91). Dilbeek, Belgium: Sustainable Foresight Institute

Typically viewed as being on the periphery, products and services affiliated with sustainability, but not necessarily in a traditional green context, are also increasing. Measures to finance a sustainable energy transition should not be at the detriment of investment in social finance and financial inclusion. Replacing the Millennium Development Goals, the launch of the SDGs in September 2015 provided a call to action for the private sector to play a fundamental role to end poverty by 2030. This critical roadmap consists of 17 goals and an estimated investment of \$5–\$7tn per year including investment in infrastructure, clean energy, sanitation and agriculture.[9] One approach is through impact investing where assets under management increased from \$25.4bn in 2013 to \$35.5bn in 2015, representing a compound annual growth rate of 18%.[10] Over 60% of investment was allocated to emerging markets, with 70% allocated through private debt and private equity and with the highest allocations to microfinance, other financial services and energy. Moreover, in October 2015, a group of banks and investors launched a new financing paradigm called the Positive Impact Manifesto, calling for an impact-based approach to investing where businesses, financial institutions and their counterparts in the public sector, and civil society work collaboratively to develop new business models and financing approaches to help address the SDG funding gap.[11]

The role of global integrated frameworks

Governments and investors agree that the sustainable energy transition will require a financial system that is based on common standards. For the green finance market to develop for the long term, this will require that companies develop a disclosure baseline and then consistently report data on environmental factors including carbon emissions, air, water and land pollution, energy savings, and water intensity. Poor public disclosure makes it difficult for investors to measure their exposure to climate risk. Companies in India and China have a particularly steep curve ahead to increase disclosure of greenhouse gas emissions. According to Sustainalytics, only 15 of 71 Chinese companies under coverage report this data.[12]

Public companies often cite that they do not receive enough demand from stakeholders to invest in tracking and reporting environmental, social and governance (ESG) information on a regular basis.[13] Investors, on the other hand, cite their commitment toward ESG integration through the 1,500 signatories to the United Nations-sponsored Principles for Responsible Investment (PRI) which represents \$62tn in assets under management (AUM) or 50% of the total global institutional asset base.[14] Furthermore, Bloomberg has seen the number of investors on its integrated platform accessing ESG data increase from 1,545 users in 2009 to 12,078 users in 2015, indicating a 680% increase over a six-year period.[15]

There is an immediate need for investors, especially the signatories of the PRI who have committed to active ownership and to seek appropriate disclosure on ESG issues by the entities in which they invest, to engage with companies who inadequately address the transition to the low-carbon economy in their strategy as well as encourage companies to use the available resources for reporting consistent and comparable ESG information. There is a distinct opportunity to transform this current scenario into one where capital markets reward sustainability performance with capital and credit and there are multiple initiatives and frameworks available to companies, which define what is needed to ensure that the right ESG information is consistent and comparable for investors.

Marissa Blankenship

Marissa Blankenship is a senior ESG analyst with Allianz Global Investors, which she joined in 2011. As a member of the firm's environmental, social, and governance team, she is responsible for research and engagement on companies in the financial and real estate sectors. Marissa also serves on the advisory committee to the Sustainable Stock Exchanges Initiative, Investor Working Group. She has spent over ten years in sustainable finance, with prior roles in developing an impact investment fund of funds and as an adviser to a microfinance fund at Incofin Investment Management. Marissa started her investment career in the equity strategies group at Hall Capital Management in San Francisco.

Marissa holds a BS in Economics from the University of California, Davis. She also holds an MSc in Latin American Economic Development from the University of London and a Masters in Sustainability Leadership from the University of Cambridge.

Cooperation between exchanges and regulators

To meet the ever-growing need for ESG data, international cooperation between regulators and stock exchanges is needed to ensure that guidelines, listing rules and frameworks are harmonised. The plethora of frameworks and initiatives currently available evidence the importance of providing ESG criteria. While it is not mandatory in most markets to disclose ESG information, projects such as the Sustainable Stock Exchanges (SSE) initiative have been successful in promoting the dialogue on best practice in ESG reporting. Approximately 60 stock exchanges to date have joined the peer-to-peer learning platform for exploring how exchanges can enhance corporate transparency and ultimately performance on ESG issues and encourage sustainable investment.[16]

Apart from encouraging companies to enhance ESG reporting, stock exchanges have a critical role to play in advancing the green bond market. The 11 stock exchanges that currently list green bonds, including Johannesburg, London, Luxembourg, Oslo, and Shenzhen, have made an important contribution to green finance by defining the basic rules of the market and fostering innovative green finance products. However, more stock exchanges need to be involved in listing green bonds as well as educating issuers and investors on climate risk disclosure, promoting green products and services, and introducing listing rules for green bonds.

In addition to ESG guidance from stock exchanges, voluntary reporting frameworks have evolved as the importance of material ESG factors has developed. Trendsetters in the industry include the Equator Principles (EP), Carbon Disclosure Project (CDP), the Global Reporting Initiative (GRI), and Integrated Reporting. The Equator Principles have become a market standard for financial institutions in the assessment and management of environmental and social risk in project financing. More than 80 banks have adopted EP and use their standards in their due diligence process and reporting on the infrastructure projects they finance, many of which are in the energy sector.

The CDP has played a key role in socialising climate risk among investors over the past 15 years and has created a system upon which investors can engage with companies on environmental issues including climate change, water scarcity and deforestation. More than 5,600 companies respond to the questionnaire and investors representing over \$100tn in

9. http://www.ohchr.org/Documents/Issues/Business/ForumSession4/SDGs_UNPGs 14oct.pdf.
10. https://thegiin.org/assets/GIIN_Impact%20InvestingTrends%20Report.pdf.
11. http://www.unepfi.org/fileadmin/documents/PositiveImpactManifesto.pdf.
12. https://www.researchgate.net/publication/310503419_ESG_Spotlight_China_leaps_ahead_at_G20_A_carbon_market_on_the_horizon_6_September_2016.
13. Wendy Stubbs and Paul Rogers, 'Lifting the veil on environment-social-governance rating methods,' *Social Responsibility Journal*, 9(4): 622–640, 2013.
14. https://www.unpri.org/about.
15. https://data.bloomberglp.com/sustainability/sites/6/2016/04/16_0404_Impact_ Report.pdf.
16. http://www.sseinitiative.org/wp-content/uploads/2012/03/SSE-Report-on-Progress-2016.pdf.

assets are requesting this detailed environmental disclosure.[17] The CDP is also aiding companies to look beyond the environmental impact of their own operations to the environmental impact of their supply chain, where according to the founder of the CDP, Paul Dickinson, the world could see a predictable industrial revolution as there are vast efficiencies to be gained from the greening of supply chains.[18]

Similarly, the GRI, started in 1997 by the Coalition for Environmentally Responsible Economies (CERES), has evolved into a set of standards that help companies to undertake sustainability reporting of material economic, environmental and social issues. About 82% of the world's largest 250 corporations use GRI to report on their sustainability performance.[19] For companies who have already embedded sustainability into their strategy and are able to quantify the financial impact, the Integrated Reporting framework enables them to present a comprehensive view of how value is created over time as measured by how various capital – such as financial, manufactured, intellectual, human, social and relationship, and natural – increase, decrease or transform as a result of an organisation's business activities and outputs.[20]

Some of the most powerful tools in the ESG integration debate have been developed from research assessing important energy transition hurdles, such as the systemic risk of a carbon bubble leading to stranded assets and the resultant impact of fossil fuel divestment. Carbon Tracker, an independent financial think tank, has been instrumental in bridging the gap between capital markets and climate change by defining the term 'stranded assets' or capital expenditures which may be allocated to investments that may not yield the expected returns in a low demand, low price scenario.[21] Carbon Tracker is particularly critical of the oil industry, which they believe is still operating on the basis of very aggressive assumptions, including the OPEC assumption which is predicting a 40% growth in fossil fuels out to 2040.[22] However, in the context of the transition to sustainable energy, about 60% of publicly held debt in oil and gas companies, representing $636bn, matures after 2020 and is at risk of repricing as investment in clean energy grows and investment in fossil fuels decreases.[23]

Divestment from fossil fuels does not fully address the need to transition to a sustainable economy, and therefore the debate has continued to deepen on the subject, in part driven by the almost 200 countries which agreed at COP21 in December 2015 to reduce greenhouse gas emissions and accelerate the transition to a low-carbon economy.

As the financial risk implications of climate change are often misunderstood and the long-term nature of the problem makes it challenging in the context of economic decision-making, the G20 finance ministers and central bank governors asked the Financial Stability Board to review how the financial sector takes account of climate-related issues. The resulting industry-led Task Force on Climate-related Financial Disclosures has made recommendations to banks, insurance companies, asset managers, and asset owners to help influence organisations to provide more consistent climate-related financial disclosure. The key recommendation is that companies should stress test their potential climate-related risks and opportunities under different scenarios, including a 2°C scenario to understand the full impact across their portfolio.[24]

Richard Burrett

Richard Burrett is a partner at Earth Capital Partners – a company specialising in providing advice on investments that address the challenges of sustainable development. He has spent over 30 years involved in international finance. In his 20 years with ABN AMRO, he developed extensive experience of project and structured finance, particularly in the energy and infrastructure sectors. In the role of global head of project finance, he was also instrumental in the creation of the Equator Principles, a market-recognised standard for managing environmental and social risk issues in project financing. Latterly, as global head of sustainability, he chaired the group's Sustainability Council and developed the bank's strategy on climate change and the carbon markets. Richard is a Fellow of the University of Cambridge Institute for Sustainability Leadership and senior adviser to the Earth Security Group. He holds a BA in Modern Languages and an MBA, both from Durham University.

Overall, there is a lack of systematic integration of ESG issues into capital adequacy assessment in the financial regulation of both the banking and insurance sectors.[25] Long-term systemic risks such as climate change are not integrated into Basel Committee on Banking Supervision frameworks.[26] However, some central banks have been involved at the country level in terms of promoting integration of ESG. In 2012, the Central Bank of Nigeria launched the Nigerian Sustainable Banking Principles, which are compulsory and require that banks develop a management approach that balances environmental and social risks through their business activities. In 2016, the People's Bank of China and the G20 Green Finance Study Group released the Guidelines for Establishing the Green Financial System which states that its main purpose is "to mobilise and incentivise more private capital" to invest in green industries.[27] The fragmented approach to ESG integration from all actors including governments, regulators, stock exchanges, investors, companies, and NGOs is a significant risk to the SDG funding gap.

Can the momentum be sustained?

While awareness is growing of the role investors and other financial institutions can play in financing the transition to a low-carbon and sustainable economy, the policy and regulatory environment to facilitate this at the scale and pace required is lacking. The financing needs of the Sustainable Development Goals will run into trillions rather than billions.[28] Policymakers should have a duty to the wellbeing of both current and future generations, as well as to the natural capital upon which we all depend. The current reliance on largely voluntary initiatives from the private sector to address these sustainability challenges will not promote the transformational change required. Policy action is required to scale up the flow of capital towards sustainable businesses of the future and away from the unsustainable practices of 'business as usual'. This will include putting pressure on policymakers to address the key sustainability challenges within capital markets and the broader

17. https://www.cdp.net/en/info/about-us.
18. https://www.theguardian.com/sustainable-business/blog/carbon-disclosure-project-cdp-frances-way.
19. https://www.globalreporting.org/information/about-gri/Pages/default.aspx.
20. http://integratedreporting.org/why-the-need-for-change/.
21. http://unepinquiry.org/wp-content/uploads/2016/09/The_Financial_System_We_Need_From_ Momentum_to_Transformation_Summary_EN.pdf.
22. http://www.opec.org/opec_web/static_files_project/media/downloads/publications/ WOO%202016.pdf.
23. https://www.bloomberg.com/news/articles/2017-01-23/oil-bonds-may-face-sharp-repricing-on-climate-boe-analysts-blog.
24. https://www.fsb-tcfd.org/wp-content/uploads/2016/12/16_1221_TCFD_Report_Letter.pdf.
25. http://www.iisd.org/pdf/2012/lenses_clocks_june_2012.pdf.
26. http://www.cisl.cam.ac.uk/publications/publication-pdfs/stability-and-sustainability-basel-iii-final-repor.pdf.
27. http://www.pbc.gov.cn/english/130721/3131759/index.html.
28. http://www5.worldbank.org/mdgs/post2015.html.

economy. Government inaction in this area will increasingly reduce the wellbeing of current and future generations. At its heart, this means changing the cost of capital.

The role of overarching incentives

A World Bank study from late 2016 charts how carbon markets have developed around the globe,[29] but, as stated above, the volume and price of carbon trading remains low as does the degree of linkage between these fledgling markets. As such, no meaningful price signal is being sent to the markets or factored into decision-making. Sir Nicholas Stern described this as the greatest market failure the world has seen.[30]

In terms of broader ecosystem benefits, the situation is arguably less favourably developed. A 2014 study on ScienceDirect by De Groot et al produced global estimates of the value of ecosystems and their services. Acknowledging the uncertainties and contextual nature of any valuation, the analysis shows that the total value of ecosystem services to the global economy is considerable but, perhaps more importantly, their results show that most of this value is outside the market and "best considered as non-tradeable public benefits".[31] The continued over-exploitation of ecosystems thus comes, they argue, at the expense of future generations and this information is not being used to improve decision-making and institutions for biodiversity conservation and sustainable ecosystem management.

One attempt to address this has been the Wealth Accounting and Valuation of Ecosystem Services (WAVES) global partnership program launched by the World Bank.[32] WAVES is a partnership that aims to promote sustainable development by ensuring that natural resources are mainstreamed in development planning and national economic accounts. Another manifestation of this approach is the creation of the Natural Capital Committee in the UK, which advises the government on natural capital, such as forests, rivers, minerals and oceans, and looks at the benefits we derive from natural assets, such as food, recreation, clean water, hazard protection and clean air. It is questionable, however, what impact this advisory group has had on UK policy development in this space and what signals, if any, this has sent to the wider market.

Despite the lack of these external market pricing signals, responsible investment initiatives such as Principles for Responsible Investment (PRI) with their large global memberships claim to promote the analysis and integration of emerging ESG issues into both risk management and product development. The degree to which these factors are being systematically integrated is however an area of debate and arguably many ESG impacts remain as externalities in decision-making terms. In 2012, a study by Mercer[33] (a leading global investment consultant) of 5,000 different fund management strategies found low levels of ESG integration. Mercer's work in this area led to a report in 2014 setting out their own thinking on *An investment framework for sustainable growth*.[34]

Despite a plethora of studies showing clear links between ESG integration and positive corporate financial performance, there is still an urban myth that ESG integration will lead to underperformance. The global sustainability movement has made significant progress in the past decade, evidenced in part by the increasing number of companies and governments actively pursuing sustainability strategies. Despite this, the massive financial investments necessary to achieve environmentally and socially sustainable business models appear somewhat hindered by lingering misperceptions regarding financial returns. These persist in the investment sector where it is often argued that the business case for sustainable investment strategies has yet to be conclusively made and there is a trade-off between being socially and environmentally sustainable and achieving superior financial returns.

Morgan Stanley research[35] argues that in the world of finance nothing helps dispel a myth quite like a solid business case. "There is a realisation that resource scarcity and the incorrect pricing of resources such as water, clean air and soil will ultimately impact business," says Mindy Lubber, president of Ceres, a non-profit organisation that works with companies and investors to incorporate sustainability into business planning and decision-making. "The connection between environmental, social and governance factors and corporate financial performance is becoming increasingly clear." This implies significant value at risk.

An increasing body of academic research is arguing this case. Khan and Serafeim and a team at Harvard Business School, using quantitative research methods, support that view. In a 2015 HBS paper[36] the team looked at the investment performance over time of firms with high and low focus on material sustainability issues and revealed a significant outperformance by those companies with a high focus on material sustainability issues.

A key finding emerging from the research is that understanding the materiality of the different sustainability issues for different companies (and their respective sectors) seems to be an important factor for understanding the financial impact of these issues. This may appear obvious but some corporate sustainability strategies are wide-ranging and externally focused and less focused on the issues that are really material to the company.

According to Serafeim, this means that companies can create economic value or just waste shareholders' money by trying to "do good". Which one of the two happens depends on whether the company is trying to improve performance on an underlying topic that is important for the industry that it is in, Serafeim argues. Identifying what is material for a company, and how to improve performance on that issue in a way that is synergistic to financial performance, requires demanding work from the part of the company. There is a clear pointer here for the management to ensure real internal understanding of the sustainability issues relevant and material to the business and that these are proactively managed, and performance disclosed in the company's reporting. This will be critical for those corporates undertaking sustainability or integrated reporting and engaging and communicating to end investors.

The theme of identifying sustainability issues that are both relevant and material to company performance and hence investment return is gaining traction. Similarly, approaches that look at the relevant performance of different investment strategies with alternative weightings to reflect issues such as climate change and carbon intensity are increasingly under review. Given the recent increase in the growth of 'passive' investment mandates, PRI members are currently looking at how enhanced passive and sustainable smart beta approaches to investment analysis can generate superior returns in this growing sector. If the use of smart sustainability focused indices gains traction, then companies that lead their sector in terms of sustainability performance may retain positions in these indices and maintain investment levels.

A German meta study in 2015 entitled *ESG and financial performance: aggregated evidence from more than 2,000 empirical studies,* (Gunnar Friede, Timo Busch & Alexander Bassen)[37] looks at the link between ESG integration and corporate financial performance (CFP). The fact that this

29. http://documents.worldbank.org/curated/en/598811476464765822/pdf/109157-REVISED-PUBLIC-wb-report-2016-complete-161214-cc2015-screen.pdf.
30. http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/sternreview_index.htm.
31. http://www.sciencedirect.com/science/article/pii/S2212041612000101.
32. https://www.wavespartnership.org/
33. http://www.actuarialpost.co.uk/article/only-9---of-investment-strategies-attain-top-esg-ratings-1983.htm.
34. https://www.mercer.com/our-thinking/an-investment-framework-for-sustainable-growth.html.
35. http://www.bloomberg.com/sponsor/morgan-stanley/sustainable-investing/?mvi=d52781b9515544919e17eae200115fc4.
36. http://hbswk.hbs.edu/item/corporate-sustainability-first-evidence-on-materiality.
37. http://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917.

study takes aggregated evidence from more than 2,000 empirical studies over 30 years makes it the most comprehensive data set analysed. While roughly 10% of studies find a negative ESG-CFP relationship, 48% of studies report a positive effect on CFP (the remainder are mixed or neutral results). Furthermore, the positive ESG impact on CFP appears stable over time. "Promising results" are obtained when differentiating for portfolio and non-portfolio studies, regions, and young asset classes for ESG investing such as emerging markets, corporate bonds, and green real estate. This study concludes that the business case for ESG investing is empirically very well founded. It may however not be the final word on this subject.

Fiduciary duty remains a potential reason for some to push ESG to the fringes as immaterial. Short-term focus on financial return is often cited as the key reason for this and several legal and structural issues that promote this financial focus and short-termism are under scrutiny. Many investors are still not systematically considering ESG integration as part of their fiduciary duty, claiming that financial return is their dominant fiduciary focus. Increasingly, it is being argued that investors should consider ESG integration as part of their fiduciary duty rather than ignore it. UNEP FI has partnered with the PRI, the UN Global Compact, and the UNEP Inquiry to review investors' practices and policies. The project will identify investors' needs and concerns to be addressed to achieve ESG integration at a global level and will reveal how policies and legal frameworks can accelerate the process.

Disclosure of ESG impacts and dependencies

Stakeholders are calling for enhanced reporting of corporate responsibility and other information that impacts business performance. This is predicated on the thesis that today an organisation creates value not only for its shareholders but also for the society as a whole by means of a sustainable strategy. Disclosure of the material ESG impacts and dependencies becomes critical to understand the fundamental sustainability of a business and is at the heart of the integrated reporting.

In advance of the Earth Summit in Rio in 2012 (Rio+20), a coalition of investors, the Corporate Sustainability Reporting Coalition (CSRC),[38] convened by Aviva and representing \$2tn of assets, asked participants at Rio+20 to commit to an agreement on sustainability reporting to enable investors to help guide the world towards a sustainable future. They argued that this agreement needed two core elements for such a convention to work.

First, the convention would be a commitment by UN member states to develop regulations, codes or listing rules that encourage the integration of sustainability issues within the annual reports of all listed and large private companies. Second, they offered an opt-out for companies that elect not to report on sustainability issues. In that case those companies would be required to explain their reasons to their stakeholders. In other words, corporate sustainability disclosure would be on a 'report or explain' basis. Despite this pressure from mainstream financial institutions, governments participating at Rio were collectively reluctant to make integrated reporting mandatory. Disclosure was discussed but left as a voluntary recommendation in the summit output document.

In December 2014, the European Commission adopted a new directive obliging large corporations to provide non-financial disclosure to the markets. Companies falling into that classification would be required to report on environmental, social and employee-related, human rights, anti-corruption and bribery matters. Additionally, these large corporations would be required to describe their business model, outcomes, and risks of the policies on the above topics. The reporting techniques are encouraged to rely on recognised frameworks such as GRI's Sustainability Reporting Guidelines and will also include recommendations from the Task Force on Climate-related Financial Disclosure. At the time of writing, this 'obligation' remains a work in progress. It remains a case of 'should' rather than 'must'.

Despite the seemingly growing pressure, resistance to such sustainability reporting remains. There is a perception of higher costs and resource requirements at every level of the corporation to enable this to be done, primarily due to lack of experience in the assessment and understanding of this issue set and an increase in the proliferation of reporting requests from different bodies. It can be argued the lack of overall progress towards formal mandatory disclosure has led to that proliferation of voluntary initiatives such as the Carbon Disclosure Project, and Dow Jones Sustainability Initiative imposing a range of different requirements and using differing standards of reporting.

Some also fear that in more litigious environments, greater transparency can lead to potential new risks for the company due to the disclosure of negative performance and the corresponding responsibility to redress it. Understanding an organisation's key impacts and dependencies becomes a potential liability rather than a matter of responsibility. The historic denial by certain fossil fuel-based companies of climate change impacts is perhaps founded in that concern.

The lack of appropriate information flowing between the market and financiers causes issues of both market inefficiency and ineffectiveness. Both potentially lead to the misallocation of capital. Due to governmental failure to require proper internalisation and disclosure of environmental and social costs into companies' profit and loss statements, the capital markets do not systematically incorporate these full social and environmental costs into valuation models. Indeed, until these market failures are corrected through government intervention of some kind, some have argued that it would be irrational for investors to incorporate such costs[39] as they do not affect financial figures and appear on the balance sheet or – therefore – affect companies' profitability. At its most basic level, this means that corporate cost of capital does not reflect the true sustainability of the firm. This market failure leads inter alia to issues such as the carbon bubble and resultant investment in future stranded assets. Ultimately, this leads to growing concerns on financial stability.

The need for transformation

A comprehensive transformation of the entire financial system is arguably required to deliver a sustainable low-carbon economy. However, it will be difficult to keep the momentum from 2016 going without both the public sector and private market leadership to fully embed sustainability into each step of the process – from regulatory policy level through to integration of sustainability criteria into mainstream private sector financial decision-making.

Recommendations in 2016 from UNEP's Inquiry into the Design of a Sustainable Financial System highlight that a shift in the system is required, including developing common methods, tools and standards, embedding sustainability at the national level into long-term road maps for financial reform, leveraging public finance, and raising capacity building.[40] Each part of the financial system has its part to play to ensure the transition to a sustainable economy including the public sector, pension fund management, issuers and regulators.

The public sector, including central banks, finance ministers and public financial institutions, is taking a leadership role and is involved in the debate including the Financial Stability Board's Task Force on Climate Financial Disclosures and the G20's Green Finance Study Group. While harnessing private capital is essential to make up the lack of funding from public finance, the creation of new markets such as green bonds

38. https://www.theguardian.com/sustainable-business/investors-sustainability-agenda-rio-2012.
39. https://sustainabledevelopment.un.org/content/documents/10574avivabooklet.pdf.
40. http://unepinquiry.org/wp-content/uploads/2016/09/The_Financial_System_We_Need_From_ Momentum_to_Transformation_Summary_EN.pdf.

has been critical to the mainstream development of sustainable finance. The public market has also pioneered incentives and subsidies that support sustainable development, including tax relief on debt, savings, and pensions, as governments use incentives and innovation to align with sustainability goals.

Asset owners have a responsibility to publish commitments to ESG integration and report to beneficiaries how these commitments have been implemented. Furthermore, there is a need to build capacity with trustees, boards and executives so that they have the knowledge to hold asset managers and consultants to account for their performance in terms of long-term value creation of the assets under management. Asset owners should also not solely rely on their asset managers to engage with companies on providing ESG transparency. This will almost certainly necessitate a review of the remuneration and incentive mechanisms built into asset management contracts to ensure that they are managed for the long term.

Issuers will also be aware of current market momentum as governments and public finance institutions emphasise the importance of ESG disclosure as part of the larger post-2015 sustainable development framework. This will increase a company's need to evaluate (or re-evaluate) their sustainability strategy and to consider how to improve their ESG communication to the market. As it stands, the market is lacking an effective system by which to price sustainability into financial asset values and therefore reward companies by directing flows toward sustainable assets. Effective disclosure of relevant ESG information is necessary to ensure greater allocation of capital to sustainable outcomes by rewarding sustainable companies and encouraging a shift in behaviour by less sustainable companies.[41] Research indicates that companies that successfully integrate ESG considerations in their business strategy gain significant economic, accounting, reputational and market advantages[42] and firms that voluntarily disclose information to the market including sustainability data, have a lower cost of capital than firms that do not.[43]

Global regulators such as the International Organization of Securities Commissions (IOSCO) have not historically placed ESG disclosure on their agenda nor have they adequately responded to collective investor calls to action requesting that they work more closely with regulators, stock exchanges and other related parties to improve the disclosure of material and high quality ESG information in the global marketplace. Change is starting to filter through at regulators, including the US Securities and Exchange Commission (SEC), which in April 2016 published its consultation on *Business and financial disclosure required by Regulation S-K*. Nonetheless, the chair of the SEC, Mary Jo White, has continued to urge investors that want to change corporate behaviour on sustainability-related issues to use their stewardship.[44] Until regulators globally push for mandatory ESG disclosure in listing requirement and information memoranda, stock exchanges will continue to create their own voluntary guidance which is a step forward but still lacking in terms of a system shift.

Supporting global sustainable finance initiatives

We should not underestimate the role that public finance institutions play in mobilising private capital and stimulating market leadership for sustainable development. Multilateral and development finance institutions have played a significant role in recent years in promoting co-financing with private sector institutions to address sustainable development challenges. At the same time, the development of many sustainability standards and approaches in private sector financial institutions can be traced back to or were supported by public sector entities. The UNEP Finance Initiative is one such example of this. The Principles for Responsible Investment received UN patronage. UNEP FI facilitated the development of the Principles for Sustainable Insurance and the IFC (International Finance corporation) had a pivotal role in the creation of the Equator Principles.

As previously highlighted, there needs to be a massive scaling of finance around achievement of the SDGs. About $5–$7tn a year until 2030 is needed to realise the SDGs worldwide, including investments into infrastructure, clean energy, water and sanitation, and agriculture. Public-private sector partnerships (PPPs) and 'blended finance' will be one core element of that response and the work currently being done by private sector banks and investors around 'positive impact finance' is an acknowledgment that the greater part of the necessary financing and investment will come from private finance.

The institutions involved argue that "while a wide range of sustainable finance products and services are available in the market, these mobilise limited funds compared to what is needed and for a limited number of things – based on a pre-identification of acceptable sectors and activities."

They quote often unattractive risk and return profiles as barriers to greater investment and consequently the amount of private finance mobilised to date to achieve the SDGs is in marked contrast to the scale of the needs.[45]

To bridge that funding gap for sustainable development and the attainment of the SDGs requires a new, impact-based approach, based on a holistic consideration and integration of the three pillars of sustainable development into all decision-making. The manifesto around which the leaders of this initiative align calls for "a collaborative, solution-building approach to developing and implementing new business models and financing approaches that will help address the SDG funding gap and realise the SDGs themselves".

Financing the 'future we want' (the mantra of Rio+20) makes sense from both a risk management and resilience perspective. It aligns the social purpose of finance to agreed development objectives such as the SDGs. Some financial institutions are beginning to think through what such an approach might look like at a national level. Lloyds Banking Group's Helping Britain Prosper Plan[46] is one such example in the UK. In South Africa, Nedbank's Fairshare 2030 plan describes itself as "a carefully calculated flow of money, allocated each year to invest in future-proofing the environment, society and our business".[47]

These are just two examples of the way financial intermediaries can apply their influence and creativity to increasing the flow of capital into business models that serve society's long-term interests. To channel technological innovation to finance sustainable development. To finance the future and not the past.

Conclusion

In this paper, we have set out to look at some of the critical issues around financing the sustainable energy transition. We have deliberately looked at the issues of the broader green finance sector as many of the factors that will ultimately lead capital flows towards positive sustainability impact and away from the financing of unsustainable social and economic

41. Siobhan Cleary, 'Stock exchanges and sustainability', UNEP, 2015.
42. Mozaffar Khan, George Serafeim, and Aaron Yoon, A., 'Corporate sustainability: first evidence on materiality,' The Accounting Review 91(6): 1697-1724,2016.
43. Edwige Cheynel and Beatrice Michaeli, 'Asset management, loanable funds and the cost of capital,' 2012.
44. https://www.responsible-investor.com/home/article/sec_drafting_board_diversity_ disclosure_mjw/
45. http://www.unepfi.org/positive-impact/positive-impact/.
46. http://www.lloydsbankinggroup.com/Our-Group/responsible-business/prosper-plan/.
47. https://www.nedbank.co.za/content/nedbank/desktop/gt/en/aboutus/about-nedbank-group/vision--values-and-strategy/fair-share-in-a-nutshell.html.

activity are common to both low-carbon and green finance approaches. At a development level, it can be argued that the sustainable energy transition is a core element to several of the global sustainable development goals (SDGs). Numbers 7 (Affordable and clean energy) and 13 (Climate action) have direct impact on that energy agenda but it is equally difficult to see how others, including 3 (Good health and wellbeing); 9 (Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation); and 12 (Ensure sustainable consumption and production patterns), can be achieved without a focus on sustainable energy transformation. How indeed can goals 14 (Life below water) or 15 (Life on land) be achieved without a move from the fossil fuel driven pollution of our current energy mix?

Much progress has been made in recent years despite the setback of the Copenhagen COP and the failure then to reach a global agreement to set clear policy signals towards a low-carbon energy transition. The success of Paris 2015 COP and the launch of the SDGs have further encouraged market momentum in the development of green finance. The growth in green financing instruments and issuance has increased the flow of capital towards that transition. At the same time, the development and largely voluntary adoption of global integrated frameworks are providing the criteria for ESG integration into mainstream finance decision-making and encouraging capital flows away from negative sustainability outcomes. As a reality check, however, the environment is not yet conducive to raise the momentum to deliver the scale of capital required to fully finance that transition. Overarching incentives, such as carbon pricing, are growing but the market development is failing to send the strength of pricing signal to trigger the scale of change required. Negative externalities are still poorly recognised and understood. Disclosure by companies of their material ESG impacts and dependencies are being socialised through initiatives such as the CDP, GRI and integrated reporting. The uptake, however, is not uniform and widespread. To achieve the level of ambition required will demand a holistic transformation of the entire system. This necessitates sustainability criteria becoming mainstream in both public and private finance sectors led by clear policy signals and regulation. Only then will capital flow to support sustainable energy finance sectors worldwide. Only then will the sector be geared to finance the sustainable low energy society of the future.

MARKET CRISES: SHOULD WE DISCUSS THEM MORE – INCLUDING WITH OUR CLIENTS?

Dr Quintin Rayer, DPhil, Chartered FCSI, SIPC,
Chartered Wealth Manager, Head of research and ethical investing at P1 Investment Management [submitted January 2018]
quintinrayer@p1-im.co.uk

Introduction

Although markets regularly have periods of falling prices, financial professionals seem to focus on the upside, directing relatively little effort towards spotting the next crisis. Equally, little emphasis seems to be placed on discussing the potential for negative outcomes with clients, especially prior to investment. This raises questions about the awareness of the regularity of market crises amongst financial practitioners as well as (despite difficulties in anticipating market crises) their role in forewarning clients of potential risks when markets are highly valued.

Portfolio managers, intermediaries and clients are all aware that stock markets can suffer from 'bear' markets, corrections and other periods of falling prices. Except at the time and in the immediate aftermath, this is a topic that seems to be little discussed. Press coverage seems short-term, and negative market events appear to be rapidly forgotten. Discussions with portfolio managers and intermediaries tend to concentrate on the positives, often to the extent that the potential for downward market moves can seem neglected.

Looking at market CAPE ratios (cyclically-adjusted price-earnings ratios), the S&P500 is currently valued at 34.1x (December 2017). By way of comparison, before the August 2000 sell-off, the S&P500 index level was 1485, with a CAPE of 42.7x, although a higher ratio of 44.0x had been seen a few months earlier in December 1999. [1] Between January 1970 and December 2017, the average was 19.9x, with a 25.6x average since January 2000. Thus at current levels, it is hard to say that markets are necessarily over-valued, but at the same time, neither do they look particularly cheap.

Global and political events often impact markets, and as recent events have shown (2016: Brexit, US presidential elections), the outcomes may not be as anticipated by mainstream opinion. In this context, it seems surprising that those in financial services (including portfolio managers and intermediaries) do not spend more time discussing the potential for future financial crises. These discussions might extend both amongst financial professionals themselves and to conversations with their clients. Although anticipating the precise timing of crises can be difficult, who else should clients look to for guidance but their financial advisers and portfolio managers?

In this context, it may be worth clarifying that 'clients' could mean not only the retail clients of financial intermediaries but also clients of investment portfolio managers within the financial services sector.

This paper reviews ideas around the fundamental causes of financial crises, which are often rooted in human nature. It also looks at characteristics identifying the top of a 'bull' market, the most financially dangerous period to invest, being the 'eve' of a 'bear' market, or other downward correction. It then asks what investors can do to remain rational and not get caught out by investing at a market top. The next question is what financial professionals should be doing given the known regularity of financial crises, including from a client perspective, and why they may find it difficult. Finally, some thoughts are offered on portfolio stress-testing as a response and how this could open the door to a better quality of conversation with clients.

The fundamental nature of financial crises

For investors, bear markets and corrections are a source of great concern since a stock market crash can result in a cumulative decline of 25% or more in real equity values. [2]Markets often appear to be driven as much by sentiment as by economic reality and, as famously suggested by Federal Reserve Board chairman Alan Greenspan during the dot-com bubble of the 1990s, can suffer from 'irrational exuberance'. [3]

Stock market values are perceived to be linked to economic market cycles, but since market participants seek to anticipate investment opportunities ahead of competitors, markets are forward-looking. Investors must, therefore, make judgements and forecasts about economic and investment outcomes in the face of incomplete information. This results in the possibility of error and decisions coloured by human psychological and behavioural biases. With many market participants a wide range of views is also generated. Logically, not all of these can be correct.

Even if 'normal' economic cycles could be predicted from interest rates, unemployment and other data, national economies are subject to external influences from foreign countries via trade, decisions made by their governments and wider geopolitical events. Some countries may be 'serial defaulters' on their sovereign debt. These countries tend to over-borrow during good times, leaving them vulnerable during the inevitable downturns. [4,5] Governments can be prone to treat favourable shocks as permanent developments, fuelling a spending spree and borrowing that eventually ends in tears. [4] Alternatively, financial innovations can appear to render illiquid assets more liquid, permitting them to command higher values than previously, such as during the US sub-prime mortgage crisis of 2007. [4]

Secular trends

Secular trends can significantly change the investment landscape, creating new opportunities while undermining others. Market practitioners have a range of opinions, so while some may correctly anticipate trends, others will not. Further, the results of elections or national referendums may turn slight popular biases into clear-cut outcomes which can come as a surprise to the consensus view. Examples of secular trends include:

- Growth in nationalism, including the UK's 2016 Brexit vote, and the election of more nationalistic political candidates, with potential for protectionist trade policies as a contrast to a previous era of increasing free trade.
- New technologies, including, more recently, the internet dot-com stocks bubble (the 1990s). [3] However, this is hardly a uniquely recent phenomenon considering, for example, the 1840s railroad mania and 1793 canal mania of earlier eras. [6]
- Demographic impacts as populations age, creating increased demand for healthcare and associated support services, combined with disinvestment associated with drawdown from pensions.

Human nature

Human nature often seems to lead to the over-anticipation of future developments (both good and bad) and exaggerated valuations. The fickle nature of human confidence plays an important role.[4] People prefer simple explanations, and prefer any explanation to none; that does not mean such explanations are correct. [5] Leaders in the financial sector may believe that their innovations have genuinely added value and underappreciate the risks their firms are taking. [4] Alternatively, financial product providers may be responding to inappropriate incentives in less well-regulated areas. [5] Almost all bubbles require some form of new financial technology or financial engineering. [5]

Governments

One economic role governments play is to maintain a balance between producers and consumers to assure fair market prices. However, other forces are at work in politics, with constituencies attempting to influence governments through money, polling or petitioning (the 'will of the people'). Governments respond to political influences both to silence critics and to stay in power. Market events can also provoke responses from financial authorities, which, although intended to address current difficulties, may sow the seeds of future problems, such as quantitative easing. [5] The outcomes that result can lead to financial bubbles, caused by creating artificial criteria to achieve political goals. Government can exert its power over financial markets and on public thinking in ways which can set things up for a future disaster. [7]

It is possible that the complexities of financial markets make them prone to fingers of instability which extend throughout the system, so they can amplify small events with potentially catastrophic consequences [5]. Hyman Minsky also pointed out that stability leads to instability. For example, long periods of stability can lead to debt accumulation until dangerous levels of leverage are reached. [5]

Some characteristics of the top of a bull market

At the top of a bull market (the 'eve' of a bear market), when a fall in market values is more likely, media commentary may justify stretched valuations by saying there has been a change in economic circumstances so that "this time it is different", [8,9] although almost certainly it is not. [4] Indeed, in the run-up to the 2007 sub-prime crisis, the International Monetary Fund concludes in its April 2007 World Economic Outlook that risks to the global economy have become extremely low. [4]

A simple outline of a financial mania is given by Slater: [8]

- An image of instant wealth attracts and forms the financial, psychological 'crowd'.
- People see what they want to see, a mixture of facts and fancy which builds an image in their minds. A few examples of exceptional gains in the new area of interest are promoted as representative of the profits that can be made by all.
- Acknowledged experts in the field urge the crowd on its way.
- The financial crowd becomes irrational and blind to danger, ignoring fundamentals and traditional measures of value, while prices continue to rise in a self-feeding process that encourages more buyers to participate.
- Suddenly the image that has attracted and formed the financial crowd changes.
- Fear replaces greed as the bubble bursts with disastrous financial consequences for those who invested near the top.

Although only a stylised outline of a market crisis, awareness of this pattern may be of some help for avoiding developing market crises.

Additional guidance for rationality

What other guidance can be used to help ensure that investors do not get caught up in irrational behaviour?

In 1949 Benjamin Graham introduced an imaginary business partner called 'Mr Market' who makes daily offers to buy your share of a business that you had previously purchased for (say) $1,000, or else to offer you additional equity at the price he offers. Mr Market's offers depend upon his moods; sometimes they appear reasonable, but on other occasions he lets enthusiasm or fears run away with him and makes offers that seem foolishly high or low. [10] The message is that you should have your own idea of what your share in the business is worth and not let Mr Market's daily communications determine your assessment of the value of your holding.

Clearly, investment managers should develop and use their own asset valuation metrics to help guide them away from emotional responses. Of course, investment managers' valuation models are often based on their own theories, giving scope for a range of opinion, or even, more dangerously, on momentum in stock valuation.

In addition to flawed forecasts, external influences, secular trends, political activities and misinterpretation of underlying economic factors, investors are vulnerable to human psychological characteristics identified by behavioural finance theory. These can include herding behaviours (following the crowd) as well as tendencies for investors that result in irrational behaviours including loss aversion, framing relative to some reference point, mental accounting, overconfidence, inertia, representativeness and basing decisions on information availability which may be incomplete. Overconfidence touches the irrational belief that financial crises happen to other people at other times; not us, here and now. [4] Behavioural finance theory has become a large topic – an overview can be found in. [11]

Actually, the appreciation of the importance of crowd psychology is long established, with a discussion of how a crowd can assume a personality of its own explored in Gustave Le Bon's classic work *The crowd* originally published in 1895. [12] Many historical manias are also outlined in Charles MacKay's *Extraordinary Popular Delusions* [13] which details a sobering list of human follies.

Financial professionals and market crises

The role of financial professionals' client relationships is worth consideration in the context of market crises. Clearly, clients would not wish to invest their hard-earned savings on the eve of a financial crisis. It is also natural that they would expect to be able to turn to financial professionals for guidance on when it is safe to invest and when it might be wiser to wait.

Financial professionals may be able to help identify periods when markets, asset classes and assets may be overvalued or undervalued, particularly in extreme cases. Of course, that is not to say that identification of overvalued markets is easy. With many opinions and different valuation models available at any point of time, there will be a wide range of opinion as to how advanced the level of the market is – however this should not absolve the financial professional from their obligation to try to do so.

Yet it appears to be a rare event that a fund manager, fund provider or sales team would admit that 'right now' might not be the best time to invest in their asset class and that it might be better to wait for a period. Usually, some argument can be found to justify an otherwise apparently high valuation for an asset. If the valuation method used differs from that used in the past, the argument might be used that "this time is different". [4]

One message appears to be that it is unwise to revise valuation methodologies simply to accommodate ever-rising market prices. The problem is that markets appear capable of price rises well beyond what might be expected from rational pricing models for extended periods. An investor relying purely on pricing models would likely find themselves missing out on periods of meaningful returns, creating difficulties for an adviser in determining whether to invest or not.

Long, strong positive trends in an asset price tend to generate a positive response from investors wishing to allocate funds to it. Of course, the price rise could be an overdue correction for a previously unloved asset class, or it could herald the development of genuine new investment opportunities. On the other hand, it may be an irrational response of the type documented by behavioural finance theory. The concern is that a fund management house could see this as an opportunity, perhaps launching new funds at or near the top of a strong positive asset class trend. One could argue that this would increase the probability that prospects for that asset class might be poor. However, given human nature, it also makes for an easier sell in the fund business.

The danger is that asset prices are often cyclical, so after a long period of strong growth, the potential for further meaningful upside may be reduced, while the likelihood of losses on the asset class may be growing. If a fund management house were to launch a fund in an asset class after a period of strong growth in that sector, would that be a case of self-interest? Although the intention may be genuine (perhaps making a new product type available to investors), financial practitioners that launch funds under such circumstances should perhaps be aware that they could stand accused of exploiting investors' behavioural weaknesses by encouraging investment after a period of strong growth in an asset class. If a fund launch transpires to have occurred at, or near the top of, the cycle for that asset class, one could ask whether the fund manager knew this and was acting in self-interest, or the fund manager did not appreciate the asset class was at the peak of its investment cycle. Either way the fund manager does not come out looking good: they were either self-serving or else not as knowledgeable about the asset class as they claimed.

Alternatively, a fund manager could wait until they are confident of further future upside potential. However, from a sales perspective, a fund management house might prefer investment immediately (even if this could place the client's wealth at additional risk), since judgements regarding the timing and extent of an asset's valuation cycle and prospects are not certain, and if the investment is delayed a client might change their mind.

A thought-chain for potential behavioural implications of client investments under fluctuating market conditions might be expressed in a question-and-answer format as follows.

Question	Answer
Are clients more inclined to invest after a long strong trend than when an asset is weak?	Yes (behavioural psychology, herding)
Should they be?	No (probably not as many asset classes can be cyclical in their returns)
Is a downturn or correction more likely after a long strong positive trend than before it?	Yes (probably, again due to the cyclical nature of returns on many asset classes)
Should financial professionals help try and protect their clients from their behavioural weaknesses?	Yes
Would that be an easy sell to clients?	Probably not, although if made aware, many clients might appreciate the additional effort on their behalf
Would clients appreciate it?	In the short term probably not, in the long term, quite possibly yes.
Does it increase the chance of a financial professional being seen to have mistimed the market?	Yes (the problem is that if an adviser recommends waiting and the market goes up they will look bad, and vice-versa)
Does it make a financial professional's job harder?	Yes, absolutely (the potential to look bad to a client is amplified)
But should financial professionals at least try?	Yes (but they need a strong framework to help support this)

The difficulty is that by advising clients to wait or invest, based on professional judgement of the state of the market, an adviser runs a clear risk of being seen to be wrong in their market timing decision. A view expressed as 'market timing is impossible, we cannot know' consistently applied makes for an easier sell to a client, although it transfers market timing risk from the (presumably more knowledgeable) financial professional to their (presumably less knowledgeable) client. In essence this seems to be something of an abdication of responsibility, but given the difficulties in reliably timing the market, what is an adviser to do? In the section below one possible response is offered.

Stress testing: a response to the risk of market crises

Given the difficulties in timing markets and challenges around dealing with clients, in this context a framework that offers a consistent approach is required. Ideally, this framework should facilitate discussion with the client around potential market risks (including market crisis events) and generally promote a better quality of dialogue. One potential solution might be to use tools like portfolio stress-testing to help identify and quantify non-standard investment risks.

Market practitioners know that assessing portfolio risks is difficult, and conventional risk measures such as volatility and value-at-risk may assume normally distributed returns, which may underestimate the true portfolio risks. Measures such as beta depend upon volatility and so are subject to the same difficulties. For clients, such measures are arcane, and while useful for financial practitioners, are unlikely to be helpful in relation to discussions with clients. Market crises tend not to fit into a convenient theoretical framework and are extremely unlikely to be captured by conventional assumptions of normal or log-normal returns distributions. Even other measures of risk, such as drawdown, are likely to depend on using data derived from some historical period, which may be insufficient to capture information from previous market crises. Forthcoming market crises are unlikely to replicate historical crises, and even if there are some similarities, usually some new aspect will be present.

To address concerns about a potential future market crisis, a portfolio manager or other financial practitioner may wish to consider stress-testing a portfolio against significant historical market events, or against invented scenarios that reflect their (or their clients) particular concerns. [14]

Portfolio stress-testing helps identify and quantify risks within a portfolio, to indicate how it might respond to specific market outcomes or other concerns. Stress-testing can include looking at the potential downside risk of portfolios, or methods that help estimate what response might be expected under difficult (crisis) conditions. Although not guaranteed to identify actual impacts of future events on a portfolio, it is a helpful tool in an investment portfolio manager's armoury. Stress tests should be designed to determine how a portfolio might respond to adverse developments so that weak points can be identified early and preventative action is taken. Typically the focus may be on key risk areas, such as credit or market risk and liquidity. [14]

A strength of this approach is that stressed scenarios can be discussed with clients in fairly straightforward terms ("we are worried in case the dollar collapses against the euro by 20%'" or "after the recent long bull market, we think there is a chance that stock markets could correct by 15%. Given your investment time horizon, how do you feel about that?"). Furthermore, clients can even express their own fears, which may be already captured by existing stressed scenarios, or may be worthy of further investigation.

Once the outcomes of stress tests are known, a portfolio manager can determine what actions may need to be taken, if any. If the test reveals that an identified scenario has little impact, the manager and client may be reassured. On the other hand, if the testing suggests that the portfolio may be adversely impacted to an unacceptable degree, it can be restructured to reposition the portfolio to make it more resilient to the events considered.

Portfolio stress-testing is a large topic in its own right, with a wide range of techniques used. For an introduction and overview see, [14,15,16] while [17] explores a portfolio diversification stress-testing.

Conclusions

Anticipating market crises is not easy. Financial professionals must overcome their inbuilt human biases, as well as political and economic systems that can leave markets prone to periodic crises. Given difficulties in anticipating such crises, market practitioners should constantly be on the alert for them, particularly during quiescent periods when everything seems to be sound and markets are generating consistent positive returns.

Although difficult, portfolio managers and intermediaries should be attempting to form judgements about the likelihood of near-term market crises and having conversations with their clients about this topic.

One tool available to professionals for exploring and assessing the impact of non-standard risks on investments is portfolio stress-testing. This provides a framework for financial professionals and advisers to discuss what may be seen as 'outlier' risks amongst themselves and with their clients. In this context, the clients of investment managers may include other financial professionals, such as intermediaries, as well as retail clients and other underlying investors.

By discussing potential future market crises with clients, as well as carrying out regular portfolio stress-testing designed to capture specific concerns raised both by themselves and their clients, this will promote a better quality of dialogue. It will stimulate a more open and rounded discussion about the potential for market crises and the damage they could cause to investment portfolio values. This, in turn, can lead to portfolio restructuring to address key concerns. As a result, portfolios would be more robustly positioned and it would also be clear that portfolio managers and financial intermediaries are actively working to protect the value of their clients' assets.

References

1. DQYDJ, 'A calculator for the cyclically adjusted pe ratio (CAPE) – in any timeframe!' 15 January 2018. [Online]. Available: https://dqydj.com/shiller-pe-cape-ratio-calculator/.
2. R. Barro and J. F. Ursua, 'Stock-market crashes and depressions,' NBER Working Paper 14760, National Bureau of Economic Research, Cambridge, Mass, 2009.
3. Federal Reserve Board. [Online]. Available: https://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm. [Accessed January 2017].
4. C. M. Reinhart and K. S. Rogoff, *This time is different*, Princeton: Princeton University Press, 2009.
5. J. Maudlin and J. Tepper, *Endgame*, New Jersey: John Wiley & Sons, 2011.
6. C. P. Kindleberger, *Manias, panics and crashes, a history of financial crises*, 3rd ed, London: MacMillan Press, 1996.
7. J. Blessings, *The anti-demographic cliff*, Createspace, 2014.
8. J. Slater, *The Zulu principle*, Butler & Tanner, Somerset, UK, 1992.
9. J. Slater, *Beyond the Zulu principle*, Butler & Tanner, London, 1996.
10. B. Graham, *The intelligent investor*, 4th ed, New York: HarperCollins, 1973.
11. Q. G. Rayer, *Portfolio construction theory* (exam workbook), 4th ed, London: Chartered Institute for Securities and Investment, 2017.
12. G. Le Bon, *The Crowd*, New Brunswick: Transaction Publishers, 1995.
13. C. Mackay, *Extraordinary popular delusions and the madness of crowds*, Wordsworth Editions, 1995.
14. Q. G. Rayer, 'Dissecting portfolio stress-testing,' *Review of Financial Markets*, vol. 7, pp. 2-7, 2015.
15. Q. G. Rayer, 'Testing times,' *STEP Journal*, vol. 24, no. 8, pp. 62-63, October 2016.
16. Q. G. Rayer, 'Testing times, part 2,' *STEP Journal*, vol. 25, no. 3, pp. 66-69, April 2017.
17.Q. G. Rayer, 'An investigation of hypothetical variance-covariance matrix stress testing,' *Journal of Risk Management in Financial Institutions*, vol. 9, no. 3, pp. 264-288, 2016.
18. B. Schachter, 'Stress testing,' in *The professional risk managers' handbook*, vol. III, C. Alexander and E. Sheedy, Eds., Wilmington: PRMIA Publications, 2004.

CONDUCTING QUANTITATIVE ETHNOGRAPHY IN THE FINANCE SECTOR

Vasudha Chaudhari, PhD candidate, Open University
vasudha.chaudhari@open.ac.uk

Professor Allison Littlejohn, chair of learning technology & academic director of digital innovation, The Open University
allison.littlejohn@open.ac.uk

Uncertainty is inherent within the finance sector. In a general sense, it arises from incomplete knowledge necessary to predict events, or to undertake any course of action, while being sure about the results. According to Dosi and Egidi (1991), to analyse how finance professionals behave under uncertainty, one needs to understand the gaps in their knowledge, the learning processes they undertake to address those gaps, and their epistemic frames (which describe how people make decisions and justify their actions) used for evaluating their choices (what are the industry standard procedures or organisational cultures for dealing with specific uncertainty situations?). But the incompleteness of knowledge is not merely absence of facts or vital pieces of information, it could also mean lacking the cognitive ability to link these information elements together into a bigger picture. Finance is a knowledge-intensive sector, and professionals need to learn how to frame, investigate, and solve problems that require more than basic facts and skills in order to succeed.

Results from the first phase of this study show that there are at least five different types of uncertainties faced by finance professionals, because of factors such as: environmental changes; structural changes; political decisions; financial crises; and technological advancements. Depending on the uncertainty, different learning strategies are used by professionals to help them navigate through uncertain times. Thus, it can be posited that professionals operate from different epistemic frames depending on the uncertainty they face. There were two prominent strategies that emerged from in-depth qualitative interviews with finance professionals: networking/help-seeking behaviour and reflection/drawing from their experiences.

Adopting Schon's (1993) theoretical perspective on how professionals solve complex problems, in this research we will focus on how to support this learning in immersive virtual learning environments. Practitioners who work in complex domains cannot solve problems by referring to pre-existing procedures or by directly applying a method used in a previous problem. Instead, solutions are found through an iterative process of trial and observation. These trials are not random guesswork. Schön argues that when professionals encounter novel problems, they try to solve them by running informed experiments performed and evaluated in real time as the problem is addressed. Our earlier research with the CISI illustrates the ways finance professionals solve novel problems by learning on the job, drawing on their professional networks.

Building epistemic networks

Epistemic Network Analysis (ENA) was developed to model cognitive networks based on the assumption that 'the structure of connections among cognitive elements is more important than mere presence or absence of those elements in isolation' (Shaffer, 2016, p.9). Fig.1 shows an Epistemic network that depicts the cognitive network of a first-year undergraduate engineering student. The diagram shows the skills (S) and knowledge (K) the student focuses on as she participates within the network. Network models can be used to compare how novice students interact in the network compared with the ways experts collaborate. Network analysis can illuminate the contributions of each individual to the network and how these contribute to the network as a whole.

The first step in building similar cognitive networks within domains of the finance sector requires elements of the epistemic frame of each domain, which can be identified *a priori* from theoretical or empirical analysis or from an ethnographic study of the community in action. Each professional's network will model the structure of connections between knowledge, skills and self-regulated learning and other aspects of finance practice. Direct comparison of network projections is challenging. Comparison can be calculated manually with small numbers of participants. However, this study will be done with the CISI, which has more than 45,000 members, and others. Comparing such large quantities of networks requires summarising the important network features. This is where ENA is useful. It represents each network as a single point in space, where each point is the centroid of the corresponding network.

ENA expedites two main objectives: 1) it processes coded data 2) it uses the results of this analysis to create visualisations that facilitate exploration and interpretation of data.

Intervention

To build epistemic models for professionals, we need in-depth information regarding following five SKIVE (skills, knowledge, identity, values, epistemology) elements within the finance sector (or the domain for which we build the simulated learning activity):

- Skills: the things that people within finance do.
- Knowledge: the understandings that people within the profession share.
- Identity: the way that members of the professional community see themselves.
- Values: the beliefs that professionals hold.
- Epistemology: warrants that justify actions or claims as legitimate within the profession.

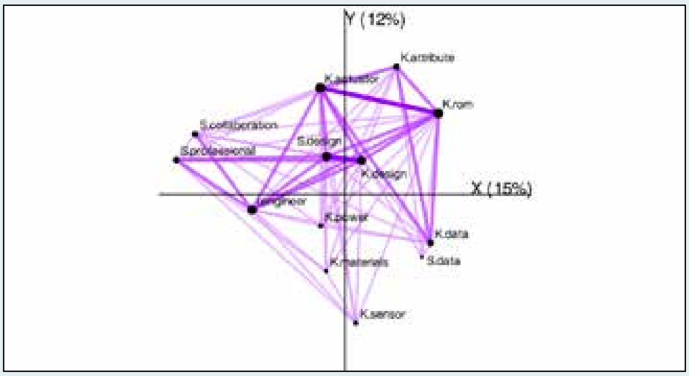


Fig.1: Cognitive network of first year undergraduate student representing the connections the student made while solving a simulated engineering design problem (Shaffer, 2016, p.13)

References

Arastoopour G, Shaffer DW, Swiecki Z, et al. 'Teaching and assessing engineering design thinking with virtual internships and epistemic network analysis'.
Dosi, G., & Egidi, M. (1991). Substantive and procedural uncertainty. *Journal of evolutionary economics*, 1(2), 145-168.
Littlejohn, Allison; Milligan, Colin; Fontana, Rosa Pia and Margaryan, Anoush (2016). 'Professional learning through everyday work: how finance professionals self-regulate their learning'. *Vocations and learning: studies in vocational and professional education*, 9(2) pp. 207–226.
Schön, D. A. (1992). The crisis of professional knowledge and the pursuit of an epistemology of practice. *Journal of interprofessional care*, 6(1), 49–63. http://dx.doi.org/10.3109/13561829209049595.
Shaffer DW. *Quantitative Ethnography*. Madison, WI: Cathcart Press; 2017.

CISI
CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

Your competitive edge

World-renowned qualifications and membership to further your career in financial services

The CISI is proudly part of the
CHARTERED BODY ALLIANCE