the review
JULY 2023
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Published on behalf of the Chartered Institute for Securities & Investment by Sunday, 207 Union Street, London, SE1 0LN
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welcome

"How should we respond to the exponential rise in technology?"

'Artificial intelligence' (AI), including machine learning, natural language processing (NLP), speech recognition and computer vision, went mainstream in November 2022 following the launch of ChatGPT (generative pre-trained transformer). The NLP tool, which can provide detailed replies to text prompts, "captured people's attention due to very human-like responses," says Professor Michael Mainelli, Chartered FCSI(Hon), in the introduction (p.14) to our tech-themed edition.

AI's text analysis, among its other applications, is used in regulatory technology (regtech) and in supervisory technology (suptech). Our two-part piece on regtech and suptech looks at developments in this space, how regulators are reacting, and what you need to know (p.18).

And how should we respond to the exponential rise in technology? There has been much debate about whether it will take our jobs. Our piece on the roles emerging in and around new tech examines some of the practical skills needed (p.26).

Speaking of career progression – if you're considering entering politics, turn to our 'Ask the expert' for practical guidance from Councillor James Jamieson OBE (p.50). Another route could be via training, such as that provided by Civic Future, an organisation co-founded by former senior civil servant Pamela Dow. In our profile interview, Pamela discusses creating a "generation of leaders" and enabling people from all backgrounds to enter public leadership roles (p.34).

Other highlights in this edition include our feature on global regulation of cryptoassets (p.28), our ethical dilemma about taking clients to a new firm (p.46), and Andy Davis's column, in which he puts ChatGPT to the test (p.62).

And finally, a warm welcome to…
Our new publisher, Sunday, will be working with us as *The Review* evolves. As ever, please get in touch with any comments or suggestions.

Jane Playdon
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CISI.ORG

Online content accessible through our MyCISI app

WATCH

What is the Young Professionals' Network?
By joining our Young Professionals' Network, you have access to events and learning opportunities tailored to support your career journey.
View our short video explaining the benefits at cisi.org/ypn-benefits

MOST READ

Take a harder look at soft skills
cisi.org/soft-skills

Tackling inequalities
cisi.org/inequalities

An ESG backlash is simmering
cisi.org/backlash

LISTEN

The CISI podcast: Mental health of young men in financial services
This podcast discusses the role banter plays in a working environment, and the professional and personal scenarios where it can negatively affect performance and progress.
cisi.org/banter-podcast

READ

Is the EU rulebook still heading for the bonfire?
We weigh up the arguments for a demolition of EU rules versus a more moderate middle ground.
cisi.org/bonfire

EVENTS

CISI Financial Planning Conference 2023
Wotton House, Surrey
3–4 October
Bookings are now open.
cisi.org/fpc23

To read more, visit *cisi.org/review*

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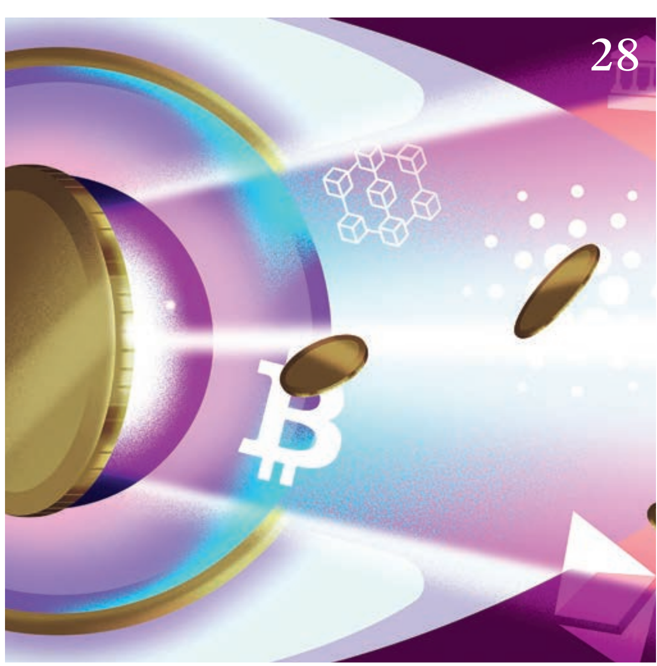
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GLOBAL NEWS

AROUND THE GLOBE

The CISI's international network of offices looks after circa 44,000 members worldwide

UK

Chief executive officer: Tracy Vegro OBE

On 3 April 2023, we announced that our Future Foundation's charitable status had been confirmed, and we had appointed nine trustees.

The CISI Future Foundation's objective is:

> The advancement of education for the public benefit by advancing knowledge and improving skills in financial capacities and capabilities, in particular, but not exclusively through the provision of grants and promotion of research and dissemination of such research.

The Foundation will partner with existing organisations by offering funding, both in the UK and internationally, to work primarily with young people from disadvantaged backgrounds on programmes or initiatives which align with the Foundation's objective of increasing financial literacy.

The Foundation has a governing structure separate from the CISI.
cisi.org/futurefoundation

Shaping the future of finance
On 21 April 2023, we had the pleasure of hosting a delegation from the World Alliance of International Financial Centers, led by their managing partner Jochen Biedermann (pictured with the delegation, standing fourth from the right).

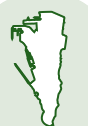
We talked about developing professionalism and investing in talent, the challenges and opportunities that sustainable finance presents, and what finance needs to do to ensure we attract top talent to financial services.

PAKISTAN

Assistant director, Global Business Development: Helena Wilson, Chartered MCSI

On 15 March 2023, we signed a memorandum of understanding (MoU) with the Pakistan Stock Exchange (PSX) and the Institute of Financial Markets of Pakistan (IFMP) to introduce a globally recognised benchmark certification. PSX and IFMP initiated the MoU with the support and guidance of the Securities and Exchange Commission of Pakistan. The initiative aims to build the capacity of market intermediaries to provide enhanced services to their clients and augment investor confidence. Professionals in the sector will be able to take CISI's globally portable securities and wealth management certificates. When these are partnered with the local regulatory module, candidates will receive the Certificate in Securities (Pakistan) or International Certificate in Wealth and Investment Management (Pakistan).

cisi.org/pakistan-mou



GIBRALTAR

Assistant director, Global Business Development: Helena Wilson, Chartered MCSI

On 22 March 2023, we hosted an 'Operational resilience in Gibraltar' event focusing on topics such as cybersecurity, business continuity and crisis management. Lorraine Mouat, head of payment services at compliance consultancy Thistle Initiatives, provided a thorough overview of the challenges and offered valuable insights into the latest trends and best practices.

The event saw CISI members and industry professionals network and share knowledge. All attendees, including the Gibraltar National Advisory Council (NAC), contributed to the event's success. We thank the NAC for its contributions to the growth of the CISI in Gibraltar.

SRI LANKA

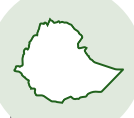
Country head: Asanka Wijeratne, Chartered MCSI

In March 2023, while visiting Colombo, CISI chief executive Tracy Vegro OBE met our Sri Lanka National Advisory Council (NAC) and its president, Nandika Buddhipala MCSI (pictured with Tracy).

Tracy was struck by the "potential in the Sri Lankan financial services market for learning and self-development" and encouraged "young Sri Lankans considering a career in finance to take a look at how [we] can help [them] accelerate and develop, both as an exam candidate but also a lifelong learner and CISI member".

Nandika said they were encouraged by Tracy's "enthusiasm, understanding and appreciation of our extraordinary resilience and determination as a nation" and look forward to working together to enhance knowledge, skills and behaviour standards in the sector and to "further improve much-needed diversity, equity, inclusivity, and belongingness within our corporate culture".

cisi.org/tracy-sri-lanka



ETHIOPIA

Assistant director, Global Business Development: Helena Wilson, Chartered MCSI

Partnership with ECMA

On 25 April 2023, we met the newly established Ethiopian Capital Market Association (ECMA) at the British Embassy in Addis Ababa to celebrate our successful capacity-building activities to support the development of Ethiopia's capital markets. We have been working together to promote the financial services sector's growth – a partnership that has helped strengthen ties between the two countries.

In addition, CISI and ECMA signed a letter of intent to demonstrate a commitment to future collaboration in the presence of the UK prime minister's trade envoy to Ethiopia, Laurence Robertson MP pictured (left), alongside Sandy Wade OBE JP ACSI (middle) and Dr Brook Taye, director general, ECMA (right).

New CISI Accredited Training Partners

On 29 April 2023, we attended the launch event of CISI Accredited Training Partner Addis Ababa University School of Commerce (AAUSC). Market stakeholders came together to learn about the CISI's work in Ethiopia and the qualifications, training and resources offered by AAUSC to promote professionalism, as Ethiopia looks forward to the launch of its capital market.

We also accredited CISI Accredited Training Partner Bruh Finance in October 2022. Through this partnership, the CISI continues to expand its global network of training providers, collaborating to promote professional development.

CAREERS IN FINANCIAL SERVICES IN NORTHERN IRELAND: MAKING A DIFFERENCE

We have worked closely with the Northern Ireland Department for the Economy Careers Service to spotlight exciting career opportunities in the world of financial services

WORDS BY LORA BENSON MCIPR, CISI HEAD OF MEDIA

cisi.org/ni-bulletin

During his recent visit to Northern Ireland, marking the 25th anniversary of the Belfast/Good Friday Agreement, US president Joe Biden highlighted that "peace and economic opportunity go together". The growing success of the financial and professional services sector in Northern Ireland is an example of this opportunity in action, employing approximately 46,000 people.

To further boost these numbers, the Northern Ireland Department for the Economy (DfE) Careers Service has recently published a 37-page bulletin about careers in financial services. It features video clips, jargon busters and case studies, five pages of references to our 'Get into finance' guide, and a link to a four-minute video featuring Colin Anderson, CISI client relationship manager for Scotland and Northern Ireland.

Reasons to consider a career in financial services

The video is embedded into page 6 of the bulletin. Colin, who has worked in many areas of financial services, including customer service, operations, and technical training, talks about the many different professions within the sector, including pensions, retail banking, financial planning, insurance and fund management and entry routes. He emphasises that the sector needs a diverse skill set, i.e. not just an ability with maths, but people who are good at communicating, problem-solving and time management. He also emphasises that the sector has a range of roles for those with IT, PR, marketing and HR skills. Given financial services' broad client base, those passionate about customer service have a real chance to make a difference.

Developing the bulletin

Jillian Strain, Careers Occupational Information Unit, DfE Careers Service, led the project to develop the bulletin, with research and planning beginning in the summer of 2022. It was initiated in response to the DfE's 10X Economy – an economic vision for a decade of innovation, which identifies financial services and fintech as "priority areas" that are "important to the growth of the NI economy," she says.

The DfE began collaborating with several stakeholders in the financial services space, including the local sectoral partnership forum, local colleges, universities and employers, and the CISI Northern Ireland branch.

Colin says: "It was a great experience working with the Career Services team at the Department for the Economy, being a part of the programme and

helping shape the communications which will inspire students, returners or career changers to think about financial services as a career. This is vital to CISI's purpose and our engagement with the next generation. Many of the firms that I work with closely, such as FinTrU and Citigroup, are looking for people to think about a career in our sector and help continue to increase its growth in Northern Ireland."

Purpose and outlook

The bulletin is a plain-speaking guide for those thinking of entering the Northern Ireland financial services sector via degrees, apprenticeships, internships, school leaver programmes and, in some cases, career returners. It defines financial services and lists some career options in the sector, identifying applicable subject areas and skill sets and a range of available entry routes. The 'Career snapshots' section features eight case studies, most including video clips, of young people working in various roles and firms in Northern Ireland.

Jillian says that the goal is for the locally orientated careers information and snapshots in the bulletin to "raise awareness of the career opportunities available in this growing sector in Northern Ireland and inform citizens including pupils, parents/carers, teachers, careers advisers and others who support career planning/decision-making about the variety of roles and pathways available".

The project is an excellent example of government, the private/charitable sector and the wider local community working together to increase awareness of the career options available in Northern Ireland's growing economy.

Colin Anderson, CISI client relationship manager, in a video for the DfE bulletin

The CISI is undertaking a new education programme in Belfast to provide access points to financial services careers for young people.

If you are a school interested in learning more, please contact kirsty.crosby@cisi.org

New presidents announced

Meet the members who are stepping up to lead local branches of the CISI

BIRMINGHAM

Tom Perks, Chartered FCSI, investment manager at the Birmingham office of Quilter Cheviot, takes over from Mark Rogers, Chartered MCSI, a wealth planner at Succession Wealth.

Tom started his career in investment management in 2008 and became a member of the CISI shortly afterwards. He joined Quilter Cheviot in 2017 – the same year he joined the Birmingham branch as a committee member.

During his time with the CISI, Tom has launched the Young Professionals' Network and organised many social events for members in the region.

Tom said he is "thrilled to carry on the fantastic work" of the incumbent president, who "led the committee excellently, both before and throughout the pandemic, and played a key role in our adaptation to a new way of delivering for our members". He is looking forward to working with the "many new faces" on the committee in Birmingham. They will "continue to deliver our financial education service" and "build upon our relationships with local schools and universities," he says.

Tracy Vegro, CISI chief executive, thanks Mark for his contribution to the thriving Birmingham committee and congratulates Tom on his appointment.

Read the full story by Lora Benson MCIPR, CISI head of media, at cisi.org/tom-perks

COTSWOLDS

James Swaby, Chartered FCSI, senior investment director at Investec Wealth & Investment, takes over from Sandra Paul, a consultant at Prestwood Software.

James leads the portfolio management team for the region. He oversees a suite of strategies for private clients, trusts and charities, including multi-asset fund portfolios and international direct equities, and he co-manages a family unit trust. James also sits on the CISI Disciplinary & Appeals panel.

He says: "I am pleased to assume the role of president of the Cotswolds branch. I want to thank my predecessor, Sandra Paul, for all her hard work and dedication, particularly as her time in office was longer than she had anticipated and coincided with the Covid pandemic.

"Despite this, she raised the CISI's profile with many local schools making sure that as many young people as possible could see financial services as a viable career. I look forward to continuing her work with schools and developing the CPD programme with the branch committee and my fellow members."

Tracy thanks Sandra for doing a great job and congratulates James on his appointment.

Read the full story by Lauren Johnson, CISI copywriter, at cisi.org/james-swaby

CISI Presidents' Day 2023

Kirsty Crosby, CISI head of education development, shares some key takeaways from the event on 10 May, in which regional CISI presidents gathered to discuss strategy for the year ahead

Our annual Presidents' Day had a renewed focus and energy surrounding the important topic of youth and the next generation.

We spoke at length about the importance of attracting not only the next generation but also ensuring we are reaching out to a diverse talent pool.

There are several CISI education programmes – some new, some maintained – and they mainly target areas of low socioeconomic status, where it has been widely recognised that there is a need to provide opportunities for young people.

Making a difference to young people

The school hubs that the education team is planning to set up are in Manchester, Belfast, Glasgow and Dundee alongside the maintenance of the existing Liverpool and Derry projects. Regional presidents expressed not only a strong desire to give back to youth but also that these programmes have the power to really make a difference to young people. Our school programmes provide students with a level 2 professional qualification, are packaged with employability and skills workshops and, critically, the chance to engage with professionals in the roles they aspire to.

Each region was pleased to hear of the expanding student ambassador programme, and all agreed that ambassadors should become a part of the committees themselves – yet another way of enticing young people to become lifelong members. Most regions now have at least one university partnership (where applicable) and we are set to expand this network significantly over the next two years, with a long-term view of having as many of the degree courses in the UK offering CISI qualifications as possible.

Financial literacy and employability

There was also unanimous support for financial literacy education, with the recognition that while this is a saturated market, there is still so much more to be done and our latest project, in conjunction with the financial planning community, might mean that every school in the country could be offered a financial literacy session.

Our employability strategy enables us to facilitate professionals to engage with young people and raise the profile of the sector. This is pivotal in motivating and inspiring young people to choose financial services, and opening their eyes to the benefits of being a member of a professional body.

CISI EDUCATIONAL TRUST GLOBAL AWARDS 2023 TOTAL £19,000

Congratulations to our top-performing postgraduate and undergraduate students, Viren Vishwanathan, from ISBR Business School, Bangalore, and Aarathi Kannan Govindu, from Christ University, India, who received £5,000 and £4,500 respectively, and to the ten other winners who received £9,500 between them.

All candidates, following nomination by their university, were invited to submit a 500-word essay or a PowerPoint presentation for the opportunity to attend an interview with the CISI Educational Trust (the Trust).

The essay title for 2023 was: 'Assess whether the tools and policies available to governments and central banks are likely to be sufficient to resolve current global economic problems arising from, for example, war, inflation, economic slowdown, supply shortages and climate change.'

We then invited candidates - who for the first time included top performers outside the UK, from Africa, Asia Pacific, Europe and India - to be interviewed by Trust practitioners. As well as the cash prize, overall winners were given the opportunity for work experience in London with expenses paid by the Trust.

Viren Vishwanathan, top-performing postgraduate student

Before participating in the Trust global awards, Viren achieved a merit for our level 3 International Introduction to Investment qualification. "There was an outpouring of emotions when the winners were announced," he said. "This has been one of the proudest moments in my life, to win a prestigious award organised by a stellar organisation in the world of finance and investments."

Aarathi Kannan Govindu, top-performing undergraduate student

Aarathi said she is honoured to win this award, which has boosted her confidence to pursue a career in finance. "The competition challenged me to research and learn about a dynamic topic relevant to the current economic situation. I cannot speak highly enough of the CISI's commitment to supporting and recognising young finance students."

Read the full story by Lora Benson MCIPR, CISI head of media, at cisi.org/trust-awards23

Navigating the Consumer Duty

Innovative marketing strategies and the use of AI can help the finance sector traverse a changing compliance landscape, says **Chris Daly**

Chris Daly, chief executive of the Chartered Institute of Marketing (CIM), explains how marketing teams and financial services firms can work together to provide evidence of positive customer outcomes – a requirement under the new Consumer Duty regulation.

For over 100 years, CIM has supported the marketing sector. With over 20,000 members in more than 100 countries, CIM strives for business leaders and opinion formers to recognise the positive contribution professional marketing can bring to their organisations, the economy and wider society.

When it comes to building lasting relationships with customers, trust is paramount. Knowing that a business partner or organisation will treat you fairly is essential to long-term relationships. This applies whether you are a wealth manager or advertising planner, with accountability for your actions at the heart of each practitioner's professional code of conduct.

Fairness is also at the centre of the Financial Conduct Authority's (FCA) new Consumer Duty and offers an opportunity for marketing departments and agencies to assist securities and investment firms in adapting to these obligations. Maintaining trust involves making values-based decisions, and for us at CIM, this is a key role of a professional marketer: to recognise and secure competitive advantage by navigating ever-changing cultural norms.

Under the new FCA regulatory standard, securities and investment firms will be responsible for providing evidence that their products consistently deliver positive customer outcomes. This places a fresh emphasis on proactive prediction of customer behaviour and analysis of decision-making influences. Although these areas do not solely belong to marketers, they significantly overlap with our domain of expertise. To meet the needs of target segments, product development lifecycles must be well-managed and governed, supported by solid and up-to-date market research.

Empathy and creativity have always been crucial to ensuring that communications fulfil a target consumer's information needs and sufficiently interest them to ensure the message is received. The challenge lies in effectively conveying complex financial products and services without misleading or oversimplifying, all while complying with regulations that can introduce jargon and fine print. In the digital age, where attention spans are shrinking, marketing teams can find opportunities to align with the Consumer Duty by embracing customer-centricity and delivering tailored, transparent and well-communicated offerings.

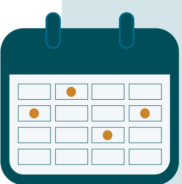
While some may perceive the work of sales and marketing teams in product reviews and communications testing as less glamorous, it is undeniably vital in providing consumers with the best possible service in one of the UK's most significant industries. The Consumer Duty catalyses refocusing on aligning products and services with target consumers' needs and ensuring effective communication. It aims to balance profitability and the value and support consumers receive. Embracing the Consumer Duty means providing exceptional, well-tailored products and services while achieving commercial success. Marketing teams can rise to this challenge, supporting wealth and investment managers by combining innovation with compliance to create disruptive strategies that benefit both businesses and consumers.

By actively participating in product development, market research and transparent communication, marketing professionals can help investment professionals navigate a changing landscape to ensure compliance while simultaneously seizing opportunities for customer-centric innovation. Nowhere is innovation more rapid than in the application of artificial intelligence (AI) across our industries. The investment industry has long pioneered algorithmic trading, while marketing's focus on programmatic advertising has helped fund the new generation of AI.

AI can significantly enhance the capabilities of both CISI and CIM professionals. Advanced data analytics and machine learning algorithms can provide valuable insights into market trends, investment patterns and customer preferences. By leveraging AI-powered tools, CISI professionals can make informed decisions, identify potential risks and ensure compliance with the Consumer Duty. Simultaneously, CIM professionals can leverage AI to refine customer segmentation, personalise marketing campaigns and improve communication strategies.

Collaboration between CISI and CIM professionals will be crucial to ensure AI's responsible and ethical use. Joint efforts can be made to address the ethical implications, algorithmic bias and data privacy concerns associated with AI adoption. By working together, our professionals can establish best practices, compliance frameworks and governance mechanisms to ensure AI technologies are deployed with fairness, transparency and accountability.

Looking forward, I am excited by the possibilities for collaboration between CISI and CIM professionals in ensuring AI's fair, responsible and ethical use. In a world of artificial intelligence, genuine empathy in designing and communicating financial products will be critical to fair outcomes for clients. As the regulatory landscape undergoes significant change in the financial services sector, the role of marketing teams becomes increasingly pivotal. Through knowledge sharing, cross-training, and ethical considerations, CISI and CIM professionals are well-placed to pave the way for a fairer future where innovations can continue to unlock responsible growth for us all. ●



EVENTS PREVIEW

We offer many opportunities to help you meet your requirements for continuing professional development (CPD). Below are just some of the highlights of the Institute's CPD events programme. For comprehensive details and to book, please download the MyCISI app or visit *cisi.org* and click on the 'Events' section. (Please note that dates listed below are subject to change.)

In-person events

Thu 7 Sep CISI Northern Ireland Young Professionals' networking event

Thu 14 Sep CISI Birmingham & West Midlands branch annual dinner

Tue 19 Sep CISI Guernsey branch: Impact investing goes mainstream – proof that profit and purpose are not mutually exclusive

Thu 21 Sep CISI Manchester & District branch annual dinner

Wed 27 Sep CISI Scotland Young Professionals' Network: Leadership at all levels

Thu 28 Sep CISI Essex branch classic car event

Thu 28 Sep CISI Wealth Management and Fintech Forum: The future of platforms in wealth management – views from the C-suite on the pace of platform adoption

Fri 29 Sep CISI Jersey branch annual dinner

Mon 2–Tues 3 Oct Financial Planning Conference

Thu 12 Oct Bristol & Bath branch annual dinner

Fri 13 Oct Joint Isle of Man Wealth & Fund Services Association and CISI Isle of Man branch annual dinner

Thu 2 Nov Scotland branch gala dinner and awards night

Thu 16 Nov South Coast branch annual dinner

Disciplinary rules: important notice

CISI members agree to abide by the Membership Regulations. An important aspect of this is the obligation to promptly inform the CISI (by emailing *standards@cisi.org*) of any matter which may impact your suitability to remain a member. Failing to do so may be considered an aggravating factor in a disciplinary case.

Examples of matters which may impact suitability to remain a member include (but are not limited to): whether in the course of work, a member has committed any act or default likely to bring discredit to them, the Institute, or the securities, investment, wealth and financial planning professions; if a member has performed their work incompetently; and, if a member has failed to satisfy a judgement debt, has made an assignment for the benefit of creditors, a bankruptcy or interim order has been made against them, or if the member has entered into a voluntary arrangement as defined in the Insolvency Act 1986.

More information at cisi.org/mrules

QUICK QUIZ

The Review's quick quiz features questions from CISI Professional Refresher, an online learning tool. Find the answers below.

AI can be regarded as:

A High-volume, high-velocity and high-variety information assets

B Technologies with the ability to perform tasks that would otherwise require human intelligence

C Sophisticated algorithmic programmes that consist of a series of instructions for performing a calculation

D The application of neural networks composed of artificial neurons connected to one another

Machine learning is a discipline of AI that allows technology systems to:

A Automatically learn and improve from experience without being explicitly programmed and with minimal human interaction

B Process vast amounts of data very quickly

C Automatically learn and improve from experience but requires explicit programming

D Automatically learn and improve from experience without being explicitly programmed, but still requires significant human interaction

Machine learning improves the effectiveness of transaction monitoring by:

A Using robotic process automation

B Being able to assess a larger number of transactions

C Alerting staff to review out-of-pattern transactions

D Reducing the number of false positive transactions

Answers: 1.B, 2.A, 3.D

global insights

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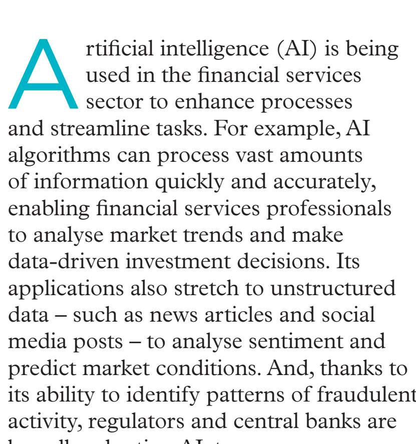
IMAGE BLACKDOVFX/ISTOCK



In keeping with this issue's theme, the images on these pages have all been created using an AI image generator. Our art team prompted the tech with suggestions such as 'AI and financial growth' (left) and 'financial market trends and patterns' (below)

INTELLIGENT DESIGN: AI AND THE FINANCE SECTOR

AI is transforming the financial services industry, altering how we work and invest. **Hazel Davis** investigates its different forms and potential benefits – as well as its caveats

HAZEL DAVIS is a freelance journalist who writes across a range of subjects for the UK's leading broadsheets

The term 'artificial intelligence' is a broad umbrella term that covers the combination of a number of emerging technologies that have the potential to mimic human intelligence. These include machine learning, natural language processing, speech recognition, computer vision and many more besides, and they have the ability to perform tasks that would otherwise require human intelligence, such as visual perception, speech recognition, and language translation and have the capacity to learn or adapt to new experiences or stimuli.
CISI Artificial Intelligence Professional Refresher
cisi.org/pr-ai

Artificial intelligence (AI) is being used in the financial services sector to enhance processes and streamline tasks. For example, AI algorithms can process vast amounts of information quickly and accurately, enabling financial services professionals to analyse market trends and make data-driven investment decisions. Its applications also stretch to unstructured data – such as news articles and social media posts – to analyse sentiment and predict market conditions. And, thanks to its ability to identify patterns of fraudulent activity, regulators and central banks are broadly adopting AI, too.

One way AI does these tasks is through machine learning, in which computers use statistical models and algorithms to identify patterns. The machine can then use the data it has gathered to learn, adapt or make predictions – without being explicitly programmed to do so.

Another AI tool is natural language processing (NLP), a subset of AI that utilises large language model (LLM) algorithms, allowing computers to understand user intent and generate meaningful human language. NLP tools are especially noteworthy because some, such as ChatGPT, have "captured people's attention due to very human-like responses," says Professor Michael Mainelli, Chartered FCSI(Hon), founder and chair of commercial think tank and venture firm Z/Yen.

AI image generators work by using machine learning algorithms that have been 'trained' on large datasets of art, photos and even 3D models. For this image, we used the prompt 'AI predicting financial market outcomes'

The prompt: 'AI interacting with financial assets'

Generating content

Generative AI is designed to enable computers to create new content, such as text, images, and even music, without direct human intervention. The applications of generative AI are wide-ranging and include creative industries, such as advertising and entertainment, as well as practical uses in fields like medicine and finance. As technology continues to advance, it has the potential to revolutionise the way we create and consume digital content.

In fact, generative AI is so capable of creating written content it only took seconds to write the paragraph above. This neatly highlights the dilemma central to its use: the content it creates – and any false information it may glean from unverified online sources – sounds plausible and persuasive. "Garbage in, garbage out is a phrase long associated with computer-generated results," says Michael. "In the case of AI, this can be magnified."

Keith Bear, a Fellow at the Cambridge University Centre for Alternative Finance, adds that it can be "difficult to discern AI-generated content manually". But he says that technology such as the OpenAI classifier may help. While OpenAI acknowledges that this new tool is a work in progress – currently, it correctly identifies only 26% of AI-written text – it's likely to become increasingly adept as the use of generative AI becomes mainstream.

Meanwhile, the evolution of chatbot models is already underway, with newcomer AutoGPT (still in its early stages of development) promising myriad applications for the financial sector. Unlike ChatGPT, which requires specific prompts from the person using it, AutoGPT can be given a higher-level goal. For instance, it can be asked to design an investment portfolio and it will self-generate the prompts – such as 'review the client's financial goals' – to do so. Its unique feedback loop gives it the ability to plan, learn and improve, allowing it to adapt to changing market conditions in real time.

Regulation and compliance

The Financial Industry Regulatory Authority (FINRA) – a US-based self-regulatory membership organisation that works under the supervision of the Securities and Exchange Commission – and other regulators are currently using AI effectively in market surveillance, Keith says. This technology utilises machine learning's capacity to identify dynamic patterns and uncover anomalies that help to identify problems in advance.

"A good and long-standing application has been the use of AI to detect best-execution problems," explains Michael. "The machine-learning algorithm 'guesses' the price movement a trade 'ought' to generate. The larger the difference between the guess and the actual price movement, the more time compliance functions or regulators should spend investigating."

Keith adds that regulators also use AI to provide "easier access to rules". FINRA is developing a machine-readable rulebook that will help users more readily analyse and search its rules, saving legal and compliance staff time and costs. RegGenome, a startup affiliated with Cambridge University's Judge Business School, has a broader aim: to arrange and organise machine-readable content from regulators worldwide around a single, universally applicable set of regulatory requirements (see p.25 for more).

Asset management

The higher the frequency of trading and the larger the available datasets, the more likely asset managers will be able to use

> "The global AI in asset management market was valued at US$2.61bn in 2022"

MORE FROM THE EXPERT

Read our profile of Michael Mainelli at ***cisi.org/polymath***

The prompts: 'AI creating a stock portfolio' (above) and 'creating a financial database' (right)

AI – and its applications are numerous. It is already used to balance portfolios by applying a set of predefined investment guidelines that help it determine the adjustments necessary to realign a portfolio with a client's objectives. Similarly, it can set asset allocations, execute trading strategies, prepare client reporting and produce investment performance analysis.

Keith says there are also multiple applications of AI and machine learning on the selling and buying sides. "It can be used effectively in know your customer and anti-money laundering exercises, as well as providing easier, more targeted access to researching internal and external information sources."

Additionally, AI tools can offer the innovative ability to interpret alternative data. For example, during 2021's controversial trading activity surrounding GameStop and other 'meme stocks', retail investors used social media sites like Reddit and Twitter to drive up stock prices (see *cisi.org/game-on*). AI allowed online trading apps such as Robinhood, popular due to its commission-free approach, to monitor and respond to sentiment-driven behaviour in real time.

And it's a growing area. According to *AI in asset management*, a 2022 report by Grand View Research, an India- and US-based research and consulting company, "the global AI in asset management market was valued at US$2.61bn in 2022 and is expected to witness a compound annual growth rate of 24.5% from 2023 to 2030".

The future of AI

While this emerging technology presents unique challenges – such as data privacy, ethical considerations, and the need for regulatory frameworks to ensure responsible AI implementation – it undoubtedly has the potential to transform how the financial services sector works.

In the short to medium term, regulatory compliance, fraud prevention, investments, data-driven insights, and risk assessment will see the most impact. Keith believes that the evolution of natural language processing tools – and the improvement in customer service and support that they can provide – are also likely to make a meaningful difference in years to come.

Regarding longer-term predictions, "the big debate in AI is its potential to evolve from performing a single task, like Amazon's Alexa, to a general, human-like capability. The possibilities may then be endless, but will also bring new levels of risk," Keith says. Although, he cautions that crystal-ball gazing may be futile. "To quote Einstein," he says, "'I never think of the future; it comes soon enough." ●

The prompt: 'AI supporting asset management'

AI IMAGE GENERATORS DALL·E / BING / VANCEAI

AI'S ETHICAL CONSIDERATIONS

Bias

AI can be inadvertently influenced by the gender, race and age of the development team who set up its training data. Great care should be taken to avoid bias both in its initial implementation and on an ongoing basis.

Hallucination

AI has been known to create fabricated results that don't match the data its algorithms have been trained on, negatively affecting decision-making and giving rise to ethical and legal issues. Diverse, accurate datasets and frequent training updates may help to mitigate this problem.

Data permission

Concerns around the use of data in AI training mean that some tech companies have performed U-turns in their processes. For example, in 2020, IBM withdrew its face recognition software for ethical reasons, and in 2022, Microsoft curtailed its software's use for gender, age and emotion recognition.

Job losses

The World Economic Forum reports that by 2030, incumbent financial institutions expect a net reduction of approximately 336,000 roles worldwide. AI's benefit in taking over repetitive tasks is clear, but the ethical question of whether this will come at the cost of meaningful employment remains.

Increasing intelligence

There remains a looming strategic and ethical dilemma as to whether humanity can control AI as it evolves, highlighting the need for even greater regulation as we move into a future where AI's intelligence could supersede our own.

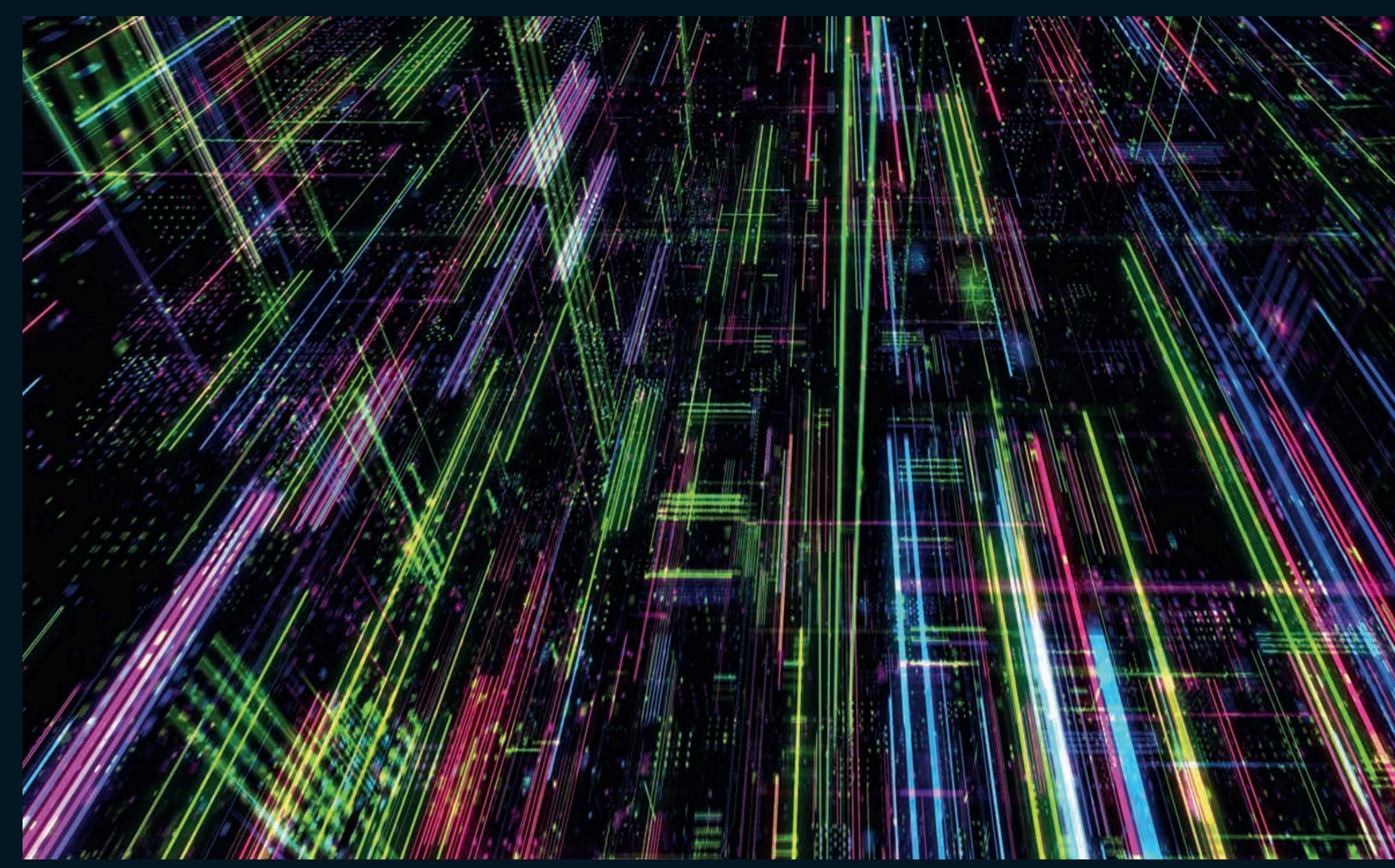
High-tech

Pioneering advancements in regulatory and supervisory technology promise to

TIM COOPER has over 20 years' experience as a financial journalist and writes for *The Times* and *Investors Chronicle*, among others

disrupt and modernise compliance. **Tim Cooper** examines what you need to know

compliance



REGTECH: A GROWING SPHERE

Technology is pushing regtech beyond its infancy – but baby steps might be needed to overcome firms' reservations

The regulatory burden on financial institutions is growing. A 2023 white paper by KPMG, *Unlocking the potential of regtech*, finds regulatory alerts skyrocketed globally from 8,700 in 2008 to 64,000 in 2021.

Correspondingly, KPMG estimates that the global market for financial regulation technology (regtech) is increasing at around 19% annually – from €7bn in 2021 to an expected €20bn in 2027.

Despite this growth, KPMG has joined regulators in calls for even wider regtech adoption. This is primarily to do with its benefits, says Deborah Young, chief executive at The RegTech Association, a global nonprofit headquartered in Sydney, Australia, that connects regtech buyers and sellers. "Regtech can bring productivity and efficiency gains to reduce the cost of compliance," she explains. "But it also reduces the risk of non-compliance. And it helps teams surface risks earlier, access better-quality information and data, and improve business decisions. This ultimately benefits and protects consumers."

Study of the cost of compliance, a 2021 report from the European Banking Authority, finds financial institutions gain significant benefits from using regtech, including "enhanced risk management, better monitoring and sampling capabilities and reduced human errors". The technology can also help financial services professionals solve compliance challenges across everything from anti-money laundering (AML) regulations – by automating know your customer (KYC) checks, for instance – to environmental, social and governance (ESG) monitoring, by helping firms to track updates in sustainability rules. (For more on the extensive uses of regtech, read our article at *cisi.org/regtech*.)

Chris Davies ACSI, the founder of UK-based regtech platform Model Office, adds that another key benefit of the technology is its ability to keep an audit trail of firms' compliance efforts. "In the UK, this is essential with the Financial Conduct Authority (FCA) proclaiming itself a 'data-led regulator' and placing metrics at the heart of consumer protection," he says. "Our mantra is: 'If you don't have the data, it didn't happen; and if you have the data, it better have happened'."

Practical tools

Several regtech providers have emerged in recent years, offering financial professionals practical solutions to enhance their regulatory processes. These include tools such as file checks and risk rating systems to highlight any compliance gaps, and guides to regulatory areas such as AML, data protection, complaints and whistleblowing – resulting in a potential time and cost saving of between 31% and 50%, according to a 2021 report by Deloitte, *Explore the tangible value of regtech solutions*.

While regtech is not a replacement for human judgement, it can aid and increase efficiency. For example, its tools can be used by firms to understand their anti-financial crime risks and demonstrate compliance – something Anthony Quinn, chief executive of global regtech firm Arctic Intelligence, says firms need to be able to explain with a full audit flow. Spreadsheets are often no longer fit for this purpose, given the complexities involved in many organisations. Anthony says regulated businesses have the same money-laundering obligations regardless of size, so small and medium-sized firms benefit as much from regtech as larger ones.

And the recent addition of AI has only enhanced regtech's applications. According to a report by global fintech firm Aveni, *The value of voice*, AI's natural language processing capabilities are used to monitor 100% of customer calls in some firms. The technology can then analyse the information gathered, helping to drive performance and ensuring that advisers meet compliance rules such as those on suitability.

AI text analysis is another significant development. The technology can help advisers auto-audit client reviews and compliance documents – which can often run to hundreds of pages – while looking for issues in areas such as AML, advice suitability reports, and client agreements. Using an algorithm to benchmark the content of such documents against the relevant regulations, it can provide an instant report showing the strengths and weaknesses of the client files against suitability regulations and Consumer Duty outcomes, for example.

Model Office's 2022 research suggests firms can save up to seven hours a week on governance, risk and compliance activities by using regtech to cut time on travel, fact-finding, manual client file and compliance document reviews, and audit report writing. Chris adds that this saving depends on the firm's size – it would likely be one to three hours a week for larger firms.

Perceived drawbacks

Yet, despite AI's ability to enhance regtech, some in the finance sector are more tentative about its adoption. "We're hesitant to move towards AI, as most of our clients would also be hesitant," explains Devon Card CFP®, director and financial planner at Crue Invest in Cape Town, South Africa (read more about Crue Invest's use of regtech on p.22). "Humans are emotionally linked to their finances. They want to deal with a human who has had real-life experiences." But, says Helen Packard, digital skills lead at the FCA, stronger compliance should involve working with AI – "it's not about one or the other," she explains.

Another perceived barrier is that AI is only accessible to large institutions. Small and midsize firms may believe that their operations don't warrant the significant investment it poses and opt to use traditional rules-based systems – which don't require the same extent of technical or analytical expertise – instead. However, this approach can be risky. Rules-based systems are based on past experience or best practices, making them inherently reactive rather than proactive. AI, on the other hand, enables firms to identify novel fraud and money laundering behaviours as they occur, allowing them to take action immediately.

Where to from here?

Helen points out that "as regtech work is common between firms," open-source software will likely become more widely adopted. The increased collaboration and innovation provided by new platforms such as the Fintech Open Source Foundation could allow firms to combine their approaches and benefit from sector-wide participation in regulatory compliance rather than adopting individual tactics.

The pace at which AI and open-source software are developing in the compliance sphere makes it clear that regtech is only just emerging from its infancy. But, as we start seeing its benefit in more tangible ways, barriers will surely diminish, and adoption will grow. ●

CHOOSING AN IN-HOUSE VERSUS THIRD-PARTY REGTECH PROVIDER

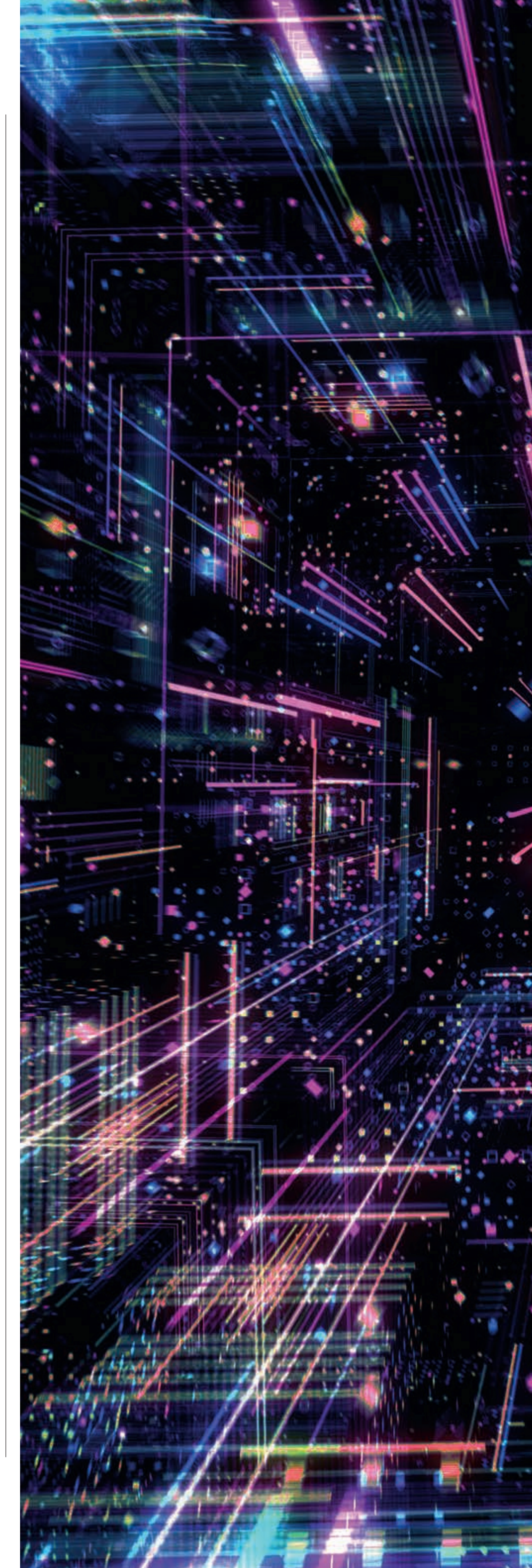
To build regtech capability, firms should search the market to ensure the right technology and expertise is available for their needs. Then run a cost-benefit analysis of in-house versus outsourced solutions.

The RegTech Association's (RTA) Deborah Young says one con of developing a regtech solution in-house is the time and resources involved in implementation – and the risk that something more appropriate might come out in future at a lower cost, using more contemporary technology.

The RTA helps firms select suitable technology by filtering providers according to risk, function, technology type, and vendor location. There are some challenges to consider. In its *Industry perspectives report 2022*, the RTA identifies inflexible procurement practices, internal conflicts and priorities, and agreeing contracts as the most common challenges to regtech adoption. Plus, users can perceive several risks associated with using regtech, such as data security and privacy concerns and regulatory uncertainty around the use of new technologies.

Christian Markwick, head of adviser support at Verve Compliance, says: "Another problem is that many advisers have established processes and implementing regtech requires significant effort. Previously they thought, 'If it ain't broke, don't fix it', but Covid changed that. Remote working and increased digitisation made firms realise they can no longer carry on doing what they used to."

IMAGES QUARDIA/ISTOCK



CASE STUDY: HOW CRUE INVEST IS NAVIGATING THE EARLY STAGES OF REGTECH

Cape Town-based Devon Card CFP®, director and financial planner at Crue Invest, says South Africa's incoming Conduct of Financial Institutions regulations will likely be more onerous for financial planners and is expected to increase the demand for specific regtech solutions.

Crue Invest uses web-based tool Xplan to manage client cases with built-in compliance processes around client onboarding and advice criteria. "The system creates a framework and manages that compliance process for us," Devon says. "For example, you can't close the case until you've completed certain processes, such as uploading a signed record of advice given."

The implementation of Xplan, and tailoring it to Crue Invest's needs, has been a process of trial and error, Devon says. "Often these systems are designed by someone who isn't client-facing and while the tech is there to help, it requires human intervention to set it up in a way that makes practical sense for our business. It would be ideal if our customer relationship and compliance management systems had an AI feature where we could explain to it how we want the systems set up and then it did all the leg work."

The firm also uses software called ThisIsMe (TIM) to comply with KYC regulations, which claims to cut KYC processes from three weeks to three minutes. "TIM is very simple and easy to use," Devon says. "Without it, I imagine the process would be time-consuming and tedious, as we would have to manually access various databases and sanctions lists to verify each client.

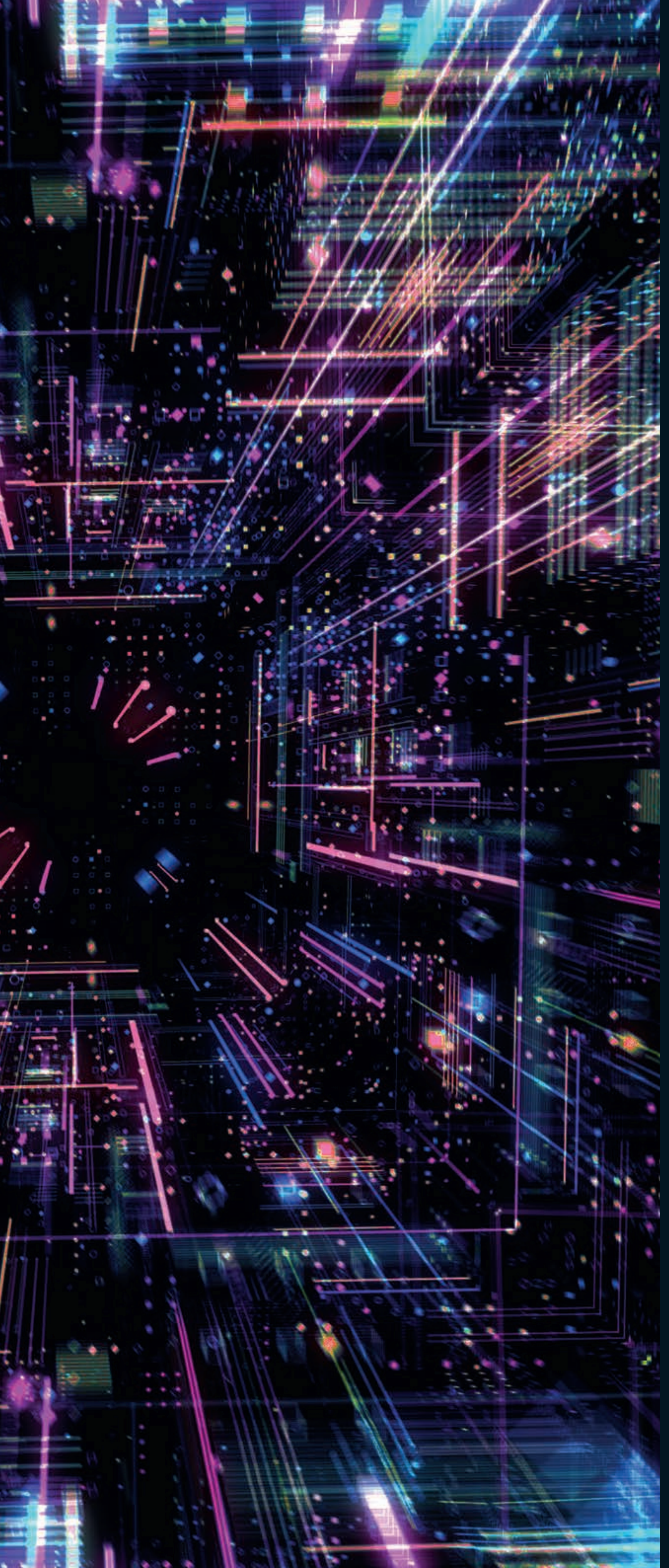
"Humans manage all other compliance processes, such as around risk profiling," he adds. "We believe financial plans are bespoke, so they need manual input – rigid automation is inappropriate."

That said, he is open to the ways in which technology can improve compliance, pointing out that many financial planning practices struggle with documenting their advice because it is given in so many different ways. He believes there is a need for more technology to record that efficiently.

"It would be short-sighted to say there will be no role for AI and machine learning in that area," Devon adds. "We have been experimenting with drafting proposals in ChatGTP. It will save us time compared to manually drafting such things. Theoretically, the technology could do that in a way that ensures compliance too.

"A point will also come when AI can analyse and pick up any compliance issues, say in a property purchase order, which could save time."

Devon says the costs of developing and maintaining in-house IT solutions for a small business are extreme. "So, if we want a specific regtech solution, we would look for a specialist partner," he says.



SUPTECH: A GLOBAL CONCERN

The race is hotting up for regulators worldwide to provide technological solutions that combat financial crime

Regulatory authorities worldwide are ramping up their technological surveillance capabilities and digitising their rulebooks at pace. Supervisory technology (suptech) uses various tools to improve compliance and make it easier for companies to navigate the increasingly complex regulatory landscape.

According to Cambridge University's 2022 *State of suptech* report, most financial authorities have started initiatives to enhance their use of technology. However, many projects are nascent and experimental, and most focus on improving data collection and basic analysis.

Authorities use suptech to optimise existing processes and tools and open new opportunities. Examples include using massive datasets such as social media streams to analyse market sentiment, parse online reviews to help identify fraud and conduct real-time analyses for supervising digital assets. However, the report identifies vast room for growth.

Suptech should also enable authorities to pull information from different sectors to get a more global picture of compliance, which will help them and firms benchmark compliance activities.

Overcoming obstacles

According to the *State of suptech* report, there are significant barriers to suptech adoption. Limits in the budget, data quality and technical skills at authorities remain the most significant challenges.

The report highlights a "remarkable mismatch between the experience of financial authorities and vendors in procurement, with technology providers urging public agencies to address legacy procurement processes" and says that "financial authorities express an unmet need for data teams, data sharing and data synthesis as a foundational part of their modernisation".

Suptech challenges also differ between agency types. For central banks, the issues mainly relate to internal culture and strategic buy-in. Capital markets, securities, and investment instrument supervisors have more problems upgrading their existing processes. For other supervisors, the main challenges are with IT systems.

But, despite these barriers, regulators worldwide have ambitious plans to grasp the opportunities offered by suptech. Professor Bob Wardrop, executive director of the Cambridge Centre for Alternative Finance and chief executive officer at RegGenome, a repository for all actionable regulatory content (see the case study on p.25 for more), says: "One barrier is that technology

savvy people do not generally populate regulators, and they are extremely budget constrained. Investment in suptech globally would provide a huge payoff, but allocating resources is difficult. We need a public-private solution to allow industry and regulators to benefit."

Suptech developments worldwide

The United States

The US Financial Industry Regulatory Authority (FINRA) has developed an arsenal of suptech tools. These include using AI applications – such as natural language processing and machine learning – to review financial services adverts and ensure they comply with regulations, thereby improving the efficiency and effectiveness of market surveillance programmes.

"We're exploring how AI can help reviewers prioritise which submissions may have problems so they can review them first," says Haimera Workie, vice president and head of financial innovation at FINRA. "But we use it most in surveillance of securities markets to help our team identify potential areas of market manipulation by market participants so that they can investigate further. This includes data analytics to help us see if there are issues around how products are trading."

> "Investment in suptech globally would provide a huge payoff"

Another project at FINRA is a machine-readable rulebook, which facilitates compliance with regulations in the securities industry. It has developed a taxonomy search tool to enhance information searches and make the rulebook easier to navigate. Haimera notes that the 40 rules that have been tagged have been found to receive around 50% of all the page views of FINRA's rules. FINRA has also created an application program interface (API) protocol that allows the entire rulebook to be ingested and tagged in a way that can interface with firms' compliance policies and procedures, enabling firms to get bespoke updates automatically.

The European Union

In September 2022, Elizabeth McCaul, a member of the Supervisory Board of the European Central Bank (ECB), gave a speech on 'the impact of suptech on European banking supervision'. She outlined its suptech agenda and plan to create a single supervisory mechanism for digitally enabled banking supervision across Europe, including looking for tools to simplify data flows and improve connections between systems. To support this, the ECB has created a 'virtual lab' – a platform that allows collaboration on supervisory tasks via powerful cloud computing and advanced analytics.

The bank has also trained more than 1,000 staff on AI and digitalisation. It is rolling out its Data Science School to provide technical knowledge on topics such as programming, data science and data visualisation. Many resulting tools have gone live, including one that streamlines assessments by automatically reading 'fit and proper' questionnaires filled in by supervised institutions, flagging issues and using analytics to reduce manual workload and human error. Another tool analyses complex data networks to give supervisors an overview of bank owners and interdependencies to boost interconnectedness in the sector.

The United Kingdom

The UK's Financial Conduct Authority (FCA) updated its data strategy in 2022, with the aim of better using data and technology to become a more innovative, assertive and adaptive regulator.

Among many other projects, the FCA has created data science units to analyse risk, triage cases and automate processes to detect harmful activities more quickly. It has combined social media and other online information to increase understanding of how firms market products and services online. And it has introduced analytical tools to spot harmful activity in high-risk financial adverts. For example, it uses 'web scraping' (extracting data from websites) to identify potential scams, and scans around 100,000 sites a day for fraudulent activity, says Jessica Rusu, FCA chief data, information and intelligence officer, in a speech in April 2023 at the Innovate Finance Global Summit.

Rusu provides examples of the FCA's tech development activities, including events such as its 2022 APP Fraud TechSprint, which launched several projects that aim to identify fraud through data strategies. And its internal tech accelerator programme has built other proofs of concept to help identify online financial promotion scams and greenwashing.

The FCA is also creating an Open Regulation Platform to build a machine-readable set of regulations.

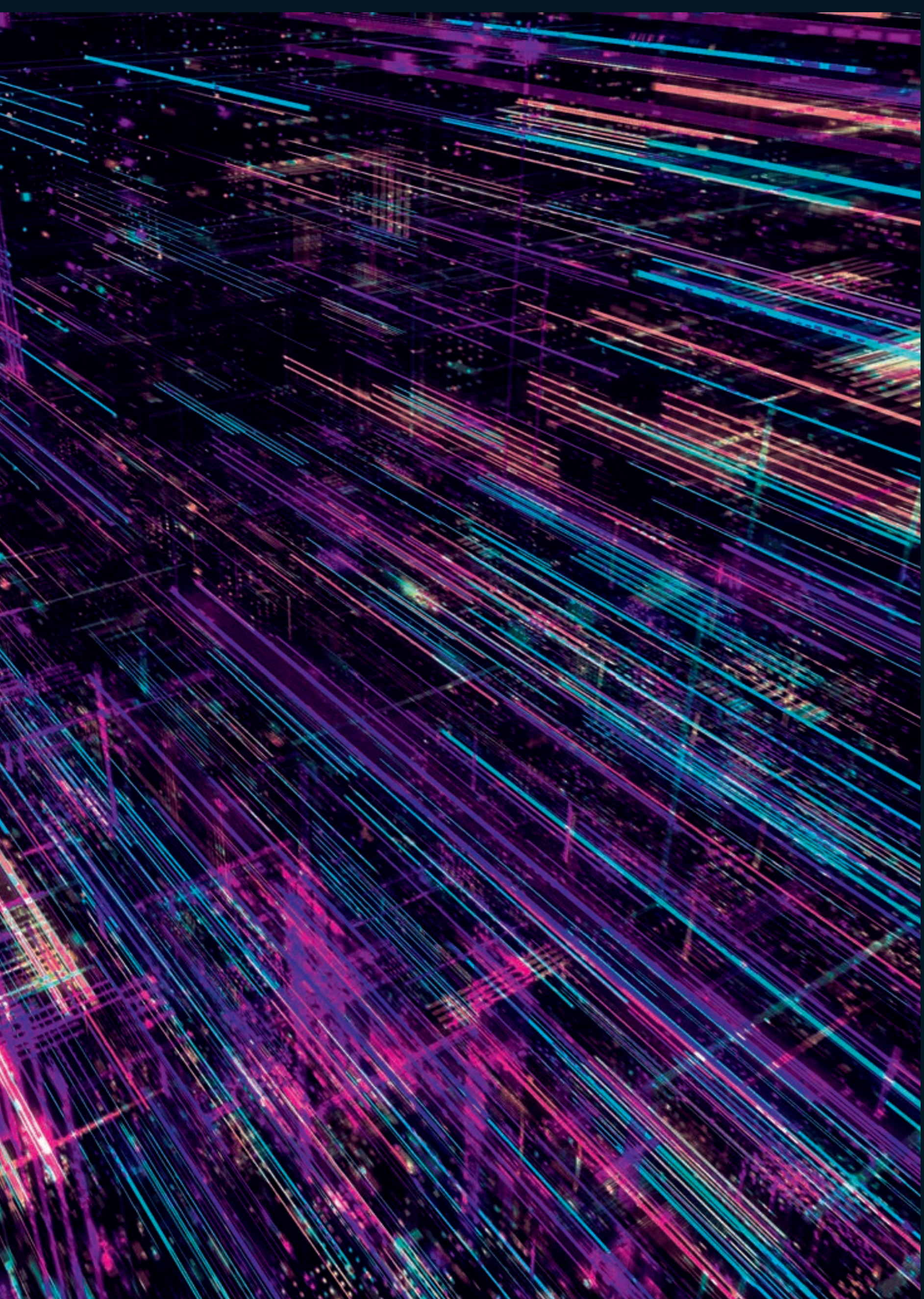
The Bank of England has said it believes AI can play a crucial role in stopping money laundering and detecting credit card fraud by, for example, using AI transaction analysis to detect fraud in real time. It has also developed a cognitive search engine that uses AI to generate real-time predictive insights, enhancing searches and creating intuitive dashboards.

Worldwide cooperation

The number of suptech initiatives globally forms a complex picture that could result in compliance teams struggling to keep up with new developments. But authorities are collaborating to increase coordination. In 2021, the European Banking Authority recommended that authorities converge supervisory practices, harmonise regulatory requirements and employ a greater use of sandboxes and innovation hubs to test solutions.

Authorities are responding. For example, the Bank for International Settlements Innovation Hub is working on joint international efforts to monitor decentralised finance markets through an open-source data platform; integrate regulatory data and analytics; and observe financial markets in real time.

By continuing to develop technological and collaboration efforts, the hope is that authorities will gradually ease the burden on compliance teams and continue to fight financial crime more efficiently. ●



CEO Professor Bob Wardrop says that this helps many regtech providers focus on their main value-adding activities rather than having to create this content themselves. "The regulatory environment is mushrooming with more and more firms impacted by regulation, and complexity growing," he says. "We need a drive to automate processes to reduce human error and manage cost. But this drive must also fit firms' digital agendas to become more agile and find new market opportunities. Regulators have lagged the market on the form in which regulatory content needs to be consumed to enable automation and analytic insights."

Bob says that many regtech players have entered the market, concentrating on areas such as anti-money laundering, know your customer and regulatory reporting. But each is doing it their way. And all the individual authorities' efforts to change regulatory content and make it machine-readable have created a 'Tower of Babel' of disunity and chaotic communication.

"Regulators recognise the need to catch up and make their rulebooks machine-readable," he adds. "So, for example, they are moving the format of their rulebooks from PDFs to forms of structured data. FINRA's machine-readable rulebook and the FCA's Open Regulation Platform are good examples. But these efforts are also fragmented. For example, the data structure the FCA uses for AML can be different from what the Japanese or Singaporean regulators use. If they all approach it slightly differently, that compounds the Tower of Babel problem."

Working together to harmonise taxonomies globally will help solve this problem, Bob concludes.

CASE STUDY: THE REGULATORY GENOME PROJECT IS SET TO TEAR DOWN THE TOWER OF BABEL

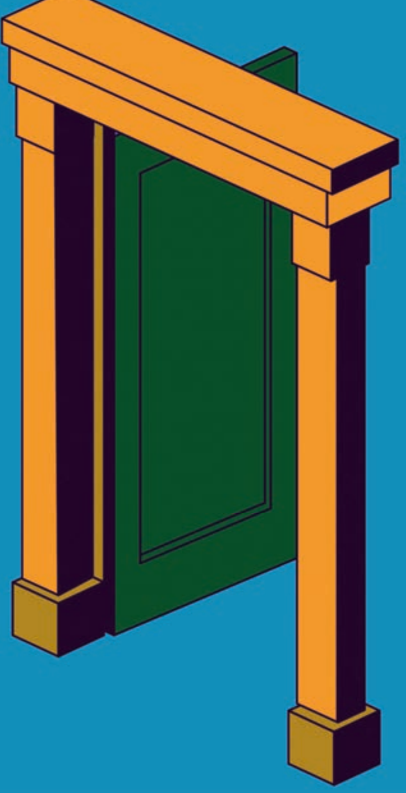
The Regulatory Genome Project (RGP) at the University of Cambridge Judge Business School is a collaboration aiming to transform how the world consumes regulatory information. The project will enable the organisation and comparative analysis of financial regulations across jurisdictions by developing an open information structure. This will address fragmentation in how regulatory information is currently shared globally.

RGP is collaborating with industries and regulators to create common taxonomies, which it will start releasing in 2024. These taxonomies are created as a public good. But RGP also has a spin-out company called RegGenome that captures and creates content from thousands of regulatory sources. It then makes this information, together with the taxonomies, machine-readable to regtech users, such as banks, asset managers and insurers.

New tech, new roles

Hannah Smith explores the new jobs technology is opening up in finance and the practicalities of switching to these careers

HANNAH SMITH
covers all aspects of personal finance and has written for *The Times*, *The Telegraph* and many more



Much has been said about the ways in which artificial intelligence could take over human jobs but, says Andrew Hawkins, chief executive officer for UK and Europe at B2B payments business Shieldpay, it also brings with it career opportunities. He points out that AI will allow businesses to focus resources on new, high-value roles, providing real opportunity to achieve scale.

With AI able to automate tasks like drafting and reviewing documents, employees will be better able to focus on the complex work that requires human judgement and emotional intelligence, says Andrew. “There will always be a need for accountability with human intervention – especially when dealing with complex high-value or high-volume transactions.”

New roles and opportunities

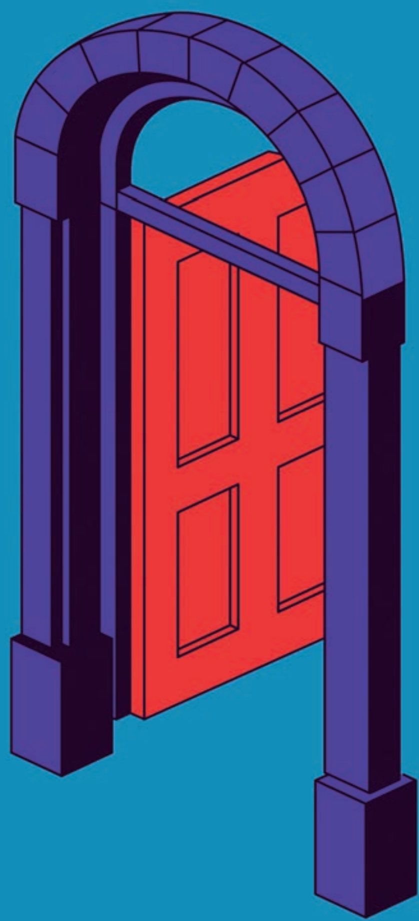
What might these new jobs in AI look like? One possible shift is that the need for textbook knowledge, which AI can assimilate from datasets, will become obsolete. Instead, emphasis will be placed on critical thinking, with roles such as that of an AI ethicist – who can evaluate the potential biases and transparency issues associated with AI in finance – rising in prominence.

AI-related emerging roles are so new that you can shape them as they evolve

Similarly, with AI-driven personal finance applications becoming more prevalent, financial wellness coaches may emerge to advise clients on the best ways of leveraging AI tools for saving and investment strategies.

A 2023 report from professional services company Accenture, *A new era of generative AI for everyone*, proposes that the large language models used in generative AI, such as ChatGPT, could

ILLUSTRATION HARRY HAYSOM / IKON IMAGES



create "entirely new roles to recruit, including linguistics experts [and] AI editors". Alex Lartey, chief business development officer at chatbot design company Tovie AI, adds that excelling at these 'language tasks' can open up opportunities for those with finance backgrounds to explain AI to firms as consultants.

It may also create specific roles for financial chatbot consultants, who would combine their financial and linguistic abilities to train AI-equipped chatbots to help customers navigate investment procedures, for example. "No one knows the context of customer interactions better than the people who work with clients daily," Alex explains.

On the regulatory side, jobs for auditors specialising in reviewing blockchain transactions and identifying potential vulnerabilities for fraudulent activities may emerge. Crypto compliance officers, who work with financial institutions to ensure adherence to regulations around cryptoassets, will be highly in demand too.

BY 2027, THE WORLD ECONOMIC FORUM PREDICTS

40%
jump in the number of AI and machine-learning specialists

30-35%
rise in demand for roles such as data analysts and scientists or big data specialists

31%
increase in demand for information security analysts

Sell your skills

Ben Davies, client services director at Cpl's Talent Evolution Group, has almost 25 years of experience in recruitment, including for the Financial Conduct Authority, where his team supported the recruitment of a cybersecurity and data science division. He suggests that AI-related emerging roles are so new that you could shape them as they evolve.

Ben says that many of these futuristic-sounding jobs are not clearly defined and don't have a 'typical' career path. He believes that by enhancing baseline skills around statistics, data management, linguistics, and client relations, employees can learn the rest of what they need to know while in the role.

The key is transferable skills. For instance, a background working with data could transfer well into a data scientist role, while people who have worked in compliance or risk may have the relevant skills needed for the new jobs arising as authorities globally look at how to regulate AI.

However, the crucial element for employers will be proof that a candidate's experience will translate into the uncharted territory of these new roles. As Ben puts it, "Half the battle is selling yourself."

How to make your move

If you're already working in financial services but want to move into a tech-based role, there are practical steps you can take. Ben suggests speaking to people who hold related roles in your current organisation to find out their skills and background. You might also look at forums, participate in techsprints (collaborative events that help develop technology-based ideas to address specific industry challenges) or attend talks to learn more about your area of interest. Having a mentor helps too, he adds.

Sharjil Ahmed, the former chief of business development for private equity firm Dux Capital in Dubai, founded Cykube – a London-based fintech company that helps firms realise the full potential of AI and blockchain – in 2018. He agrees that a mentor with "real-world experience" is invaluable and says he approached senior colleagues with established tech knowledge before making the move himself.

"The advice they gave was all the same: education, education, education," he says. He followed this guidance, gaining training and certification in fintech and blockchain from Oxford University's Saïd Business School. In his view, the only way firms can effectively "bridge the gap between the tech team and business team" is if people with financial expertise gain equivalent insight into technology.

Now, as an industry associate at University College London's Centre for Blockchain Technologies, he mentors young tech entrepreneurs himself. His advice? "Do your research. Find what you want to specialise in – whether it's machine learning or regulation – and then choose a course you like and get it from a reputable institution. Then use that knowledge in your current work environment. Only once you feel confident in your new skill set, should you look for a new role." ●

WHAT ARE CRYPTOASSETS?

HM Revenue & Customs defines a cryptoasset as "a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored, or traded electronically".

UNLEASH CRYPTO'S POTENTIAL?

Nick Huber takes a global scan of the regulatory changes that could pave the way for cryptoassets to become more firmly embedded in countries' economic environments

NICK HUBER is a business journalist specialising in technology. He has reported for the *FT*, *The Guardian*, BBC and others

In December 2022, HM Revenue & Customs (HMRC) announced a change to the UK tax system. At first glance, it appeared to be a minor update to government policy. However, the purpose of the rule change – to make it easier for non-UK investors to include cryptoassets (see left for HMRC's definition) within their portfolio when investing through a UK investment manager – is noteworthy. And it forms part of a more significant shift in UK tax, financial regulation and investment markets.

The update highlights the bind in which many governments worldwide find themselves. The vast majority want to encourage a technology that may boost economic growth. Yet all are held back by the threat that crypto's volatility could pose to mainstream finance. It also provides additional ways in which criminals can commit fraud, theft, and fund criminal activity, with minimal scrutiny.

The collapse in November 2022 of FTX, one of the world's largest cryptocurrency exchanges, sent shockwaves through the sector and further focused regulators' minds. So, how are regulators in the UK and worldwide approaching cryptoassets, including cryptocurrencies and 'stablecoins' (cryptocurrencies pegged to other assets, such as stable currencies)? What are the risks and opportunities for investors? And how is the market likely to develop in the short term?

The UK's emerging regulatory regime

In April 2022, the UK government announced plans to regulate stablecoins and establish a financial market infrastructure sandbox for experimenting with crypto technologies. The former will pave the way for cryptoassets to be used in the UK as a recognised form of payment, and the latter will allow companies to experiment with technologies such as distributed ledgers, the best known of which is blockchain, which support cryptoassets and crypto services.
In response, Innovate Finance, the independent

industry body for UK fintech, released a statement saying it and the "responsible crypto firms" it represents welcome the regulation "as essential for consumers, stable markets and a level playing field". However, the body also warns that further work is still needed in critical areas.

Matthew Long, director of payments and digital assets at the Financial Conduct Authority (FCA), agrees that more work is necessary and adds that investing in crypto is high risk. He says that although a government consultation in February 2023 proposed bringing cryptoassets into the regulatory framework set out in the Financial Services and Markets Act (FSMA), it is still unregulated. "That is why the FCA continually warns consumers that they should be prepared to lose all their money if they invest in cryptoassets," he says.

Major market approaches

Europe is arguably leading the way in regulating cryptoassets. In April 2023, the European Parliament announced in a press release that it had approved a draft legal framework for the Markets in Crypto-assets (MiCA) regulation, including cryptocurrencies and 'emoney tokens' not currently regulated by existing financial services legislation. The press release quotes Stefan Berger, lead MEP for MiCA: "Consumers will be protected against deception and fraud, and the sector that was damaged by the FTX collapse can regain trust."

Like many others, the US government is trying to strike a regulatory balance between encouraging legitimate cryptoasset businesses and discouraging criminal activities that use cryptocurrencies. However, while it has extended existing financial regulations – including anti-money laundering laws and efforts to combat cybercrime – some experts believe it is trailing Europe and the UK in developing a regulatory regime.

"Europe is arguably leading the way in regulating cryptoassets"

Speaking at the *Financial Times'* crypto and digital assets summit in May 2023, US Securities and Exchange Commissioner Hester Peirce stated that, rather than issuing enforcement against crypto activity on a state-by-state basis, America needs to put overarching regulations in place.

"[The UK's] approach is one that can serve as a model for us. MiCA can serve as a model for us," she said. "I think we're shooting ourselves in the foot by not having a regulatory regime in the US." She clarified that by building a "good regulatory regime" the country would retain crypto business that might otherwise go to jurisdictions with rules that are perceived as more friendly.

Is global regulation on the cards?

In February 2023, the International Monetary Fund (IMF) announced that it had released a board paper about effective policies for cryptoassets. The report presents a framework to help its member countries develop a coordinated policy response to cryptoassets. That same month, following G20 meetings in India, the IMF also issued a report on the macro-financial implications of cryptoassets, recommending that global standards should be set for their regulation.

Following a committee meeting in Niigata, Japan, in May, the G7 issued support for the IMF's work, particularly the creation of a 'Central Bank Digital Currencies (CBDC) Handbook' for nations to follow. In a communiqué released after the meeting, the G7 nations also commit to further deliberation on policies related to digital money "to harness the benefits of innovation such as payment efficiency, as well as financial inclusion, while addressing potential risks to the stability, resilience and integrity of the monetary and financial system". CBDCs, the communiqué continues, will have a substantial role in establishing "a reliable, stable, and transparent global payment system".

A global payment system may, however, still be some way off, as different countries currently take a disparate approach to crypto. Nine, including China, have banned cryptocurrencies outright. China has also warned its citizens against cryptoassets such as NFTs, but its aversion to crypto trading does not carry across Asia. In October 2022, the Monetary Authority of Singapore stated it was encouraging the development of stablecoins as a "credible medium of exchange".

Elsewhere, jurisdictions such as Australia, Greece and Romania have introduced measures to ensure that crypto exchanges are subject to national anti-money laundering and anti-terrorist financing laws. It's clear that the IMF's recommendations, and the steps it outlines for member countries in creating effective cryptoasset policy, could harness a more cohesive response to regulation in the future.

The approach in the UK is to work closely with other major markets to get the right outcomes for the global response, says Matthew Long. But, he adds, regulators are focusing on a shared global outcome rather than the process itself – that is, the ends rather than the means. He believes this will "inevitably result in variance" in how cryptoasset regulation is developed across jurisdictions due to the differing legal systems and legislative approaches worldwide.

ILLUSTRATION OLLIE HIRST

Crypto risks – and silver linings

The lack of rules currently governing cryptoassets poses its greatest threat. "The main risk is the very fragmented and, in most countries, non-existent regulatory frameworks," says Ruth Wandhöfer, an author specialising in financial services and technology and the former global head of regulatory and market strategy at Citibank. She says this is directly linked to a lack of consumer protection – "particularly when things go wrong, and consumers lose confidence."

Younger investors may be the most affected by gyrations in the crypto market or collapsing crypto companies. According to research by fintech lending platform Stilt Inc., Generation Z (born 1996–2010) and millennials (born 1981–1996) make up 94% of all crypto buyers in the US. This is of particular concern, the report says, because this demographic already faces "increased costs of living" and "debt balances significantly higher than that of older generations".

However, there is a silver lining: investors worldwide could have the chance to shape future regulation. For example, the UK government plans to establish a cryptoasset engagement group to work more closely with the financial services sector. It is also exploring ways of enhancing the competitiveness of the UK tax system to encourage further development of the cryptoasset market.

Overall, the experts are cautiously optimistic. "Many opportunities are still developing," says Matthew, "but the FCA sees stablecoins as potentially beneficial. They could make international cross-border payment faster and cheaper, facilitating increased international trade." He cautions that the benefits of a growing investment market in cryptoassets will only outweigh the drawbacks on one condition – if the regulation is right. ●

KEY POINTS OF THE HMRC RULE CHANGE

In December 2022, HMRC changed tax rules to make it easier for non-UK investors to include cryptoassets in their portfolio when investing through a UK investment manager. Cryptoassets are now included in a list of transactions that benefit from the investment management exemption (IME), which determines whether non-UK residents can appoint UK-based investment managers to make investments on their behalf without bringing them into the scope of UK taxation.

HMRC's definition of cryptoassets is broad (see p.28) and includes 'non-fungible tokens' (NFTs), 'stablecoins' and a 'crypto asset exchange', which would enable the exchange of cryptoassets for money; money for cryptoassets; or one cryptoasset for another.

The change will apply to transactions entered into during the 2022/23 tax year for non-corporate entities and accounting periods current on 31 December 2022 for corporate entities.

Chris Etherington, partner at audit, tax and consulting firm RSM UK, says that while the UK has an important global role in managing investment funds, the majority of them are not based in the UK. (The European Fund and Asset Management Association's *International Quarterly Statistics* report, published in June 2022, shows that the UK had just a 3% share of worldwide investment fund assets by domicile at the end of the first quarter in 2022.)

Chris says HMRC's rule change helps "provide comfort" that a non-UK resident investment fund will not be brought into the UK tax net due to appointing a UK resident investment manager. He adds that the previous lack of clarity surrounding the treatment of cryptoassets under the IME rule caused investment managers to consider deploying their investment strategies involving cryptoassets from other jurisdictions.

Chris also notes that the US approach to the taxation of cryptoassets has similarities to the UK. In the US, the tax payable on a cryptoasset gain depends on how much is earned, the specific transaction and how long the asset has been held.

AFTER FTX – IS THERE LIFE IN CRYPTO?

Bradley Duke, co-founder and CEO at ETC Group, discusses with George Littlejohn MCSI the implications of the FTX insolvency, how to avoid such problems in future, and the outlook for crypto.
cisi.org/ftx-crypto

TO BITCOIN AND BEYOND

A brief history of how cryptoassets have grown in value and reach since their inception

JANUARY 2009

The first ever block of the digital currency and payment system Bitcoin is mined by a developer using the pseudonym Satoshi Nakamoto. The system operates on a decentralised peer-to-peer payment network powered by its users with no central authority. Despite much speculation, the identity of Satoshi Nakamoto remains unknown.

MAY 2010

First recorded use of bitcoin in exchange for a good or service. A programmer offered to pay 10,000 BTC for pizza.

FEBRUARY 2014

MtGox, one of the largest bitcoin exchanges, files for bankruptcy after losing an estimated 750,000 of its customers' bitcoins.

JULY 2015

The Ethereum project launches. Its cryptocurrency, ether, will go on to become the world's second most valuable.

2018

The market sees a sharp increase in initial coin offerings (ICOs), in which a start-up sells a cryptocurrency to raise money from investors. Investors could choose, on average, among 482 token sales opening every day of the year, and 2,284 ICOs reached their conclusion. During 2017, the corresponding values were 91 and 966 respectively.

2021

Bitcoin's bull run, which sees it reach an all-time high value of US$68,789.63 in April 2021.

JUNE 2023

The live price of Bitcoin is US$30,246.80 (as at 28 June 2023)

AUGUST 2018–DECEMBER 2020

The so-called 'crypto winter', which sees a prolonged fall in the value of bitcoin and greater restrictions on ICOs.

NOVEMBER 2022

FTX, one of the world's largest cryptocurrency exchanges, which is run by charismatic entrepreneur and investor Sam Bankman-Fried, files for bankruptcy.

CRYPTO BALL

Where the crypto market may be headed in the next three years

Prediction one: Twitter enters the crypto market

Twitter recently applied for regulatory licenses to introduce payments access, and may start to offer payment services to users. "With Elon Musk's keen interest in crypto, it isn't a stretch to also predict that the social media platform could start to facilitate crypto transactions, helping to bring crypto adoption even more mainstream," says Daniel Webber, CEO and founder of FXC Intelligence, which provides data on the payments market.

Prediction two: Central banks start to issue digital currencies

Earlier in 2023, the Treasury and Bank of England stated that they were considering a 'digital pound' or CBDC. "The argument for the digital pound in general is that the government should guard its role of ensuring the stability and usability of money," says Hector McNeil, CISI member and co-CEO of HANetf, an investment platform for exchange traded funds.

Prediction three: Less room for new crypto coins to succeed

As cryptocurrencies such as bitcoin and ether have gained legitimacy, thousands of new crypto coins have been released. Some have performed well, but many have failed – 2018 saw an all-time high of 751 new coins becoming defunct. The trend may be reversing, with just under 5% of coins launched in 2020 failing, but many predict that as older coins become established it will be harder for new ones to reach the same highs.

PHOTOGRAPHY MICHAEL LECKIE

"We need to invest in human capital"

Pamela Dow, chief operating officer of Civic Future, talks to **Hannah Fearn** about the organisation's goal of improving the talent pipeline for public leadership

HANNAH FEARN was comment editor for *The Independent* and now specialises in social affairs for major UK titles

For a strictly non-political woman, Pamela Dow has dedicated two decades to making politics work better. The former UK senior civil servant, who once sat at the right hand of cabinet minister Michael Gove, is focused on finding and training the next generation of public leaders.

"We've been exposed!" she says, explaining that Brexit and the pandemic highlighted "fundamental weaknesses" in UK leadership.

That's why she and her former colleague Munira Mirza – one of Boris Johnson's closest aides throughout his time as London mayor and director of the Number 10 policy unit while he was prime minister, until she resigned in 2022 – have teamed up to make a change.

Together their mission is to create a generation of leaders who better understand the economy and public finances and have more confidence in handling modern economics. Pamela wants to see more "porosity" between the private and state sectors, particularly between government and finance, so that finally, people "who have built expertise" in banking and investment can use their skills to support policymaking in a practical way.

This vision inspired the creation of Civic Future, a non-party political organisation in the UK dedicated to improving public leadership.

Doing things differently

I meet Pamela at her offices in the heart of Whitehall, a hip, 'techy' workspace where her new organisation sits alongside other think tanks and spin-offs, all housed inside a grand Victorian edifice opposite the Ministry of Defence. It's an imposing setting, but the reception area, replete with giant installation artwork and rock music piping through hidden speakers, seems intended to convey another message – don't worry, we do things differently here.

It's fitting for Pamela, who, state-educated in the East Yorkshire market town of Driffield, cuts an unusual figure in Whitehall. She is the ambitious and vibrant critical thinker that civic life still sees too little of. As she speaks, she projects an understated yet uncompromising confidence. It's an aura that any woman from an ordinary family – her father was a mechanical engineer, her mother a teacher who trained for her career in mid-life – needs to hold to have got so close to power and achieved so much in her 43 years.

Pamela began her career in the private sector as a consultant and lobbyist for business and NGOs, before finding herself drawn into the nitty gritty of government. She joined the Department for Education in 2007, specialising in strategic communications. After the 2010 election, she became Gove's principal private secretary in the DfE, then in her words 'tracked' him around, becoming his director of strategy in both the Ministry of Justice and the Cabinet Office.

She found working under Gove inspiring. Though she doesn't say it directly, she implies that he embodied all the ingredients of the competent public leaders that Civic Future is trying to create. "Every civil servant loves working for a minister with a clear and ambitious reform agenda, who can explain it well and understands how the system works," she says.

Those roles, each of great seriousness and responsibility, came when she was still only in her 30s – part of a pattern of early success. Motivated by a romantic image of Oxford, generated by reading "too much Edwardian literature at an impressionable age", Pamela won her place to read

philosophy, politics, and economics despite her former teacher's lack of conviction. "My head of sixth form said, 'I just don't think you'll be happy there, Pamela,' which is a bit sad, as the colleges do loads to help people fit in. I'm sure I benefited from a state school quota, though. I found it intellectually and socially stimulating and in no way would I have been able to do the things that I've done, had I not had that experience." This is something that she hopes Civic Future will be able to change.

Breaking the mould

Pamela defines public life in the broadest sense: not just those visible positions of leadership such as MPs and council bosses, but also the behind-the-scenes roles such as charity trustees, school governors, political advisers in Westminster and the skilled professionals who lead the civil service. Her biggest concern is that most people who may make an excellent contribution don't realise these roles exist or consider that they might be appropriate for them. "I think people know about a few, but they're just not aware of all the others, so it's an information issue to solve," she says.

The result is that these jobs are often held by a homogeneous group of people, predominantly arts and humanities graduates from similar backgrounds and universities, with little training or expertise in those crucial areas of economics and finance. They may also lack the leadership skills to exercise their duty responsibly.

For this reason, she hopes Civic Future's work will have a tangible impact on financial services. She envisions "a generation of leaders who better understand the economy and public finances and have more confidence in the different fiscal and monetary levers a government can use." This circles back to the idea of porosity between government and finance sectors so that people who "have a view on what is most effective in achieving aims, based on real expertise" can support legislators in practical ways, such as through secondments or executive or non-executive roles.

Investing in skills

Pamela already has direct experience designing schemes to give people the skills they need to be better civil servants. When she left to set up Civic Future with Munira, Pamela had been leading a Cabinet Office programme of Whitehall staff training, aimed at upskilling those already embedded in a career in public service. "If my 16-year-old self had known I was going to be in civil service HR,

CAREER HIGHLIGHTS

2022–present
Chief operating officer of Civic Future, with the aim of "opening up politics to a broader range of talent"

2019–2022
Executive director in the Cabinet Office, where she founded and led the government Skills Campus, delivering the first ever curriculum for civil service knowledge and skills

2017–2019
Chief reform officer at not-for-profit organisation Catch22, improving the design and delivery of public services

2015–2016
Director of strategy at the Ministry of Justice

2007–2014
Begins her civil service career in strategic communications for the Department for Education and progresses to principal private secretary under Michael Gove

2001–2007
Corporate communications and public affairs consultant

I don't think she'd have been very happy, but I was just totally driven by this sense that the civil service is basically a human capital organisation, and we're not taking the vocational skills and training of people as seriously as we should," she says.

Pamela and Munira came together to imagine something bigger – a project ensuring these skills and opportunities are available to everyone. In the past, teens or early career professionals might have thought that these civic roles were dull or technocratic, just not something worth dedicating the evenings and weekends of your young life to.

And now there was a newer challenge. Pamela describes how Civic Future was established as a proactive attempt to counteract another more dangerous assumption: the growing sense that public leadership is no longer something to be respected.

"Munira and I had a conversation last summer, and you can imagine last summer was a particularly febrile time," she says, referring to the political turmoil the UK experienced in the lead-up to Boris Johnson's resignation as prime minister in July 2022. "We both had this sense that there is something to be done in terms of talented people considering public life and then being prepared for it in a profound way. You look at some of the stories coming out of Westminster and think: what 18-year-old is sitting there now thinking I'd quite like to serve my country?"

The problem has emerged, she claims, because the people whom we see in public life are often poorly prepared for the roles they've taken on. They have neither the broad, interdisciplinary, experience, nor the specialist expertise, to lead with confidence and rigour. Political leadership also needs significant 'tradecraft', for example, to communicate effectively – to "inform, explain and persuade," in Pamela's words. "It needs to be better than telling voters you're 'pro-growth and anti-crime'. That tells us nothing. With limited resources, will you place an emphasis on crime prevention or detection? Will you improve growth by reducing the tax burden on businesses, or spending more on research and development? We need political leaders and policymakers who can make compelling cases for the choices they will make."

Prioritising economic understanding

The most significant knowledge gap, in Pamela's experience, is a solid understanding of economics and finance. Inevitably it has huge implications for the quality of public debate and decision-making on matters as diverse as how taxes are raised and spent to the cost and value of childcare and housing. "It's not a wildly original insight that, on average, the ability of people in politics and public life to explain the complexities of public finances and economic policy, to debate different options and make a compelling case for certain trade-offs, is weak," she says.

To prove the point, she cites a statistic from an anonymous survey of policy professionals in the civil service: 31% can't describe the difference between a percentage increase and a percentage point increase. They also have a poor handle on how public finances are leveraged and managed. When asked to estimate what percentage of income tax is drawn from the

top 1% of the UK's earners (who pay 30% of the country's income tax), "survey after survey" shows that most significantly underestimate.

Why is this so important? "Well, you can't talk seriously about anything relating to the UK's land, labour, entrepreneurship or infrastructure without understanding some economic theory and history," she says. "If you are serious about childcare, or housing, or immigration, you need to be able to understand what's driving behaviour now – the economic and financial incentives and constraints. And you also need to understand the pros and cons, the trade-offs, of fiscal and regulatory interventions that influence them. You need to be able to make a case for your preferred solution."

And of course, for those already working in public leadership roles, admitting to having such large gaps in your knowledge is – as Pamela puts it – "quite a brave thing to do". That means a member of parliament who has just been reshuffled to become a Treasury undersecretary won't openly say that signing up for a short course in economics or finance would be a sensible move, particularly if the press were to get hold of that admission. And so, the situation rolls on.

For finance and investment professionals, these calculations and considerations are an everyday part of the job. Yet too few of these talented people are drawn to public life. Pamela wants to investigate why and help encourage more to take that step.

In particular, she wants to target people who have previously never had a specific interest in politics or policy but who have had "a brilliant career in finance" and then suddenly find themselves with older children and the bulk of their professional achievements behind them but who still "really care about stuff". These people, Pamela says, need to know that there are 330 non-departmental public bodies – once called quangos – which all need a board and an inspiring, financially literate chair.

"I was at a dinner with this financier based up in Scotland, and he was talking about the multi-year scandals involving the construction of new ferries to the country's Western Isles," she says, referring to the delays and escalating costs of building this infrastructure – a project that has been underway since 2015. "My family is from the west of Scotland and I've always been fascinated by those routes from a public policy perspective. They lend themselves to natural monopolies, long tenures, and are rife with opportunities for corruption.

"This man had been following the story in the papers, thinking 'I'm a contract expert and a finance expert, I could have helped Scottish ministers and civil servants make fewer mistakes.' I reeled out all the different ways in which, without changing his career, he could have been involved, as an expert adviser, or on the board of the agency or regulator, for example."

How did he react? "Well, he was quite interested. He's putting himself forward for public roles now."

Tools to bridge the gap

It's this kind of soft conversion that Pamela hopes to achieve with the work of Civic Future. The organisation is running a series of open events

> **"If you are serious about childcare, or housing, or immigration, you need to be able to understand what's driving behaviour now – the economic and financial incentives, and constraints"**

programmes on our day's philosophical and political issues, aiming to deepen understanding around the questions and considerations public leaders face.

However, the centrepiece of the organisation's work is the Civic Future Fellowship, aimed at equipping those in their early career to be effective public leaders. After a rigorous application and selection process, the first cohort has been chosen and will take part in weekly seminars, residential courses and a foreign trip, gaining knowledge in everything from geopolitics to the practical skills needed to make effective change happen. It's also about boosting and expanding trusted relationships and networks.

Pamela acknowledges that she and Munira have had unusual careers, leaving them with an enviably diverse contacts book, a network they can draw on and who may call on them in return. But not everybody is in that position, she says, particularly those who have dedicated their lives to one professional discipline such as investment, financial planning or IT.

She believes the benefit of that kind of network was seen when Kate Bingham, who left the private sector to come into public leadership as the chair of the UK's Covid-19 vaccine taskforce, called on contacts from across her lengthy career history as a venture capitalist to help pull off the ultimate public leadership challenge of our age. Bingham is another inspiration to Pamela, who sees creating many more just like her as her mission.

"We were pretty lucky as a country to have her because I don't think there are that many people who combined expert pharma knowledge with complex financing knowledge and networks, and then networking in policy as well," she says. "And the crucial thing is not only do you have those people already in your phone, but they take your call."

The Long Shot, Bingham's memoir about her role in the fight against Covid-19, is almost a blueprint for the Civic Future vision. "That first section [of the book], where she's building up the team at pace, is an excellent case study in our strategic investment in the Fellowship," Pamela says.

The opportunities for those who want to transfer their professional skills into the public sector are various and imminent. The challenges in public life that are bearing down upon us now will, Pamela believes, require the efforts of finance professionals more than ever. She adds that the rise of artificial intelligence – and its impact on jobs, economic routine and predictable activity – will be incredible but will need careful expert and moral leadership.

"If we manage it well, it could be positive," she says. "Humans can be freed up to do what they are good at: to add subjective, complex judgement and compassion and fairness."

To achieve any of this, however, Civic Future must ultimately harness the energy of others. And according to its leadership, that's where the rest of us come in. The expectation is that we must step up. Because with the right public leaders, economically literate and well prepared for the responsibility, they will be pivotal in that ultimate goal – "encouraging and enabling growth, correcting market failure, and making the UK an exciting place to grow a business". ●

OUT OF THE SHADOWS,

Non-bank financial institutions have grown into a trillion-dollar market with an important function in the economy but, says **Marc Shoffman,** the question of whether they have sufficient regulatory oversight remains

MARC SHOFFMAN
specialises in business, property and personal finance for publications such as the *FT* and *The Times*

The term 'shadow bank' refers to organisations that take part in bank-like activities but operate outside of the same regulated space. It was coined by Paul McCulley, an executive at US investment firm PIMCO, in a speech he gave in 2007 amid a boom in mortgage-backed securities. He said that "unregulated shadow banks fund themselves with uninsured commercial paper, which may or may not be backstopped by liquidity lines from real banks. Thus, the shadow banking system is particularly vulnerable to runs."

In theory, though, working on a securitisation (conversion of an asset, risk, or future cash flow into marketable securities) deal with shadow banks or nonbanks is attractive for regulated financial institutions, says John Zhang, a professor of accounting at Audencia Business School in France. "Rather than waiting 20 years for a mortgage loan to

INTO THE SPOTLIGHT

mature, a bank can package together and sell assets such as loans, leases and mortgages by turning them into securitised products," John explains, adding that investors often purchase these assets from shadow banks that use complex transactions, like repo agreements, to finance the deals. This allows banks to retrieve their money immediately, rather than waiting for a loan to mature – a process that ultimately lowers borrowing costs and increases liquidity for the banks.

Many of these securitisations were invested in by both banks' own investment arms and shadow banks on behalf of investors. But problems emerged during the 2008 financial crash amid doubts about the valuations of many of the securitised loans. In its 'Back to Basics' series on shadow banks, The International Monetary Fund explains that when investors became "skittish" about what those longer-term assets were really worth, many decided to withdraw their funds at once. This caused a liquidity crisis as investors, including banks and shadow banks, sought to recover their money, often at a loss.

A lack of transparency also meant many regulated firms were unsure how exposed they were, which posed a risk to consumers as finance became more restricted due to banks' reticence to lend to one another. In turn, this affected the ability and willingness of lenders to provide products such as business loans and residential mortgages.

Due diligence and disclosure rules have since been introduced in most securitisation markets, which has contributed to a decline in the size of this sector, says John. But it is still popular in economies such as China's where shadow banking has been rising rapidly in the past decade, according to a 2020 paper, *Shadow banking in China compared to other countries*, published by Imperial College London, Central University of Finance and Economics, and the University of Pennsylvania.

ILLUSTRATION KLAWE RZECZY

New shadow banking frontier

Shadow banking is now defined by the Financial Stability Board (FSB) as "credit intermediation involving entities and activities outside the regular banking system".

It is part of a 'nonbank financial institutions' (NBFI) sector worth US$239tn, according to the FSB's 2022 *Global monitoring report* on NBFIs – a figure which also includes the pension funds and insurance companies that may take part in bank-like activities, such as investment and lending. Within this, the shadow banking element grew 9.9% in 2021 to US$67.8tn, representing 28.3% of total NBFI assets and 14.1% of total global financial assets. This includes collective investment vehicles, loan provision, credit intermediation, insurance or guarantees of financial products and securitisations (see chart, p.43).

Analysts attribute the growth of shadow banks to increasing rules for regulated players. Nicolas Charnay, senior director, S&P Global Ratings, says that capital requirements on banks have increased for certain borrowers and assets. Although there is still a financing need that banks are less willing to meet, or their capacity to finance certain assets may be more limited. Some institutions with looser capital requirements, such as shadow banks, Nicolas suggests, can take the risk for borrowers.

For example, creditworthy borrowers such as investment-grade corporates and governments may want to borrow at fixed rates over long terms. This is debt that most banks don't want to hold, but insurance companies and credit funds may be more interested. Private credit funds may also be more interested in higher-risk consumer or commercial sector borrowers.

Systemic risks

As shadow banks become more intertwined with the real economy and regulated firms, the risks become heightened. But diversification in the economy, with both banks and nonbanks providing credit, isn't inherently bad. "If you have a system that only caters for the top, then others miss out," says Nicolas, who adds that shadow banks might become an issue for regulators as they "grow in systemic importance".

Credit risk, one of the significant pitfalls of shadow banking, has recently been in the spotlight. There are no standard rules on disclosure and transparency in the shadow banking sector. Unregulated firms help arrange finance in areas where banks may not be willing to operate. However, financial institutions often invest in the deals, creating exposure they may not be fully aware of. This can hit regulated banks financially, affecting their ability to lend to and support the real economy and impacting the wider financial ecosystem.

Even with regulation, banks have shown how their own financial troubles can cause wider contagion. For example, Silicon Valley Bank – a popular financial institution among fintech firms – collapsed in March 2023 after it sold its Treasury bond portfolio at a large loss amid interest rate rises. This caused concerns about the bank's liquidity and meant many tech businesses were temporarily unable to access their funds. It was eventually taken over by First Citizens Bank in the US, while its UK counterpart was transferred to HSBC.

Another high-profile example of shadow banking contagion is the supply chain finance provider Greensill Capital UK. Greensill was regulated by the UK's Financial Conduct Authority for anti-money laundering but not as a bank. Yet it provided trade finance to companies by lending money to them after purchasing their invoices upfront, with the idea that it would receive the full amount owed from the client later.

Greensill collapsed in March 2021 after credit insurers withdrew their cover amid concern about its US$5bn exposure to the steel and commodities businessman Sanjeev Gupta's struggling GFG Alliance. This has left backers such as the already-troubled Credit Suisse attempting to recover US$10bn of funds trapped in the Greensill business.

Shadow banks, and those that invest with them, including regulated firms such as investment banks Credit Suisse and Nomura, also face liquidity risks. Funds are often invested in long-term vehicles, so there may be issues generating the cash needed when there are large redemption requests, as seen in the 2007–8 financial crisis.

Another risk related to this is leverage, where a shadow bank may arrange a derivative to help with risk management, hedging against movements in an underlying asset. But problems can arise if there is a big move in price and parties face margin calls.

The downfall of Archegos Capital Management in 2021 – the family office set up by investor Bill Hwang – illustrates the liquidity and leverage risks. Archegos used swaps to take significant positions in technology stocks, including ViacomCBS and Discovery. However, because family offices don't have to disclose their level of investment in these stocks, other investors had no idea how exposed it was to changes in the share price.

Backers such as Credit Suisse and Nomura extended

credit through swap deals, but trouble arose when the value of the underlying securities fell in March 2021. Archegos failed to meet margin calls against swap positions made by its lenders to cover interest payments owed. That prompted a US$20bn stock sale as each lender rushed to sell off its positions to cover Archegos' defaults, leaving Nomura and Credit Suisse with heavy losses. The Securities and Exchange Commission has since charged Archegos's Bill Hwang with securities fraud, which he denies.

"Even the banks who deal with these people don't have a good, consolidated view," explains Nicolas. "Banks know about their relationships but don't necessarily know about relationships with others."

Regulatory challenges

Given these high-profile collapses, it is perhaps no surprise that regulators are paying attention to this area. Much of this is coordinated by the FSB in conjunction with the International Organisation of Securities Commissions, which is working on policies addressing leverage and liquidity vulnerabilities.

It has proposed that authorities make liquidity risk management tools available to open-ended funds to deter investors from rushing to sell out, such as swing pricing – where a redeemer bears the cost of selling rather than valuations being diluted for existing investors – and redemption gates and fees.

The Basel Committee has also set higher capital requirements for banks' equity investments in funds. It has issued standards for measuring and controlling significant exposures, including to shadow banks, leaving it up to individual regulators to implement.

But it is difficult to find a single tool to regulate shadow banking, simply because the variety of activities it engages in doesn't allow the sector to fall under a single definition. This is why Nick Smith, managing director of private credit for the Alternative Credit Council, a global body representing asset management firms, has some sympathy for the regulators.

"You cannot view nonbank financial institutions as a homogeneous bloc. It is a diverse sector," he says. "Don't assume a bank-like approach is appropriate for funds that are ultimately different animals."

Nick also points out that some areas of shadow banking already have many of the proposed regulatory policies in place. "Private credit funds use multiple tools to manage fund liquidity," he says. "These include gating provisions, lock-ups, and redemption periods, which are agreed prior to the investor making an allocation to the fund, ensuring the liquidity profile of the investor and the assets in the fund are aligned." Ultimately, Nick says, regulation is welcome, but the sector should be appraised on its own merits.

"You cannot view nonbank financial institutions as a homogeneous bloc. It is a diverse sector"

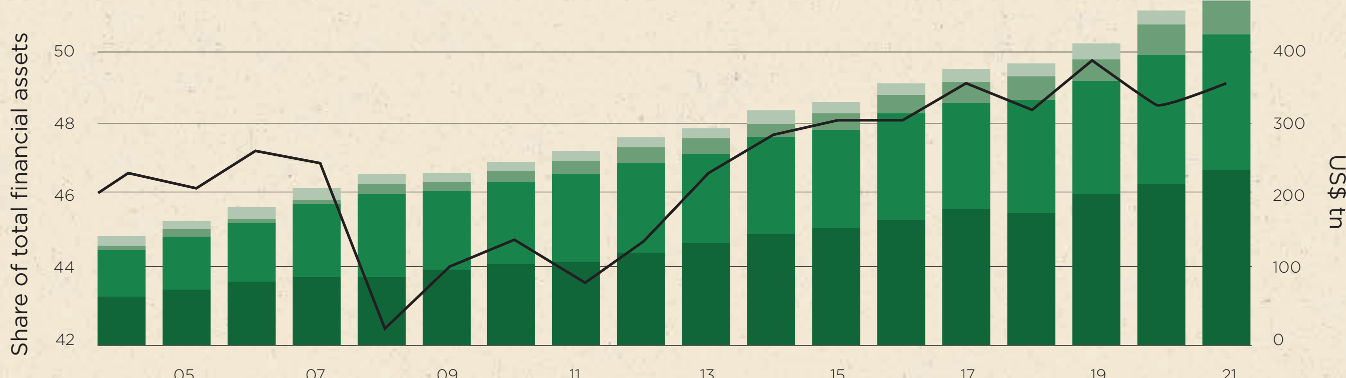
John believes that better quality governance and transparency are needed. He adds that firms in the shadow banking space may fear regulation as it could increase costs, causing firms such as pension and insurance funds to use their size and influence to lobby against change.

"You don't want to kill off the business in the same way that happened with the securitisation markets," he says. "This industry is highly specialised; it needs a lot of financial expertise to understand what is happening. Shadow banks have a role in the market, making the task more difficult for regulators." ●

NBFIs AS A SHARE OF TOTAL GLOBAL FINANCIAL ASSETS INCREASED IN 2021, AFTER A DECREASE IN 2020

21+EA-Group

Total global financial assets[1]



LHS — NBFI sector[2] **RHS** ■ NBFI sector ■ Banks[3] ■ Central banks ■ Public financial institutions

Source FSB's 2022 *Global monitoring report* on NBFIs

[1] Includes data for Russia up until 2020. [2] NBFI includes insurance corporations, public financial institutions, other financial intermediaries and financial auxiliaries. [3] All deposit-taking corporations.

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THINKING OF BEING YOUR OWN BOSS?

Becoming a self-employed adviser is an attractive idea for many. The freedom to work when and where you want, to have more control over how you operate, and of course, to keep more of the money you work hard for. These are just some of the strong reasons why many advisers are considering switching.

But it's a big step, with many things to consider beforehand. In addition to the time and energy required to run a profitable business, there are many other factors, such as meeting ever-increasing regulatory requirements.

Going solo doesn't mean you have to be alone
To help you better understand everything involved in becoming your own boss, Tenet Financial Services (TFS) has put together a detailed, easy-to-understand guide that clearly explains everything you need to consider, starting with identifying whether the move is right for you.

Completely free, our 'Be Your Own Boss' guide gives answers to the biggest, most important questions facing employed mortgage and financial advisers who want to become self-employed.

'Be Your Own Boss' covers points such as:
- Choosing the best legal structure for your business
- Detailed breakdown of setting-up costs
- Expected earnings in your first few years
- The different routes you can take to becoming self-employed
- A real-life case study of someone who successfully made the switch

Download your free guide at https://bit.ly/tenet-guide

TFS empowers you to become a self-employed financial or mortgage adviser by providing all the tools, support, and guidance you need to succeed. From admin and compliance support to marketing and business growth guidance, we take care of everything so you can focus on growing your business and serving your clients. Backed by Tenet Group, one of the largest independent adviser groups in the UK, we continue to help advisers across the country take the leap and succeed as their own boss.
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professional development

46 Grey matters: Who owns our clients? **48** Continuing professional development
50 Ask the expert: How to become a politician

IMAGE CYCLONEPROJECT/ISTOCK

Who owns our clients?

After co-founding a firm, Sumeet is offered a job at a competitor and must address the long-standing issue of advisers taking clients with them when moving to new firms

Sumeet and Willow met while completing their graduate scheme at a top international investment bank. A few years later, they built up the courage to found their own venture, OneInvest.

They have grown OneInvest considerably in the past few years and focused on making it the one-stop shop for investors. Together they have built a small but strong team of ten and, over the course of the pandemic, were able to gain new clients from more experienced competitor firms that didn't have the technology in place to assist their clients efficiently.

Sumeet and Willow use next-generation technology that helps the firm reach more mid-level clients in a shorter time frame and still deliver great customer service. They pride themselves on providing easily digestible investment advice but also being accessible to clients who are not 'traditional investors'.

They have a good working relationship – Sumeet enjoys building and developing the clients' digital investment experience and Willow deals with the day-to-day business management.

Some months pass and a firm, ABC Banking, contacts Sumeet asking if he would be interested in joining them. While he would usually ignore this type of call, ABC Banking is a leading FTSE 100 company and the opportunity couldn't have come at a better time. Sumeet is immensely proud of what he and Willow have created, but running a business comes with immense pressures and this job offer could mean doing more of what he really enjoys.

ABC Banking offers Sumeet a great onboarding package but also asks what proportion of his portfolio he could move across with him, highlighting how his clients at OneInvest could continue to benefit from his expertise at their leading firm.

Sumeet is considering the offer but he knows that, if he were to leave, most of his portfolio would come with him, which would leave OneInvest struggling to make ends meet.

With no shareholders' agreement in place and pressure for an answer from ABC Banking, what should Sumeet do next?

1. He should dismiss the offer like he has with other competitors as he has a fiduciary duty to do the right thing.
2. Sumeet is passionate about digital investing, so he should move across. He can highlight the new venture on his LinkedIn, so, should his clients wish to join him, they can do so themselves.
3. Sumeet wants to work with ABC Banking, so he should agree with Willow how many clients he can take with him.
4. The needs of the clients come first. Sumeet should work with Willow and find someone who can join OneInvest and bring their expertise to help continue to develop the firm.

What would you do? Visit cisi.org/own-client to share your views. We'll publish the survey results and CISI's opinion at cisi.org/verdict-own-client

ILLUSTRATION OSKER14/ISTOCK

TRANSFER AUTHORISED VERDICT

This Grey Matter, updated for publication in 2023, was published in the June 2012 edition of *The Review* as 'Bonus points'

The scenario sees Ray, a junior member of a small bank, unexpectedly receiving a bonus from the branch assistant manager, Christine. Under company policy, he does not yet qualify for the bonus scheme, but Christine transferred the sum of £500 directly into his account. She asked Ray not to mention it to anyone, but he told a trusted colleague and is unsure what to do next.

We asked CISI members for their choice of the following responses, and the vote results are:

1. Approach Christine directly to clarify the situation and return the bonus (34%)
2. Despite being told not to discuss it with anyone, Ray should report it to whoever is responsible for HR matters in the branch (34%)
3. Call a staff helpline and raise the matter (30%)
4. Do nothing – he was very fortunate to have received a bonus in these difficult times (2%)

Responses received: 241

The CISI verdict

The dilemma incorporates many themes from the CISI Code of Conduct, including conflicts of interest, respecting others, and Speak Up and Listen Up.

Of the four options presented, there is a consensus from respondents that something needs to be done and the issue needs to be raised. However, understanding the next best course of action can be difficult. In this scenario, Ray is a junior member of the team, and while he acknowledges that Christine has singled him out for his hard work, he also feels embarrassed about being put in this situation.

Firms have clear guidance on the steps to take if they have received inducements or incentives from anyone and regulators take a firm stance on bribery and corruption. The bonus from Christine 'feels' wrong and she should not have given him any amount, even £500. This transfer is out of company policy, out of formal practice, and may suggest a wider problem of managers not adhering to company policies.

It is also worth noting that Ray told his friend Dan about the money transfer, and while the scenario does not focus on him, it does raise the question of what Dan's responsibility is in this, now that Ray has confided in him.

Our recommended solution is option 1

Ray should approach Christine directly to clarify the situation and return the £500. Followed by option 2 – he should also report the unexpected bonus.

Should you wish to suggest a dilemma or topic to be featured in a future Grey Matters, please email ethics@cisi.org.

CONTINUING PROFESSIONAL DEVELOPMENT

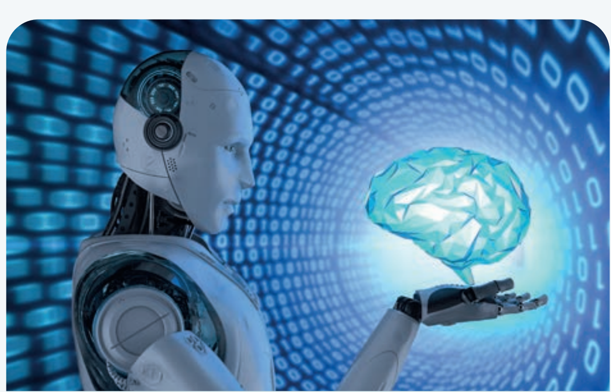
We have an extensive library of content on CISI TV and YouTube, and over 200 elearning modules in MyCISI. Here's a small selection

Access all these CPD resources on our new app. **Find out more at *cisi.org/app***

Or access them on your desktop at ***cisi.org/MyCISI***

Or view some of them at ***cisi.org/youtube***

READ



Professional Refresher: Artificial intelligence

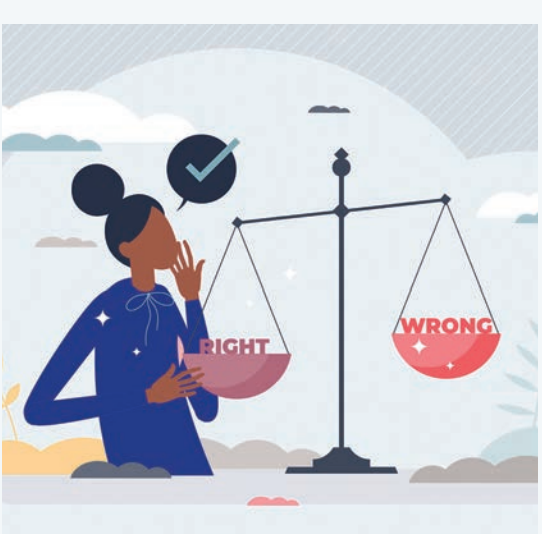
Course contents

- Background
- History
- Development trends
- Jargon
- Machine learning (ML)
- ML in practice
- Financial services
- Risks
- Ethics
- Data protection law and regulation ethics

Module test
CPD: 1 hour
cisi.org/pr-ai

Professional refresher: Kenya – Integrity and ethics
This module provides an understanding of ethical behaviour, ethics in finance, the importance of trust and trustworthiness, and an analysis of compliance versus ethics.

CPD: 2.15 hours
cisi.org/kenya-integrity



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WATCH

Webinar: WealthTech’23 event: Future-proofing the operating model through technology innovation
We analyse the inefficiencies caused by a lack of technological investment and highlight where and how a firm can future-proof its operational model.

CPD: 1.39 hours
cisi.org/wealthtech23

LISTEN

The CISI Podcast: Wealth Management Forum – The alternative alternatives
This panel session examines the risks and potential rewards of alternative portfolio diversifiers, focusing on sustainable power generation, new energy storage and music royalties.

CPD: 48 minutes
cisi.org/podcast-alternatives

EVENTS

Annual Integrity Event 2023

Thursday 2 November
12pm–3.15pm

- Our hybrid event will be broadcast live from Plaisterers’ Hall in London
- Registration begins at 11.30am for those attending in person

The event invites audience engagement through debate and voting on several ethical dilemmas.

CPD: 3.15 hours
cisi.org/integrity23

OUGH ONLINE RESOURCES, EVENTS, AND PUBLICATIONS, AND DOCUMENT YOUR PROGRESS

ASK THE EXPERT:

How to become a politician

Councillor James Jamieson OBE worked in industry and banking for more than 20 years. In 2009, he moved into local government, motivated by wanting to "give something back" but also "irritated" because he felt "things could be done better". Two years later, he was voted in as leader of the Central Bedfordshire Council and, in 2019, was elected as chair of the Local Government Association Conservative Group. Here, he shares practical advice on using your financial experience to engage in politics effectively.

While James speaks from UK experience, he has shared this advice for a global audience, identifying points equally relevant around the world.

Start at a community level

Getting involved in local government is often spoken about as the obvious first step to gaining experience and, eventually, pursuing higher office – and it is. Connecting directly with your community will allow you to establish a track record and build credibility with those who vote for you. What's mentioned less often is that the roles within parish councils, school governing bodies and local volunteer organisations – all desperate to harness the experience of people with financial backgrounds – are also hugely interesting and rewarding. These positions offer first-hand insight into the work that goes into running a community. And they can allow you to make a real difference in the lives of people in your area.

Build a network

Establishing relationships with your local council, school governors, or community leaders is vital, and the next step is to engage in as much public discussion as possible to expand your network. Get involved with your local party. If you're an independent, talk to your local councillor and learn about their role from them – if you think they're good, that is. If you think they could be doing better and want to replace them, approach a councillor you believe is capable. Leading a council is an excellent foundation for a career in politics, and they'll have many insights to share. I'm also a huge advocate for the open training days offered by the Local Government Association. These events are a chance to gain skills and build friendships with people already holding roles in public office. A friend or mentor to guide you through the pitfalls of entering politics can make all the difference.

Leverage your financial expertise

A background in the financial services sector is about more than understanding budgetary implications or fiscal policy, although those attributes are very much needed in public service (see pp.34–39 for more on the benefits of financial knowledge in the public sector). Financial experience offers a grounding in effective decision-making and long-term planning. For

IMAGE GASPR13/ISTOCK

instance, one thing I carried across from my time in finance was the idea of 'invest to save'. In basic terms, that might look like weighing up the development of a new park – which has huge value as a public good but has no income stream around it – versus building a leisure centre, which might have more considerable capital expenditure but could generate income. Sometimes there may be financial savings and, at other times, a financial cost but an improved service. It's about having the political courage to make those choices and the financial acumen to back them up.

Make use of communication skills

In politics, even once you've made the right decision, checked all the numbers and are sure it works, you still have to bring the public with you. The finance world prepares you to make a case for certain choices, but there's one big difference in doing so as an elected official: democracy. Because we're democratic, we're accountable – the public expects, and has a right, to be involved. Transferable skills, such as tailoring your message for certain audiences and effectively consulting with stakeholders, are invaluable.

Embrace different metrics

Local government needs people who can look at costs in real terms, challenge how budgets can be put to best use and analyse key performance indicators. But it also needs an understanding that numbers alone can't assess some things. For example, how do you weigh the improved care of a child or an older person against a public park or improved roads? Your yardstick needs to become 'How does my resident benefit?' And if you're prepared to enter public life, I believe you should do so with a clear recognition that empathy and emotion are equally as important as the bottom line.

Look at what others are doing

Finding inspiration in others' work can help you more effectively determine your political values and how to hone the skills necessary to apply them. I'm currently impressed by the renewal plan Andy Street, mayor of the West Midlands and former managing director of retailer John Lewis, has put in place. His background means he has the economic expertise to achieve his regeneration goals and the leadership skills to facilitate the collaboration it needs.

Stay engaged and adaptable

Moving from the private to the public sector means your views will likely be challenged on a wider forum. There's a real skill in engaging with people, listening to their concerns and being responsive to their needs, even on topics you might disagree with. Social media, where it's all too easy to hide and make accusations, makes this harder. But 99% of the people I meet daily or when campaigning are decent, good people – although many clearly disagree with me. Staying adaptable and open to new ideas and perspectives is key.

> "Finance experience offers a grounding in effective decision-making and long-term planning"

Focus on the rewards

When it comes to softer considerations, such as job fulfilment, I can't emphasise enough how rewarding public service work can be. It's not an instant reward and requires patience, but having made the move, I can look back and say I'm proud of the projects I've been involved in over the past ten or 15 years. For instance, in my area, we've built more council houses than most councils in the country. We've revitalised the local village high street by helping an independent coffee shop to open. These things can transform lives and are important to consider if you're interested in engaging in politics – local or national. ●

Consumer Duty CPD Resources

The FCA's Consumer Duty sets higher and clearer standards of consumer protection across financial services, requiring UK firms to evidence that they are putting customer needs first by 31 July 2023. The CISI offers a number of free resources for CISI members and students to help them prepare for the Duty and keep up to date on an ongoing basis.

Professional Refresher e-learning modules

60 mins

Approved Persons Regime

60 mins

Conduct rules for all staff

60 mins

Conduct rules for senior managers

60 mins

Consumer Duty

6 mins

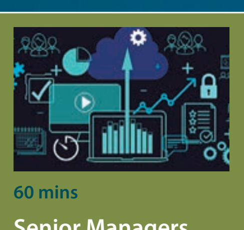
Micromodule: Consumer Duty

105 mins

Know your customer

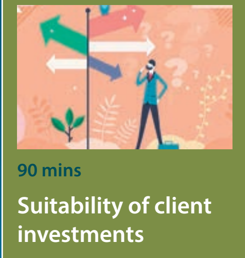
75 mins

Regulation and ethics



60 mins

Senior Managers Certification Regime



90 mins

Suitability of client investments

60 mins

Vulnerable customers

The Review article

Ask the Experts: Consumer Duty

CISITV videos

57 mins

Implementing Consumer Duty: Where should firms be?

61 mins

CISI Wealth Management Forum - Implementing Consumer Duty

85 mins

Compeer: The impact of Consumer Duty

53 mins

Compliance Forum - FCA key areas of focus for firms in 2023

Available in the CISI App or at **cisi.org/mycisi**

education

54 Regulatory update: Attempts to liberalise UK financial services (p.54) | New burdens and restrictions (p.56) | Changing of the guard (p.58) | AML crackdowns (p.58) | Failure to prevent fraud (p.58) **59** Review of financial markets: Natural capital – the next frontier for finance **62** Last word: ChatGPT's promise – and limitations

Robbie Constance, partner, and **Christopher King**, trainee solicitor, at DWF outline key regulatory developments (up to April 2023)
Robbie.Constance@DWF.law
Christopher.King@DWF.law

Urged on by politicians, the Financial Conduct Authority (FCA), Financial Ombudsman Service (FOS) and Financial Services Compensation Scheme (FSCS) are touting new consultations and reforms, apparently aimed at liberalising UK financial services, cutting back red tape and reducing the regulatory burden placed on firms. They aim to secure growth and make UK financial services internationally competitive post-Brexit. However, is this narrative reflected in our regulators' recent output and conduct? The Consumer Duty, alongside reforms introduced by the Green Finance Strategy and the Economic Crime and Corporate Transparency Bill, tell another tale.

ATTEMPTS TO LIBERALISE UK FINANCIAL SERVICES

Edinburgh Reforms announcement

In December 2022, the government unveiled over 30 'Edinburgh Reforms' aimed at taking advantage of 'post-Brexit freedoms' to develop an "open, sustainable and technologically advanced financial services sector that is globally competitive and acts in the interests of communities and citizens".

The reforms include:

- A policy statement and consultation paper, *Primary markets effectiveness* review (CP23/10), on building a smarter financial services framework by repealing retained EU law and replacing it with a new framework tailored to the UK, including proposals to replace the existing 'standard' and 'premium' listing segments with a single category, removing eligibility requirements that can deter early-stage companies.
- A policy paper, *Government response to the independent review on ring-fencing and proprietary trading* and proposals for secondary legislation on simplifying and improving the functionality of the ring-fencing regime, freeing up bank capital for investment elsewhere.
- New remit letters for the FCA and the Prudential Regulation Authority (PRA), providing for a greater focus on growth and international competitiveness.
- A consultation on reforming the Consumer Credit Act 1974, with a view to ensuring consumer protections work well in a modern and increasingly digital economy

These reforms remain in their

consultation stage. In parallel, the FCA published a *Future Regulatory framework (FRF) review*, outlining measures to be enacted through the Financial Services and Markets Bill 2022–23. These measures include the FCA reviewing its current approach to growth, a future consultation on a rule review framework and statements of policy on appointments to the statutory panels.

Considering the recent failure of Silicon Valley Bank, some political will has shifted towards maintaining the stability of the UK financial market, stealing momentum away from the reforms.

Senior Managers and Certification Regime (SMCR)

The FCA and PRA's joint discussion paper (FCA DP23/3 / PRA DP1/23), published in March 2023, reviews the operational aspects and rules of the SMCR. The Treasury, in parallel, published a call for evidence on the legislative aspects of SMCR. Both regulators seek to explore how the regime can more effectively deliver its core objectives while minimising the compliance burdens placed on regulated firms.

Core investment advice regime

A consultation paper, *Broadening access to financial advice for mainstream investments* (CP22/24), published in November 2022, proposes a core investment advice regime which would allow firms to provide consumers with access to simplified advice on investing through individual savings accounts in mainstream products under amended suitability requirements, with greater flexibility in charging structures to allow for payments in instalments. A policy statement, final rules and guidance are anticipated soon, with implementation due before the end of the 2023/24 financial year. However, while superficially appealing, the reforms are unlikely to generate significant industry change nor offer a great amount of simplification for firms. For meaningful liberalisation, the sector must await the advice/guidance boundary review and potential legal reform required to make a material difference to investment propositions and those, for example, wanting to offer 'personalised guidance'.

(For more information and views on the core investment advice regime, see our Wealth Management Annual Review 2022 | DWF on dwfgroup.com)

Delayed pensions dashboard

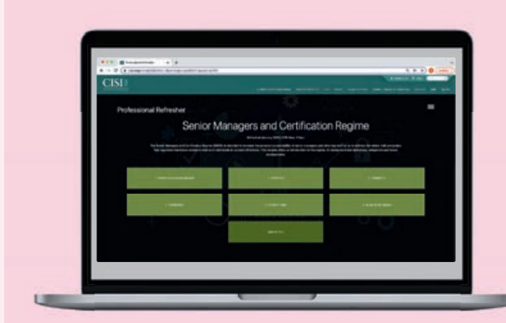
In March 2023, pensions minister Laura Trott announced further delays to the long-awaited pensions dashboard programme. A new programme board chair is now developing a revised plan for its delivery. A consultation paper, *Proposed regulatory framework for pensions dashboard service firms* (CP22/25), published in December 2022, indicates the programme is progressing slowly. The consultation paper proposes a regulatory framework to provide consumers with quick and simple information about their pension savings. Dashboard operators will be able to offer savers additional services (such as investment advice and robo-advice) provided they meet rigorous conduct standards. What it gives with one liberalising hand, the FCA is taking away with a tighter grip on the other through the proposed Pensions Dashboards Regulations 2022. These regulations set out new requirements for pensions dashboard service providers and trustees or managers of relevant occupational pension schemes. Additional burdens for these providers include connecting to the dashboard ecosystem, responding to requests from individuals and cooperating with the Money and Pensions Service by reporting on certain information.

Relaxing bonus caps and depreciation notifications requirements

Since March 2020, the FCA has adopted temporary measures on the requirement, arising from Article 62 of the MiFID Org Regulation, for firms to issue 10% depreciation notifications to investors. In January 2023, the Markets in Financial Instruments (Investor Reporting) (Amendment) Regulations 2022 (SI 2022/1297) came into force and revoked Article 62 of the UK version of the MiFID Org Regulation. The FCA will not take action for breach of the notification requirement reproduced in its 'Conduct of Business sourcebook', provided the firm meets the FCA's conduct expectations. This removes a blunt bureaucratic tool without any meaningful reduction in the regulatory burden. It is worrying that such an apparently obvious and simple reform takes so much time and effort. It does not bode well for more significant reforms.

> "What it gives with one liberalising hand, the FCA is taking away with a tighter grip on the other"

In December 2022, the PRA and FCA issued a consultation paper, *Remuneration: ratio between fixed and variable components of total remuneration ('bonus cap')* (CP15/22) regarding the removal of the current bonus cap requirements. The proposal contains a draft instrument that aims to strengthen the effectiveness of the remuneration regime by increasing the proportion of compensation at



READ
Professional Refresher: Senior Managers and Certification Regime
This module, refreshed in January 2023, offers an introduction to the regime, its background and definitions, obligations and future developments.
cisi.org/smcr23

risk that can be subject to the incentive-setting tools within the remuneration framework.

Simplified asset management regime

The FCA's discussion paper on *Updating and improving the UK regime for asset management* (DP23/2), published in February 2023, seeks responses on how it could simplify the current regime and update the rules on managers, depositaries and funds in line with the incoming Consumer Duty.

Of particular interest to the wealth management market, the FCA, after reflecting on the potential risk of harm to managed portfolio service (MPS) clients subject to a lesser standard of protection, considers whether to require MiFID service portfolio managers to meet the same standards laid out in the rules for UCITS (undertakings for collective investment in transferable securities) or alternative investment funds. This would not represent a reduction in regulatory burden for discretionary fund managers tomorrow – particularly if MPS were shoehorned into one of the existing fund regulation regimes – but might, longer term, harmonise the regimes and give MPS the status and regulatory certainty they desperately deserve.

NEW BURDENS AND RESTRICTIONS

Consumer Duty looms on the horizon

Consumer Duty has been praised as a sensible step forward for consumer protection. However, it also places an additional burden on the UK's financial services sector. With the Duty's implementation deadline on 31 July rapidly approaching, the FCA is becoming increasingly vocal about its expectations for firms and critical of those seeking to coast along on pre-existing product governance frameworks.

The end of April marked the deadline for manufacturers to complete all reviews necessary to meet the outcome rules and to share essential information with their distributors. The FCA has indicated that firms are progressing well, having reviewed a sample of Duty implementation plans and concluded that many firms are showing that they understand and embrace the shift to delivering good customer outcomes. The FCA continues to emphasise the importance of cooperation and sharing of information between business partners to avoid 'duty gaps' in distribution chains.

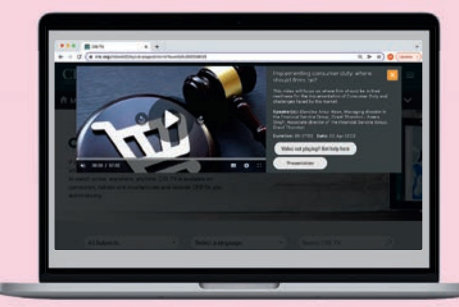
The FCA outlined in its 2023/2024 Business Plan that it will invest £5.3m to ensure the Duty is successfully embedded. This investment has so far taken the form of sector-specific in-person events (recordings are available on the FCA's website) and a substantial series of letters directed towards CEOs and directors across relevant portfolios. These letters, targeting sectors including asset management and consumer investments, outline the FCA's expectations and provide examples of what 'good outcomes' look like under the Duty.

Of particular interest was the FCA's letter to contract for difference (CFD) providers, which highlights how the FCA has yet to address how firms should achieve good outcomes in circumstances where 70–80% of clients typically lose money. Target market and consumer understanding are going to be key going forward, and firms must continue to take a proactive approach towards the Duty to prevent themselves from being made an example of by the FCA, post-implementation.

Other regulators are also getting on board with the Duty. The FOS published an annual review under the *Wider Implications Framework*, established by the FOS (acting chair for 2023), the FCA, the Pensions Regulator, the FSCS and MaPS. The report reflects on the seven issues identified by the group as benefiting from structured collaboration and includes ensuring the development of a shared understanding of the Consumer Duty between regulators.

(For updates on the Duty, please see our Consumer Duty 'hub': Consumer Duty – an overview I DWF Group.)

> **"The political imperative and messaging is welcoming and permissive. However, the regulatory reality is anything but"**



WATCH
Implementing Consumer Duty: where should firms be?
This video focuses on where firms should be in their readiness for the implementation of the Consumer Duty and challenges faced by the market.
cisi.org/cd23

Anti-greenwashing and sustainability disclosure

Anti-greenwashing rules and sustainability disclosure requirements are other priorities for the FCA that firms should keep their eyes on. The FCA has pushed back the publication of its new anti-greenwashing rules until Q3 2023 while it reviews responses received from consultation paper CP22/20, *Sustainability disclosure requirements (SDR) and investment labels*. Notwithstanding this delay,

greenwashing will remain a priority for the FCA, as evidenced by it hosting the first-ever Greenwashing TechSprint on 5 June 2023.

The Department for Energy Security and Net Zero (DESNZ) has published an update to the government's 2019 Green Finance Strategy. The update sets out how the government will meet its aim of becoming the world's first net zero-aligned financial centre. Although expressing a desire to avoid creating unnecessary regulatory burdens, the update includes a planned consultation in Q3/4 2023 on introducing net zero transition plan disclosure requirements for the UK's largest companies and reviewing the regulatory framework for effective stewardship. The FCA, the FRC, the BoE and The Pensions Regulator praised the update and reaffirmed their commitments to support the cross-regulator delivery of green finance ambitions. It remains to be seen whether anti-greenwashing and substantiality requirements will burden firms in 2024.

FOS award limits reach new highs

The FOS has increased the maximum amount that it can require businesses to pay for upheld complaints. From 1 April onwards, the FOS awards limit has gone up to £190,000 for complaints arising from acts or omissions before 1 April 2019 and £415,000 for complaints arising after 1 April 2019. Coupled with the FCA's ongoing consultation on the complaint 'gateway' thresholds for small and medium-sized enterprises, this increase could have significant ramifications for firms and their insurers, who can now be hit with sky-high awards, with limited appeal rights. Businesses must continue to be mindful of the FOS complaints procedure and must begin to manage complaints in compliance with the Consumer Duty. Regardless of its insistence to the contrary, we have every expectation that the Duty will be used against firms in relation to complaints and complaints handling.

Our way or the highway

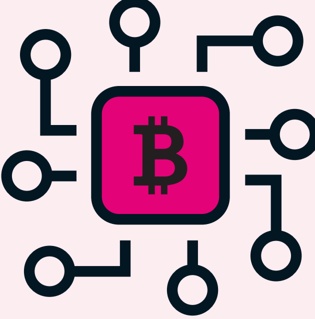
The FCA has, for the first time, removed the temporary permissions of a European financial institution (Lyonnaise de Banque) after it missed its chance to apply for post-Brexit authorisation. This may mark the beginning of a post-Brexit clampdown on EU firms which have until recently accessed the UK via temporary permissions, with the FCA sending a clear message to EU firms that failing to obtain UK authorisation will invoke FCA enforcement. Again, the political imperative and messaging are welcoming and permissive. However, the regulatory reality is anything but.

Digital innovation and the future of financial regulation

The FCA is taking steps to foster digital innovation in the UK and is embracing tech in several areas. The FCA's chief data, information and intelligence officer, Jessica Rusu, announced in April 2023 a single point of entry for firms to engage with the FCA's innovation services and digital tools and a permanent Digital Sandbox service. The FCA hopes this sandbox will encourage firms to test and adopt new technologies and innovations, bringing much-needed growth to UK financial services.

Cryptocurrency is another area of potential growth for the UK. In line with the government's ambition to turn the UK into a hub for digital asset trading, the Treasury published in February 2023 a consultation titled *Future financial services regulatory regime for crypto-assets*.

While the FCA wants to support innovation, concerns regarding gamification and online scams may put the brakes on more experimental offerings. The FCA warned stock trading apps in November against over-gamification that might prompt consumers to take actions against their interests. The FCA has also published a research article, *Gaming trading: how trading apps could be engaging consumers for the worse*, that raises concerns that some trading app customers appear to exhibit behaviours similar to problem gambling. This is a reminder, especially considering the Consumer Duty, that firms must employ gamification carefully, engage consumers positively



and avoid encouraging clients to invest money they cannot afford to lose. With the recent proposals to increase gambling regulation, including a mandatory levy on betting firms aimed at tackling gambling addiction and (familiar sounding) affordability assessments, the consumer protection objective of regulators is clearly beating the political liberalisation agenda.

In an inevitably losing battle, the FCA is trying to mitigate the risks of online high-risk investments and scams, including issuing guidance to 'finfluencers' in partnership with the Advertising Standards Authority. This follows the FCA issuing a supervisory notice against investment app Freetrade in 2022 for the conduct of a partnering finfluencer. The latest guidance follows an explosion of influencers falling 'on the wrong side of the law'. The FCA is seeking to exert more control over financial promotions, but a meaningful solution will require the FCA to fight fire with fire, deploying a mix of technology and enforcement to drive a meaningful culture change; all of which imposes increased burdens on mainstream firms.

As well as a means to liberalise UK financial services, the FCA is looking to use technology to clamp down on certain risks. The FCA published in December 2022 a consultation paper, *Introducing a gateway for firms who approve financial promotions* (CP22/27), looking at a provision within the Financial Services and

> "The FSCS is swamped with claims arising from firm failures and the FCA's failings"

Markets Bill 2022–23 which would introduce a regulatory gateway that authorised firms must pass through before they can approve the financial promotions of unauthorised firms.

CHANGING OF THE GUARD

Following the appointment of Abby Thomas as chief executive of the FOS, and Ashley Alder as chair of the FCA, in summer 2022, we are continuing to see a 'changing of the guard' at the regulators.

In March, the FCA appointed Therese Chambers (previously director of consumer investments at the FCA) and Steve Smart (previously director of intelligence at the NCA) as joint executive directors of enforcement and market oversight.

An increased emphasis on cooperation between regulators is not new but appears to be a particular focus for 2023. CEO of the FSCS Caroline Rainbird emphasised, in a speech to the Personal Investment Management & Financial Advice Association, the FSCS's focus on cooperating with regulators such as the FCA, Serious Fraud Office and the Insolvency Service, pursuing recoveries and reducing the levy in the long term. Such 'cooperation' is, however, costing the FSCS dearly. The FSCS is swamped with claims arising from firm failures and the FCA's failings. This was best illustrated by the case of LCF with the FCA's "flawed approach to the regulatory perimeter" – an observation in an independent report by Elizabeth Gloster DBE, published in 2020 – leading to the FSCS picking up the tab for the regulated aspects and, following a court battle to avoid paying ineligible claims, administering the government-funded redress scheme.

International cooperation also appears to be on the agenda, with Sarah Pritchard due to take over executive responsibility for the FCA's international work once Mark Steward steps down. The FCA's ambition to deepen international cooperation was confirmed by the FCA's warm reception of the decision in R (Sutton) v FCA, which affirmed the FCA's ability to use its investigation powers against UK firms to assist foreign regulators in their investigations.

AML CRACKDOWNS IN ENFORCEMENT

The start of the year saw several enforcement actions with a strong focus on anti-money laundering (AML) compliance. Guaranty Trust Bank and Al Rayan Bank were fined £7.6m and £4m respectively by the FCA for AML system failings, demonstrating the FCA's willingness to use Principle 3 (management and control) to punish non-compliant firms without needing to identify specific breaches of Money Laundering Regulations. We also saw several fraud-related enforcements. Three individuals were sentenced to a combined 24.5 years for investment fraud with another four individuals subject to conspiracy to commit fraud proceedings. These enforcements, alongside the upcoming 'failure to prevent fraud' offence, highlight how the FCA expects more robust financial crime prevention measures from firms.

FAILURE TO PREVENT FRAUD ARRIVES

In the wake of fraud becoming the UK's 'most commonly experienced crime', the Home Office has proposed the long-anticipated 'failure to prevent fraud' offence as an amendment to the Economic Crime and Corporate Transparency Bill.

A relevant body will be guilty of the offence where an employee, agent or another person who performs services on its behalf commits a fraud offence intended to benefit the relevant body. The relevant body will have a defence where it had in place such prevention procedures as were reasonable in all the circumstances. No definitive timeline for the introduction of the offence has yet been provided. However, we anticipate it is unlikely to come into force before Q3 2024. Again, regulators are broadening corporate criminal liability and are expecting more proactivity from firms to tackle financial and corporate crime.

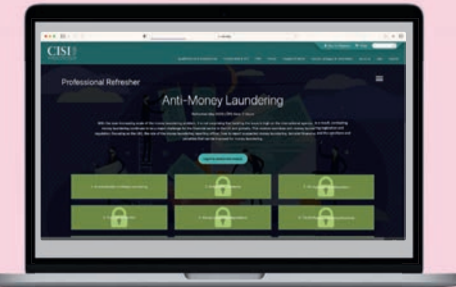
(For more information on the new offence, please see our article: UK Home Office proposes a new failure to prevent fraud offence I DWF Group.)

FINAL WORDS

Firms navigating a challenging economic climate where they must achieve good outcomes for themselves and consumers need to read beyond regulators' warm words about liberalisation and lip service paid to the reform agenda and tread more carefully than ever if they are to thrive in an inconsistent regulatory landscape.

Views expressed in this article are those of the authors alone and do not necessarily represent the views of the CISI.

READ
Professional Refresher: Anti-Money Laundering
This module, refreshed in May 2023, examines anti-money laundering legislation and regulation (focusing on the UK), the role of the money laundering reporting officer, how to report suspected money laundering, terrorist financing, and the sanctions and penalties that can be imposed.
cisi.org/aml-23



NATURAL CAPITAL

THE NEXT FRONTIER FOR FINANCE

GEORGE LITTLEJOHN MCSI
Editor
Review of Financial Markets

A recent film, *Banking on a Wilder Tomorrow*, from the producers of the series by Sir David Attenborough on BBC TV, *Wild Isles*, has helped open the financial sector's eyes, in Britain and beyond, to the twin crises of climate change and the threats to nature. These two crises are intricately connected and pose significant threats – and great opportunities – for the financial sector.

Finance has begun to tackle the climate crisis but until very recently had turned a blind eye to the crisis in nature. COP15 in Montreal in December 2022, conducted with far less noise and brouhaha than its twin in climate, COP27 the previous month in Egypt, has already laid out likely pathways for finance through the challenges of biodiversity.

A film based on the BBC series, *Wild Isles*, by the same production team and supported by a number of UK charities, alongside our colleagues at the Institute of Chartered Accountants in England and Wales, has helped focus financial minds on these twin issues. *Banking on a Wilder Tomorrow* (*cisi.org/responsiblefinance*) seeks to show that climate change and loss of biodiversity are intricately connected and that we need to deal with them in an integrated fashion.

Nature underpins everything, including our climate, and the idea of 'natural capital' parallels the idea of financial capital. Ahead of the Montreal biodiversity summit, the World Economic Forum stressed in its 2023 risk report the dangers of the 'polycrisis', the systemic risks facing us in climate, nature and inequality. The Kunming-Montreal Global Biodiversity framework

"Over 395 million jobs will be accrued as the result of nature and services it provides by 2030"

emerging from COP15 lists 23 targets, of which three are key to finance.

- **Target 14** focuses on ensuring "the full integration of biodiversity and its multiple values into policies, regulations, planning and development processes, poverty eradication strategies, strategic environmental assessments, environmental impact assessments and, as appropriate, national accounting, within and across all levels of government and across all sectors, in particular those with significant impacts on biodiversity, progressively aligning all relevant public and private activities, fiscal and financial flows with the goals and targets of this framework".
- **Target 15** involves taking "legal, administrative or policy measures to encourage and enable business, and in particular to ensure that large and transnational companies and financial institutions:
  - **a.** regularly monitor, assess, and transparently disclose their risks, dependencies and impacts on biodiversity including with requirements for all large as well as transnational companies and financial institutions along their operations, supply and value chains and portfolios
  - **b.** provide information needed to consumers to promote sustainable consumption patterns
  - **c.** report on compliance with access and benefit-sharing regulations and measures, as applicable;

  in order to progressively reduce negative impacts on biodiversity, increase positive impacts, reduce biodiversity-related risks to business and financial institutions, and promote actions to ensure sustainable patterns of production."
- **Target 16** Suggests that people be "encouraged and enabled to make sustainable consumption choices including by establishing supportive policy, legislative or regulatory frameworks, improving education and access to relevant and accurate information and alternatives, and by 2030, reduce the global footprint of consumption in an equitable manner, halve global food waste, significantly reduce overconsumption and substantially reduce waste generation".

Although the Montreal Biodiversity framework isn't legally binding, it mirrors the implementation schedule of the Paris Agreement on climate and countries will be required to report back on their plans at COP16 in Turkey in 2024. It will also be a key part of discussion in the lead-up to COP28 in UAE at the end of 2023.

Finance itself is a key part of the problem. As the film points out, if the financial sector in the UK was a country it would be the world's ninth-largest emitting nation.

The Task Force on Nature-related Financial Disclosures (TNFD) has made much progress in recent months on this front. This project, science-based and market-led, is meant to enable companies and financial institutions to integrate nature into decision-making, on the fundamental premise that while nature poses a major risk to businesses, nature-positive investments offer opportunity. It is led by David Craig, formerly a senior officer with London Stock Exchange Group (and the founder and CEO of Refinitiv, now part of the group), and Elizabeth Maruma Mrema, assistant secretary-general at the United Nations.

Its framework will provide a model that businesses and financial institutions can use to manage risks and to disclose information about those nature-related risks and opportunities. Having critical information on risks paves the way for institutions to set science-based targets to reduce their impacts on nature. TNFD is continuing its revision of its plans based on ongoing feedback from market participants and insights from pilot testing, until the first version of its framework launches in September 2023. It released v0.4, the final prototype, of its beta framework in March 2023, which it now believes to be "a complete and coherent representation of the framework". Market participants have been providing feedback and participating in pilot testing in the months since the launch.

Key quotes from the film

As Dame Sharon White, chair of British retailer John Lewis Partnership, points out in the film, science-based targets for nature matter because unless there are credible and ambitious targets that business and finance can be judged against, there may not be fast enough progress. She says that the firm has "set some incredibly ambitious targets for how we as a retailer both encourage greater biodiversity [and has also thought] about how we protect nature in our supply chains".

Dr Steve Waygood, chief responsible investment officer at Aviva Investors, says that "roughly US$400tn of capital is out there in the global financial system. We know that is many times what is needed to solve the climate crisis, the nature crisis, simultaneously. We need to invest at least US$11tn dollars in nature, between now and 2050, to have any hope of limiting warming to 1.5 degrees Celsius."

Emily McKenzie, technical director of TNFD, says that "peatlands are an example of nature as a form of capital. They are one of the biggest sinks of carbon on the land and yet once they deteriorate, they can become emitters of carbon rather than sequestering it."

Emma Howard Boyd CBE, chair of the Green Finance Institute and former chair of the Environment Agency (England) says: "If we invest in the marine environment in the right way, we're going to protect communities from flooding, we're going to stop coastal erosion, we're going to have a positive impact on carbon sequestration. All of these things have a benefit for the businesses, but also for the communities that they are serving."

Elizabeth Maruma Mrema underlines the scale of the economics: "US$10tn per year accrue from nature globally. And over 395 million jobs will be accrued as the result of nature and services it provides by 2030."

Facilitating change

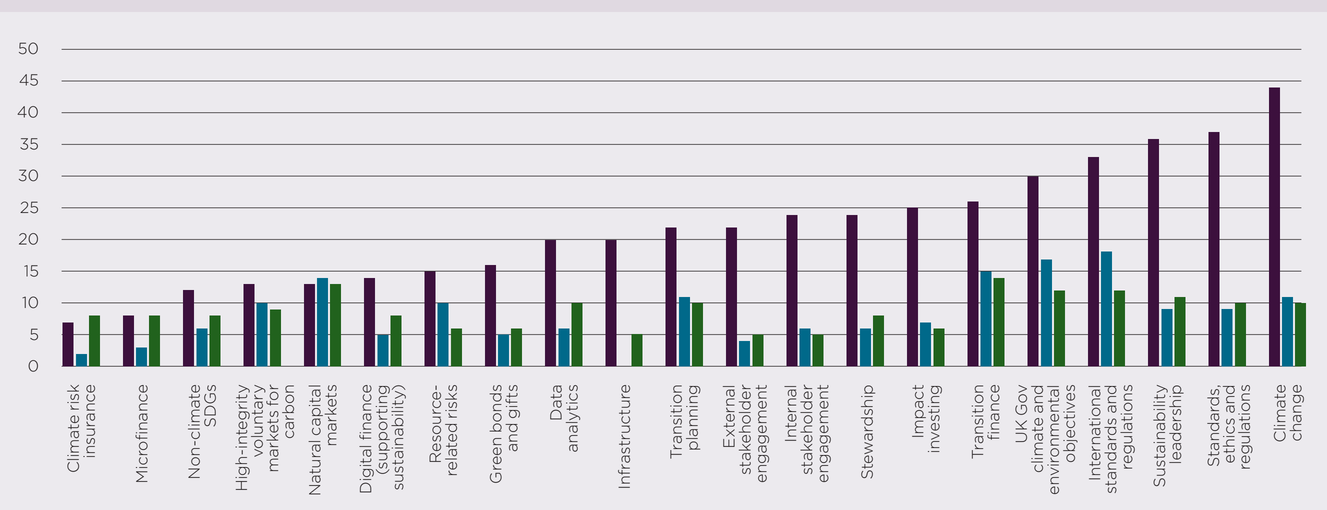
While many believe that government has to take the lead on environmental issues, others think it is the business community. Regulators believe that their work needn't hamper opportunity, but rather provide guard rails for investments, enabling firms to be creative with opportunities emerging in the shift to a net zero and nature positive economy.

There is a strong sense that investors, and large investment institutions in particular, are in a unique position – they can attach some of the criteria for change to their investments and have an opportunity at AGMs to vote for good practice, for instance, by influencing the board's reward structure, or re-electing an individual director.

GREEN AND SUSTAINABLE FINANCE KNOWLEDGE AND SKILLS GAPS

CLIMBING THE CLIMATE MOUNTAIN ...

KEY Importance Knowledge Skills



A recently published survey of sustainable finance knowledge and skills conducted on behalf of the Chartered Body Alliance (Chartered Banker Institute, Chartered Insurance Institute, CISI) by PwC gives cause for concern. The majority of respondents to the survey (see our *Review* article at *cisi.org/cba-survey*), do not consider their organisations to be "highly prepared" for future requirements in green and sustainable finance. Although 55% have engaged in training, only 8% believe their organisation is highly prepared for future knowledge and skills requirements in this area.

This is worrying, given the UK's net zero ambitions and the sustainability commitments and strategies of many financial services firms. They must be able to respond quickly to the rapidly evolving sustainability landscape to help clients and their own firms manage sustainability risks and take advantage of any opportunities that may be offered by the transition.

Added to that, most respondents are not investing in training employees in green and sustainable finance to support the organisation's sustainability strategy. The survey identifies that 65% of organisations allocate less than a tenth of their training budget to green and sustainable finance, suggesting that the focus of organisations is not to upskill employees in the topic.

ChatGPT's promise – and limitations

AI could transform investing with objective, data-led insights but, as yet, its potential remains frustratingly unrealised

WORDS ANDREW DAVIS

The GPT in ChatGPT does not stand for general purpose technology. But it probably should. Any piece of tech that can do your homework in the style of Charlotte Brontë, generate a video advert for 'Pepperoni Hug Spot' – a fictitious pizza joint complete with diners who look almost human – and create a song apparently produced by Canadian artists Drake and The Weeknd has a strong claim to that title.

Not surprisingly, the investment world has grown excited about the potential of AI chatbots such as ChatGPT since its developer, OpenAI, released it on 30 November 2022. By February, 100 million users per month were experimenting with ChatGPT's ability to compose credible answers to all manner of requests, making it the fastest growing consumer technology in history, according to UBS analysis widely shared by the media. This is impressive and feels like the kind of innovation that should be a godsend for private investors trying to make better decisions. But is it?

ChatGPT is not supposed to comment on individual companies or shares, but by phrasing his queries intelligently, Matt McKenna, head of research at fintech website Finder, persuaded it to pick a portfolio of 38 stocks. By 9 June 2023, three months after it was set up, the AI portfolio had outperformed the ten most popular funds in the UK by almost seven percentage points. It's unwise to draw conclusions based on a few weeks of data, but the results are intriguing, to say the least.

Could ChatGPT help investors in other ways? For example, could it make the case against investing in a particular company? The idea here is that AI should, in theory, be better than us at finding the negatives in an investment idea because it is not subject to the confirmation bias that afflicts virtually every human: our tendency to seize on information we believe supports our investment thesis and ignore the rest.

An inability to challenge their ideas with enough scepticism leads many investors into losing situations. Sadly, the current, free iteration of GPT4 offers only limited help. It is reluctant to comment on individual companies ("I am sorry, but as an AI language model, I cannot provide up-to-date information or opinions about specific companies or their shares"), and the data used to train it extends only as far as September 2021. So it cannot write a contemporary bear case. But once I asked it to set out the arguments that applied in July 2021 against investing in a particular company – which subsequently hit major problems – its response became more useful. It noted that the company had gone public only three years before, was not profitable in 2020 and operated in a highly competitive and fast-changing sector.

This is frustrating. It hints at how useful AI could be in helping investors escape their innate behavioural biases. To be effective, however, the algorithms need access to contemporary information. Reports suggest that in due course the free version of GPT4 will be able to scour the public internet in real time. Google's free generative AI chatbot, Bard, already uses contemporary data, which is a big improvement, but when I asked it why I should not invest in various companies, its answers contained numerous factual errors.

How about another problem that private investors find hard to overcome – researching a company's competition? Managements frequently claim that their business has unique attributes and advantages, but private investors face major challenges in checking these claims, especially when the company operates in a specialised, global niche market.

Here ChatGPT and Bard performed better. Both provided lists of competitors from all over the world for companies in various sectors. This is useful for investors trying to understand whether a proposition is genuinely differentiated. But it is valuable only if you can trust the answers.

When I asked ChatGPT to list the world's largest contract manufacturers of vaccines, it responded with a list that did not include the Serum Institute of India (SII) – a leading supplier. I was aware of SII's existence and queried the omission. "I apologise for the oversight," it replied. "The SII is indeed one of the world's largest contract manufacturers of vaccines and should have been included."

What to conclude from this 'quick and dirty' experiment with AI? Three things: ChatGPT and Bard illustrate how significant the benefits of AI will be for investors as these large language models develop; the way you phrase the questions makes a big difference to the usefulness of the answers generated; and the information you get is not infallible and should be treated as no more than a basis for further investigation, not as chapter and verse.

And for those still wondering, GPT, in this case, stands for "generative pre-trained transformer." This technology is transformational, but its training still leaves something to be desired. ●

ILLUSTRATION PADDY MILLS/SYNERGY

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Adaptability PR

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