SEPTEMBER 2016

CISI.ORG/REVIEW

THE Review

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

Inside
Now incorporating financial planning content — features, interviews, case studies and more

Master planner

IFP FOUNDER AND PRESTWOOD GROUP CHAIRMAN PAUL ETHERIDGE MBE CFP™ CHARTERED FCSI DISCUSSES THE CHANGING FINANCIAL PLANNING LANDSCAPE

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SUMMER 2016 EXAMINATION RESULTS

The real test of professionalism for wealth managers, financial planners, paraplanners and investment specialists

Congratulations!

There were too many of you to fit on one page, but all our recent examination achievers are listed on our website at cisi.org.

The Chartered Institute for Securities & Investment (CISI) congratulates all those who have successfully completed the CISI Chartered Wealth Manager Qualification, CISI Diploma, Diploma in Financial Planning, the Certificate in Private Client Investment Advice and Management (PCIAM) and the ICAEW/CISI Diploma in Corporate Finance exams in the summer 2016 session.

As the professional body for the wealth management, financial planning, securities and investment industry, the CISI is the leading provider of financial services qualifications in the UK. These postgraduate professional level qualifications are internationally recognised and are designed by senior practitioners to meet the needs of the financial services industry. Completion of these qualifications leads to full Membership (MCSI) and, eventually, individual Chartered status either as a Chartered Member or a Chartered Fellow.

For more information about how these qualifications can further your career, visit cisi.org/qualifications or telephone 020 7645 0777.

Professionalism Integrity Excellence

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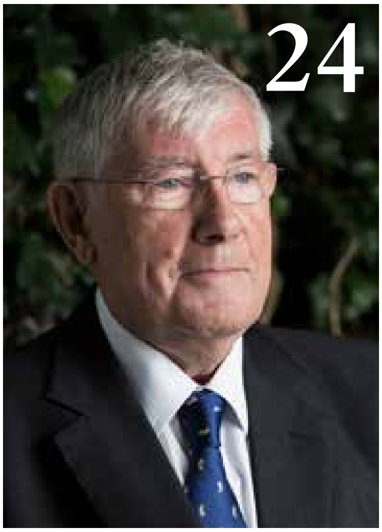

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Wardour contacts

Print Editor
Gareth Francis

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Art Director
Steven Gibbon

Account Director
David Poulton

Account Manager
Sarah Ashe

Production Director
John Faulkner

Managing Director
Claire Oldfield

Chief Executive
Martin MacConnol

Advertising sales enquiries
Deborah Maclaren
Telephone: +44 20 3004 7201

Cover photograph
Jason Alden

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34–43 Russell Street, London WC2B 5HA
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Fax: +44 20 7010 0900
www.wardour.co.uk
ISSN: 1357-7069

Publications Executive, Chartered Institute for Securities & Investment
Jane Playdon
20 Fenchurch Street, London EC3M 3BY
Telephone: +44 20 7645 0648
Email: jane.playdon@cisi.org

City view

WE ARE WITNESSING THE BIGGEST CHANGE TO EDUCATION SINCE 2001

Fifteen years ago, the then Prime Minister, elected on a promise of education, education, education, pledged that half of all young people should attend university. And he almost succeeded: in 2013/14, the estimated higher education initial participation rate was 47%.

However, degrees are a more expensive investment than they were in 2001, and the dividend is worth less.

Most students are being short-changed. Not only have university fees risen to as much as £9,250 pa for a non-medical course, but Sutton Trust research reveals that graduates now leave university owing an average of £44,500 – more than their peers in any other English speaking country. Meanwhile, the graduate pay premium is now negligible. The Institute for Fiscal Studies suggests this is because “firms have used the increased supply of highly educated workers to switch to a different, less hierarchical and more decentralised management structure”. In short, the employment market has evolved. The education system needs to evolve too.

NO GUARANTEES

In 2010, we argued that it was irresponsible to peddle the myth to young people that university is a guaranteed fast-pass to the top without taking into account three key things: the subject they intend to study; the type of degree they are likely to be awarded; and the university they wish to attend (see *cisi.org/uni*). All three factors impact on their earning potential.

The great news is that now there is a real credible alternative in the form of new style apprenticeships.

In August 2016, a report by the Centre for Economics and Business Research placed the lifetime earning premium for graduates at just £2,200 more than for apprentices. That’s a negligible £1 a week extra over the course of 40 years. In some areas, such as arts and humanities subjects, the earning potential of apprentices actually outstripped that of graduates by as much as 270%.

It is timely, therefore, that some 400 clear and concise apprenticeship standards – 40% of which are the equivalent of degree level – are being created by employers and will be overseen by an Institute of Apprenticeships.

> The employment market has evolved. The education system needs to evolve too

All apprenticeships will involve a job in a ‘skilled’ occupation with ‘at least’ 20% off-the-job training, and apprentices must be trained to a level that means they can apply for professional recognition, should this be available. Additionally, degree level apprentices will study for a full bachelors or masters degree as part of their programme.

Already, many major employers, including banks and accountancy firms, are rethinking their recruitment process, either by reallocating some positions traditionally earmarked for graduates, or by increasing the scale of their existing apprenticeship scheme.

This is welcome. Having protected apprenticeship frameworks in place will present an opportunity for individuals from all backgrounds to access a rewarding, professional career. It will also sharpen the competition amongst universities, which will need to ensure that their programmes of study are relevant and competitive.

But the introduction of new standards is not enough. In order for apprenticeships to filter through to the consciousness of students, parents and teachers – and to be recognised by them as a viable option – buy-in from employers is needed en masse.

To help achieve this, from April 17, UK firms will be subject to a levy of 0.5% on pay bills over £3m, but really a focused credit which must be offset against the cost of apprenticeship training in England or be lost.

For the 98% of employers with a pay bill under £3m, and those with training needs that exceed their levy credit, substantial funding towards apprenticeship training costs will be available.

Firms would be well advised to unlock the funding available and embrace the education revolution. By doing so, they will not only be investing in their workforce and diversifying their talent pool, they will be bringing about a long overdue change to the education system. They will be creating choice and creating chances.

60-SECOND INTERVIEW

Financial Planning & Advice (level 4) is a new exam that sets achievers on the path to CFP™ certification. CISI Global Director of Learning Lydia Romero explains its value to financial planners, paraplanners and other financial services professionals

Lydia Romero, CISI Global Director of Learning

Why was the unit developed?

Following last year's merger with the Institute of Financial Planning, the CISI has combined the Principles of Financial Planning exam and the Private Client Advice exam to form Financial Planning & Advice. This is available on demand via computer-based testing. It forms part of our Retail Distribution Review (RDR)-compliant Investment Advice Diploma (IAD, level 4), pending FCA recognition, our Certificate in Paraplanning and our Diploma in Financial Planning.

Combining the exam with the UK Regulation & Professional Integrity, and the Investment, Risk & Taxation exams will enable the achiever to hold an appropriate qualification on the FCA's qualification tables for Advising on Retail Investment Products and Friendly Society Tax-Exempt Policies (FCA Activities 4&6), pending FCA recognition. Achievers of the exam will not only meet the eligibility requirement for the Diploma in Financial Planning (of holding an RDR-compliant qualification) which leads to the CFP certification, but will also have already completed the first unit of the Diploma and have only the final financial plan assessment to complete.

What is the value of the certification?

It is a globally recognised mark of excellence in financial planning. Following completion of the Diploma in Financial Planning, candidates can apply to use the CFP™ marks after their name by going to *cisi.org/cfp*

CFP professionals form part of a global network of over 160,000 and are highly sought after by employers and consumers.

Who is it aimed at?

The new pension freedoms have highlighted the increasing need for responsible, qualified financial planning advice.

The unit is aimed at individuals advising on retail investment products – financial planners, paraplanners and wealth managers who wish to develop their knowledge and understanding of financial planning and advice.

What does the exam/unit involve?

The exam combines multiple choice/response questions with some based on case studies over three elements: financial protection; retirement planning and financial planning. This level 4 exam lasts two and a half hours, and we recommend a minimum of 180 study hours.

A sample paper is available at *cisi.org/fpa* for candidates to see the style of the questions and undertake a practice exam.

What support does the CISI provide?

As a professional body focused on education, the CISI is keen to support the growth of the financial planning sector with relevant qualifications as well as continuing professional development. For this exam we have developed an interactive *Revision Express* elearning product.

We have a suite of online modules – or professional refreshers and we also run events across the UK. This year we have held conferences which support the financial planning profession, the first – from 25 to 26 May – was the Paraplanner Conference, then the Accredited Financial Planning Firms™ Conference from 14 to 15 June, and soon we will host the Financial Planning Annual Conference at Celtic Manor from 3 to 5 October. All events are fantastic opportunities for financial planners and paraplanners to meet, learn and network.

News from the IFP Forum

Jacqueline Lockie CFP™ Chartered FCSI, CISI Deputy Head of Financial Planning, provides a snapshot of matters discussed at the IFP Professional Forum meeting in June

Membership

- 67% of former IFP members have renewed for 2016/17. Since the meeting this figure has increased to 75%.

CFP™ professionals

- 1,119 fully accredited – 25 more than 2015.
- 62 are being processed – double the usual amount in previous years.

Financial Planning & Advice exam

- Launched on 31 August. Now any newcomer to the profession can take all their professional exams through CISI and obtain CFP™ certification without having to rely on a third party provider.
- Candidates who have not passed the Principles of Financial Planning exam by December 2016 must sit the Financial Planning & Advice exam instead.

If taking the Diploma in Financial Planning, achievers can then prepare a financial plan based on a case study, which is the second assessment component of the diploma. Completion allows candidates to apply for certification as a CFP professional.

Regional events

- 142 since January 2016.
- 73 of these have been directly relevant or applicable to financial planners.
- Regional committees are now integrated with financial planners. Contact your regional committees to help design the programmes and select speakers. If you would like to see more financial planning content in regional meetings then please think about standing for the committee.

London forum events

- 7 events held since January, with 3 more planned for 2016 (including a quiz in December).

Paraplanner Interest Group news

Campbell Edgar CFP™ Chartered FCSI, CISI Head of Financial Planning, provides highlights from the first Paraplanner Interest Group meeting

With the merger of the Institute of Financial Planning with the CISI in November 2015, it was initially felt that the interests of the financial planning community would be wholly served by the IFP Forum and its committee.

But in order to organise the Paraplanner Conference, an informal group of paraplanners got together. It is this group that formed the core of the Paraplanner Interest Group, which had its first face-to-face committee meeting at the Paraplanner Conference in May.

At its last conference call in June, the two major items were to:

- Look at the feedback from the Paraplanner Conference with a view to improving content and, perhaps, venue.
- Follow up on action points from the earlier meeting. These were as follows:
  a) The CISI had produced a showreel, promoting paraplanning and the interest group.
  b) Work continues to develop on an agnostic, ie, independent of any proprietary brand, cashflow modelling training course.
  c) Research was continuing on how best to provide a mentoring programme for junior paraplanners. This linked in closely with the paraplanner apprenticeship initiative which provides government funding for firms willing to train younger paraplanning staff.
  d) There was considerable discussion about paraplanner standards and the need for liaison with other professional bodies.
  e) As part of the thought leadership function of the interest group, it was confirmed that members would provide ideas and material to be published both on line and in print.

Looking ahead, the group agreed to consider holding its face-to-face meetings at locations more in line with where its members lived, rather than almost always in London. That being said, it was agreed that the next meeting would be in London in November, before which the 2017 dates for meetings and other events will have been announced.

Paraplanner Conference 2016

The CISI's first Paraplanner Conference was held at Chesford Grange hotel in Kenilworth from 25 to 26 May, with the theme 'Getting better never stops'

Farida Hassanali CFP™ Chartered MCSI, Paraplanner, UBS and Chair of the Paraplanner Interest Group, and Dan Atkinson ACSI, Senior Technical Consultant, EQ Wealth and 2014 Paraplanner of the Year, co-chaired the event, which was attended by more than 100 delegates.

Campbell Edgar CFP™ Chartered FCSI, CISI Head of Financial Planning, welcomed delegates with an exhortation to enjoy the conference and a reminder that they were likely to learn as much or more from each other as from the platform speakers. The sharing of ideas makes everyone better off.

The event featured 20 speakers, multiple workshops and video presentations focused on providing the paraplanning community with relevant knowledge and tools to tackle present and future challenges. Last year's Paraplanner of the Year* Adam Wareing CFP™ Chartered MCSI reiterated the theme of the conference when he told the audience: "You are never too old to learn a new skill. Look to challenge yourself to practice a new skill each week just beyond your current abilities."

Rebecca Doodson, CISI Manager, Ethics and Integrity, presented an ethical dilemma† based on a case study adapted for financial planners: 'What do you do when an old colleague leaves client documents on a train which you could use to your advantage?' The audience was given five options to choose from, which generated lively discussion – and plenty of sympathy for 'Bruce', the old colleague who had left the documents and inspired the hashtags #bruciebonus and #prayforbruce.

Some other popular talks included 'Cashflow planning' by Andrew Moore, Director, Goodmans Financial Planning, and 'Understanding and communicating risk' by Nick Grogan CFP™ Chartered MCSI, Paraplanner at PWS Financial Consulting, who talked about different kinds of risk and emphasised the need to make things relevant for clients.

Campbell said: "As well as the quality of the conference itself, the most striking aspects of the conference were an average delegate age of under 35 and that 80% of them were women".

* This year's Paraplanner of the Year will be picked at the Financial Planning Gala Awards held at the Financial Planning Conference at Celtic Manor from 3 to 5 October.

† Rebecca will present another dilemma at this year's Financial Planning Conference.

Find out more at *cisi.org/fp16*

Financial Planning Week 2016

Financial Planning Week
6 – 10 June 2016

The CISI for the first time this year hosted Financial Planning Week (FPW), running 6–10 June. The annual event was originally established by the IFP to raise consumer awareness nationally, and this year's initiative aimed to build on that by highlighting the importance of the role of qualified financial planners in helping people from all walks of life, not just the wealthy, and of all ages, to think ahead and plan for their futures.

Over 50 firms signed up to offer free consultation surgeries, providing access to financial planning experts in person, via Skype or over the phone. Some of the participating firms were fully booked within hours of the press release, and CISI staff were kept busy handling over 500 calls from consumers keen to take advantage of the offer.

Ruth Sturkey CFP™ Chartered MCSI, Director at The Red House Consulting
"We, as a firm, thoroughly enjoyed being involved in FPW. The demand was high, unfortunately too high for us to see everyone. We met and spoke to a range of people, the most rewarding being younger people or people of lesser means. It allowed us to sharpen our tools to communicate the important financial planning basics to people who might not normally have access to advice. We developed a handout to take away of 10 Top Financial Planning Tips which went down well."

Duncan Hannay-Robertson CFP™ Chartered MCSI at Hannay Robertson Financial Planning
"For me, FPW is that opportunity to give something back. I find it astounding how few people have a plan, including many financial advisors. Be it as simple as a retirement income plan, or as ambitious as a comprehensive financial and estate plan, we cannot relate to each other successfully without one. A portfolio is never an end itself; it is a means to the ends of a plan. Helping people clarify their financial goals; what, by when, how much; is immensely rewarding. It is all about them.

"Whether they become a client or not, matters little, because they will become your greatest advocates, plus they will be in a much better place than they were prior to meeting you."

Ed Green CFP™ Chartered MCSI, Director at Close Brothers
said that they had eight meetings over the week, and potentially gained two clients. "It was definitely an improvement on previous years," he said.

Advisers also lent their expertise to 'Ask a planner' online sessions during the week, answering over 84% of the questions asked in that time (27 out of 32 questions answered) via email.

Campbell Edgar CFP™ Chartered FCSI, CISI Head of Financial Planning
"We have been delighted with the support shown by all the financial planners and firms, UK-wide, and the media, who have been so generous in both offering their professional services for free and creating awareness of this important initiative. However, it has highlighted the gap which exists for consumers for true, professional financial planning assistance. We believe the message that financial planning, which is distinct to financial advice, can be a positive, life-changing experience and ultimately help everyone to achieve their life goals, has been extremely well received by the consumer."

Accredited Financial Planning Firms™ Conference: Going the extra mile

Sam Rees-Adams, CISI Head of External Accreditation, on the annual Accredited Financial Planning Firms™ Conference, which took place in London at the Grange Holborn Hotel on 14–15 June

As always, the event was exclusive to members of accredited firms, providing the opportunity to mix with, and learn from, other firms at the forefront of the financial planning profession.

The theme of the conference, 'Going the extra mile', was in recognition of what makes accredited firms so successful.

Phil Billingham CFP™ Chartered MCSI, from Perceptive Planning, summed up what makes this event so special: "The level of honesty from all the firms there; the willingness to show the workings of their businesses for the benefit of others, enables you to get so much out of the event. You come away with insight that's almost impossible to get anywhere else."

The conference ended with an inspiring session from Royston Guest, CEO of Pti Worldwide. He encouraged the attendees to place as much emphasis on personal development as they do on developing themselves as professionals.

This not only contributes to peak performance but is what characterises those who always go the extra mile.

Becky Taylor CFP™ Chartered FCSI, from Aurea Financial Planning, has attended all the previous accredited firm conferences. She said: "They are always worthwhile, and you are challenged and inspired by your peers in equal measure, but this was simply the best yet."

Preview: The CISI Financial Planning Annual Conference 3–5 October 2016, Celtic Manor Resort

STAND TALL TOGETHER

Caspar Berry

Former professional poker player – will deliver a keynote speech on the topic of risk and uncertainty

"Playing poker is just the act of making a series of investment decisions. At a fundamental level the process is exactly the same. Poker can throw into sharp relief the challenges we face as investors every day. I will be doing a few exercises to show how brilliant – and flawed – our emotions can be."

Professor David Hand OBE

Chief Scientific Adviser to Winton – will speak about improbabilities and how likely they are to happen

"There are five natural laws which constitute the improbability principle. Any of the laws by themselves lead to improbable events occurring. But when the laws work together, even more incredible things happen. The laws can explain events that seem so very unlikely that they appear to defy natural explanation."

Andy Bounds

Award winning motivational speaker and author – will share innovative approaches to winning more business

"My workshops will help you win more business in ways that feel comfortable, are quick, and leave clients saying 'thank you' after they sign on the dotted line! I will also share simple ways to influence others. The great thing about improving people's ability to influence others is that it works in all walks of life."

Read the full interviews at *cisi.org/review*
Book your place at *cisi.org/fp16*

The knowledge: Marketing tips

Effective marketing is invaluable to your business. Abbie Knight, Director of financial services firm DISCUS, and owner of a specialist marketing firm for wealth managers and financial advisers, provides tips to multiply your marketing efforts and drive revenue growth.

It's easy to fall into the trap of focusing on sales rather than establishing a truly effective marketing strategy. With a little planning you can adopt an approach that will transform your business – minus the usual frustration of trying to 'fit' marketing in with everything else on your 'to do' list.

1 **Client value proposition.** Start by defining who you are, what you do and how your clients will benefit from working with you. Called your value proposition, this is the foundation of your marketing.

2 **Segment clients and services.** Customise your services and messaging to meet the needs of targeted groups of clients. Lose the jargon and make sure you speak in a language they will understand.

3 **Case studies.** Create case studies to represent each of your core services and the clients you work best with. Bring them to life with testimonials and photos.

4 **Online presence.** Update your website (or remove it entirely and use a holding page) to make sure your online image is engaging and relevant. Use social media to create a two-way dialogue.

5 **Activity plan.** Define your marketing activity plan, establishing at least 12 touch points per year. Include specific dates for delivery and assign responsibility to each item.

6 **Professional connections.** Set a specific strategy for engaging with professional partners. Define your messaging and then develop a structured engagement plan.

7 **Regular communications.** Establish an editorial calendar for the year. Include the audience, messaging and delivery mechanism (blog, twitter, email newsletter).

8 **Events.** Host events for clients, prospects and professional connections. Where possible, plan joint events with your strategic partners.

Further information

Abbie spoke at a recent CISI event on this subject. For a full list of events, visit *cisi.org/events*

CISI AGM 6 OCTOBER

The Annual General Meeting of the Institute will be held on Thursday 6 October 2016, 2.30–3pm in Merchant 1 Room at the Bristol Marriott Royal Hotel, College Green, Bristol BS1 5TA.

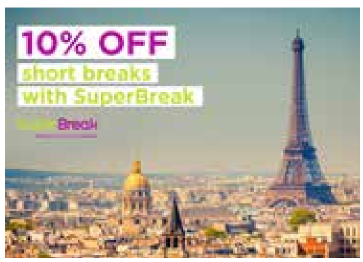
Fellows (FCSIs) and Members (MCSIs) of the Institute may vote on the resolutions by:

- voting online using the link in the MyCISI section of the Institute's website at *cisi.org*
- using Form A to appoint the Chairman as your proxy
- using Form B to appoint a proxy, who need not be a member, to attend the meeting and vote on your behalf
- attending the AGM and voting yourself.

If you would like a copy of the AGM Notice & Voting Form emailed to you, please contact *linda.raven@cisi.org* or call *+44 20 7645 0603* (you will need to provide your membership number).

Voting forms, whether completed online or sent by post, must be received by the Company Secretary no later than 11am on Tuesday 4 October 2016.

Membership Privileges



SuperBreak: 10% off short breaks

SuperBreak has you covered with everything from holiday packages to spa breaks, West End tickets, local attractions and much more. Whether you're looking for a local or overseas holiday package with all the bells and whistles or just a simple hotel break, there's sure to be an offer to suit your needs, budget and date requirements.

To get 10% off various breaks, log in to MyCISI, click on Membership Privileges and View your Membership Privileges, which will take you to the shopping portal. Search for 'SuperBreak' for a list of the available discounts. Your discount will be automatically applied if you use the portal, otherwise call 01904 436 002 and quote Xexec.

Terms and conditions apply. See website for further details.

In the know

The Review's quick quiz features questions from CISI *Professional Refresher*, an online learning tool. This popular product consists of more than 80 modules covering topics including anti-money laundering, the UK Bribery Act, information security and data protection. The answers are on page 15.

1. How is robo-advice defined by the FCA?

A An automated algorithm for generation of investment portfolios
B Web-based financial advice interfaces
C Automated advice and portfolio management models
D The FCA has not yet formally defined the term 'robo-advice'

2. Since April 2016, what is the rate of income tax on dividends over £5,000 for an additional rate taxpayer?

A 10%
B 32.5%
C 37.5%
D 38.1%

3. What will be the state pension ages for both men and women between 2026 and 2028?

A 66
B 67
C 68
D 69

4. Which of the following is the most accurate definition of the 'placement' stage of money laundering?

A The introduction of criminally-derived funds into the financial system
B Separating the proceeds of crime from their source
C The provision of apparent legitimacy to criminal proceeds
D Disguising the origin of criminal proceeds

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

Events preview

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

CONFERENCES

5–6 DECEMBER

SCOTTISH FINANCIAL PLANNING CONFERENCE

Norton House Hotel & Spa, Ingliston, Edinburgh

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

CPD WORKSHOPS

17 NOVEMBER Estate planning
1 DECEMBER Skills development

ANNUAL DINNERS

06 OCT Bristol & Bath Branch Annual Dinner
13 OCT South East Branch Annual Dinner
10 NOV East Anglia Branch Annual Dinner
18 NOV South Coast Branch Annual Dinner
20 JAN Guernsey Branch Annual Dinner
22 FEB 25th Anniversary London Annual Dinner

OTHER HIGHLIGHTS INCLUDE

3 October: Corporate Finance Forum: The impact of geopolitical uncertainty on UK and international capital markets (London)

6 October: Integrity at work – interactive workshop (London)

26 October: Passing wealth on (Lancashire and Cumbria)

26 October: Global macro and market outlook (London)

18 October: Financial planning seminar (Republic of Ireland)

18 October: Join the Bank of England for an economic outlook following the Brexit vote (Bristol & Bath)

19 October: Going for growth (Northern Ireland)

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

25 October: Communicate and connect - People skills for effective teams (Isle of Man)

26 October: Global macro and market outlook (London)

8 November: Operations Forum: How to succeed in operations (London)

9 November: Behavioral finance - bulls and bears, are we all sheep? (Isle of Man)

10 November: Fund manager seminar: income strategies using investment companies (Birmingham)

6 December: 2016 CIO view update: Using ETFs in a portfolio context (London)

IN-HOUSE TRAINING

The CISI delivers in-house training courses for members and non-members, spanning a variety of skill areas. If you have a team that requires training, please contact Alex Xavier (Assistant Director, Member Services) on *020 7645 0725 or alex.xavier@cisi.org*

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

Ask the experts: Understanding the new Client Assets Assurance Standard

What is the new Client Assets Assurance Standard?

In November 2015, the Financial Reporting Council issued its new standard for audit firms, *Providing assurance on client assets to the Financial Conduct Authority*, known as 'the Standard'. The Standard applies to all Client Assets Sourcebook (CASS) auditors and is effective for periods starting on or after 1 January 2016. Its key objectives are to improve the quality of CASS audits and to support the objectives of the FCA's client assets regime.

Although the Standard regulates the auditors, there are significant implications for firms that hold client assets. In practical terms, firms can expect an increase in audit costs as auditors spend more time planning the audit and increase the level of audit testing. Firms should also expect senior audit staff to spend more time on the audit compared to previous years, and this will require the participation of a wider population of firm staff.

What are the main changes introduced by the Standard and what is the impact on firms?

The Standard provides detailed guidance on core audit areas and increases the audit scope in others. It is likely that CASS auditors will spend more time seeking to obtain a detailed understanding of firms' business models, activities and cash flows to ensure that all client money and assets are captured. This will include understanding the exact contractual arrangements and regulatory obligations of any third parties involved in CASS operational processes. So if you have any outsourcing agreements, now is a good time to conduct a full internal review and gap analysis.

Firms will need to be able to demonstrate that they have a comprehensive approach to assessing how and where client money and assets arise in their business, ensuring that all changes to the nature of the products and services that they offer and to IT systems, clients and intra group relationships are factored into their approach. The Standard emphasises the importance of robust CASS governance and risk management. Firms should expect to demonstrate that they have a comprehensive risk framework that maps each business line to the applicable CASS rules, risks and key controls, including whether the controls are manual or automatic. The work involved in upgrading risk management frameworks is likely to be significant and neither its breadth nor depth should be underestimated.

> “Managers should consider how values are communicated”

Auditors will also carry out more work than previously on the role of the internal audit and compliance functions. They will assess the independence of these functions, as well as their policies, procedures and quality control standards. While the Standard does not prescribe the frequency or scope of expected testing, internal audit and compliance will need to demonstrate that they have a disciplined approach to CASS risk assessment and monitoring and that they follow up actions that arise from their reviews.

A new area introduced by the Standard is a requirement for auditors to assess how management seeks to maintain a culture of honesty and ethical behaviour towards the beneficial owners of the assets.

There is no prescribed approach for assessing culture and integrity. Firms should assess their values through the lens of their CASS responsibilities and ensure that the expected behaviour is articulated in policies and procedures. Senior managers should consider how values are communicated and how they inform themselves that members of staff are adhering to them.

Root cause analysis of breaches and incidents are important tools to monitor adherence to cultural standards, and the auditors are likely to spend time assessing both the adequacy of design and the accuracy of CASS management information. Senior managers will also need to demonstrate that they have allocated responsibilities effectively to members of staff who are competent and trained to discharge them. This work will have been carried out as part of the preparation of documents for the Senior Managers Regime. However, firms may wish to review the documents again.

What should firms do to prepare for the 2016 CASS audit?

To prepare for next year's CASS audit, firms should carry out a comprehensive gap analysis of their existing standards against the requirements of the new Standard. It will be important to engage early with those individuals and teams that are being brought into scope for the first time to ensure that they are fully aware of the new requirements.

When they carry out the gap analysis, firms should take into account the requirements of the Senior Managers Regime, for example, by ensuring that the CASS risk framework is clearly integrated with the reasonable steps framework of the senior manager charged with CASS operational oversight.

It is important to note that, even if there have been no actual CASS rule breaches in the period, the auditors may raise a breach if they believe that the overall governance and risk framework is inadequate. One likely impact of the Standard is that there may be breaches across the industry as auditors adopt a more cautious approach to assessing the adequacy and effectiveness of firms' CASS organisational arrangements.

The opinions expressed in this article are those of the author alone and do not necessarily represent the views of Deutsche Bank AG. This article is not intended to be comprehensive, nor does it constitute legal or financial advice.

Valerie Stainton, Director, Regulatory Risk and Control – Client Assets, Deutsche Bank

PROPERTY FUNDS: AN OPEN OR CLOSED CASE?

The Association of Investment Companies

Like 2008, 2016 has been a year that has highlighted some of the limitations of investing in open-ended property funds. Investors in these funds have been faced with swings in pricing, 'fair value adjustments' and ultimately suspensions of trading.

All these problems stem from the same root: a mismatch between the daily liquidity offered by the funds, and the weeks or months it takes to actually sell their underlying properties.

Despite this significant structural weakness, three-quarters of financial planners use open-ended funds to gain property exposure for their clients, while only a quarter use closed-ended funds, according to industry body AREF.

Closed-ended funds (also known as investment companies) don't rely on the asset manager to provide liquidity, because their shares are traded on the stock market. They are never forced sellers, because they do not create and cancel units on demand. So they can use property downturns as an opportunity to pick up assets at attractive prices. Another strength of the structure is that there is no need to maintain a large buffer of cash to meet potential redemptions.

It's important to remember that investment companies trade at a discount or premium to their underlying asset value, depending on market sentiment. Another key difference to bear in mind is that they can use gearing, which adds risk, athough it can also enhance returns.

Nevertheless, the advantages of the closed-ended structure for an illiquid asset like property are clear. According to data from Matrix Financial Clarity, the AIC Property Direct UK sector is the third most popular among intermediaries who use investment companies, behind Global and UK Equity Income.

- To find out more about the AIC, visit *www.theaic.co.uk*
- Contact *advisers@theaic.co.uk*
- Call 020 7282 5555
- @AICPRESS

CISI Corporate Members – June 2016

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At Aegon, we're delighted to continue our association with the CISI and its membership – working with them to support their drive for continuing professional development, excellence and integrity within the financial services market.

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*Platforum – UK Adviser Platform Guide – Issue 26, June 2016.

Regaining trust in experts

CURRENT EVENTS HAVE SHOWN A WORRYING LACK OF TRUST IN EXPERTISE. HOW CAN THE MOST KNOWLEDGEABLE IN SOCIETY EARN THE PUBLIC'S TRUST AGAIN?

ANTHONY HILTON JOHANNA WARD

Perhaps the most contentious remark during the campaign before the EU referendum was when Michael Gove said that the British public has had enough of experts. His comments caused outrage and he was so roundly attacked that even some of his own side sought to distance themselves.

But however offensive his words were thought to be at the time, they proved to be prophetic. The experts on whom the Remain campaign were relying to put across what they said was a factual argument about the dangers of leaving proved to be no match for the emotional appeal and romance cultivated by the Brexit camp. The experts were not listened to.

Some have said this is the latest example of the loss of trust in the establishment, the City and business, which has been so much in evidence since the 2008 crash. This is obviously true to some extent, but needs to be more nuanced. The distrust of the City shares some common threads with the distrust of experts in general, but there are big differences too.

The loss of trust in experts is in part a result of society being less deferential and having lost its automatic respect for learning and authority. It used to be the norm that the public used experts to cope with complexity – they went to the doctor when they felt ill, the solicitor when they had a legal problem, the accountant for tax advice, the stockbroker for investment, and deferred to the experts' advice. Today the relationship is much more open to challenge. Few now feel the expert is infallible.

The loss of trust in the City and business is thought to have been caused by the near collapse of the banking system in 2008, but again this requires qualification. Trust comes in two forms: intellectual and emotional. A customer has intellectual trust in finance if they think their money is safe. They do not expect the organisation to collapse, nor its employees to steal.

It was this that was dented in 2008, when people who had never thought about a bank collapse saw it very nearly happen before their eyes.

Emotional trust is rather different. Emotional trust is the belief that the expert on the other side will treat you, the client, fairly. This is where the City falls down. Not enough of its customers think they get a fair deal: they think City people get paid too much, that charges are too high and the returns too low and that they, the clients, are paying for all this. The key point, however, is that this is not new; they thought this long before the financial crisis.

Because they have focused on making the intellectual case that people need to save and their money will be safe, most of the efforts to rebuild trust since 2008 have been misdirected and ineffective. They have got nowhere because they have failed to address the emotional side. Clients will not respond positively if they still think they might get fleeced.

But there is an altogether different dimension to the loss of faith in experts, which has been brought to the fore by George Cooper of Equitile, a recently launched fund management group. In a recent paper he talked of the work of Thomas Kuhn, a philosopher who studied what happened when there was a paradigm shift in scientific knowledge – when one worldview of how things worked was replaced by another. One of Kuhn's insights was that paradigm shifts are often led by laymen and resisted by experts who have a vested interest in maintaining the status quo.

When new thinking is needed, experts are often intransigent, dogmatic and unwilling to look objectively at their beliefs. So it falls to outsiders to rock the boat and push new ideas forward.

In the context of the current world, the lay people were ahead of the experts in recognising that the EU was not working as it should, while separately they have recognised the dysfunctional nature of executive pay, the false promises of corporate governance and the way the economic system no longer delivers for them.

The current turmoil could all be noise, but alternatively the abuse of experts and the bad temper exhibited in return in recent months could be the beginnings of a new paradigm – the birth pains of a new way of thinking in economics and finance. It sounds far-fetched, but given the level of dissatisfaction with the current order, it is a possibility worth thinking about.

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

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

THE HISTORIC VOTE TO LEAVE THE EU SENT SHOCKWAVES THROUGH FINANCIAL MARKETS IN THE UK AND ABROAD. HOWEVER, THE UK REMAINS ONE OF THE LEADING GLOBAL ECONOMIES, THANKS IN PART TO ITS WORLD-CLASS FINANCIAL SERVICES INDUSTRY

JULES GRAY

Embracing change

The announcement on 24 June that the British public had voted in favour of leaving the EU caused considerable panic in financial markets. The pound fell by 10% within moments of the result being announced, hitting levels not seen since 1985. Shares on the FTSE 100 also tumbled by 8% shortly after the result.

The day before, markets had surged after polling data suggested that voters were going to hand victory to the Remain campaign. Sterling saw its best day in eight years, trading above $1.47, having spent the previous few days swinging wildly as uncertainty over the outcome reigned.

Leading up to the vote, many of the Remain camp warned that EU negotiators would seize on Britain's apparent retreat from the world by attempting to capture much of its most successful industry: financial services.

Mathilde Lemoine, Group Chief Economist at Edmond de Rothschild, told the BBC in June: "If the UK leaves the EU, [London clearing house LCH.Clearnet] dealing with euro transactions will relocate to the eurozone and therefore many foreign banks, European banks and also non-European banks will relocate to the eurozone."

Last year, the European Central Bank (ECB) tried to ensure euro transactions were cleared in the eurozone instead of LCH.Clearnet, although these efforts were later quashed in court after a challenge from the Treasury.

However, LCH.Clearnet remains one of the most important clearing houses in the world, with its subsidiary SwapClear servicing around 50% of all over-the-counter interest rate swaps. The clearing house is also second only to the US's Depository Trust & Clearing Corporation (DTCC) in terms of how many bonds and repos it clears globally, working across 13 government debt markets.

London accounts for around two-thirds of all renminbi payments outside of mainland China and Hong Kong*

While financial markets did take a significant hit after the result was announced and the subsequent resignation of Prime Minister David Cameron, the FTSE 100 and pound have stabilised since. Indeed, within a week all of the FTSE 100 losses had been erased and shares were back trading at a two-month high of 6360. When Theresa May was confirmed as Cameron's successor, markets surged, with the pound pushing above $1.30. By the middle of August, rating agency Moody's said it didn't expect Britain to enter into a recession over the coming year.

Despite the referendum result, London continues to be the centre of global services, thanks to a world-class legal system and a vast array of financial services.

The UK's financial services industry has successfully negotiated other major events in its history, such as the period of deregulation that the City underwent during 1986, known as the Big Bang (see page 27 feature).

The infrastructure and systems that underpin the UK's economy will not be disappearing anytime soon. The UK's education system is still the envy of the world, despite what the domestic press might say. According to research by global university ranking guide QS Top Universities, the UK had four of the top universities in the world in 2015. The UK also had the second-highest proportion of universities in the total list, with 71.

Our universities attract students from across the globe, and in particular countries like China and India. Indeed, the UK saw 58,810 Chinese students attend its universities in 2014, compared with just 27,364 students from China attending German universities in 2012 (the last year data is available).

To help ensure this continues, the Government is committed to supporting the UK's world-class academic research, with new Chancellor Philip Hammond announcing in August that UK businesses and universities "will have certainty over future funding and should continue to bid for

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competitive EU funds while the UK remains a member of the EU." The Government says it will underwrite existing grants that universities and research institutes receive post-Brexit. Currently, around £1bn is given to universities and small businesses in the UK by the EU for research purposes.

The US accounts for 49% of UK financial services FDI stock and 19% of UK professional services FDI stock*

The UK is also home to some leading financial institutions. Lloyd's of London is one of the most unique insurance markets in the world, offering specialist commercial insurance to companies from across the globe. As Lloyd's points out, the London insurance market controls more than £60bn of gross written premiums and is the largest hub for commercial and speciality risk in the world. Made up of 350 companies and employing more than 48,000 people, it accounts for over 20% of the City's GDP.

Inga Beale, Chief Executive of Lloyd's, says: "Lloyd's relationship with Europe goes back decades and it is one built on the expertise and quality underwriting that the Lloyd's market provides. There is a depth of knowledge and understanding that is not easily replicated elsewhere and I have no doubt that there will be an appetite for customers to be able to access the market after the UK has formally left the EU.

"Equally, continuing to enjoy access to the European market is essential. That is why we have been looking at every option to ensure that in the new post-Brexit landscape we will be able to maintain our trading relationships across the continent. We look forward to the undoubted opportunities that the UK's new relationship with the EU will provide."

Many other leading financial institutions, such as EY and PricewaterhouseCoopers, have their European headquarters in London, but it is not just London that is important for the industry.

Financial services membership body TheCityUK released a report, *UK financial and related professional services: meeting the challenges and delivering opportunities* in August, which champions the UK-wide industry in the face of Brexit. It highlights that more than two-thirds of financial services jobs in the UK are outside London, and calls for a more "aggressive" approach to building regional centres for the industry.

There is still a long way to go before Britain does in fact leave the EU. Article 50 is yet to be implemented, with few people expecting it to happen before the end of the year, and negotiations are expected to last at least two years. While this happens, the UK financial markets will still be able to operate as they have before, with the same rights, such as passporting, as before.

Passporting is a particularly important feature of the UK's membership of the EU, and something that many in the industry want to be retained. The ability for financial institutions to carry on their business across Europe free of local licences is a key part of their success. Rob Checkley, Compliance Assurance leader at Grant Thornton UK, says regulators "must ensure" UK firms can continue to passport their activities throughout Europe post-Brexit.

According to TheCityUK report, which was produced alongside management consultancy firm Oliver Wyman, the UK needs to focus on a number of areas to ensure that the economy continues to thrive, but that it is already in a strong position to grow from. "The UK has an exceptional starting position in FRPS [financial and related professional services]," it says.

LOOKING AHEAD

The report calls for the Government to refocus its attentions on key non-EU markets, including Canada, the US, Japan, and other Commonwealth countries. The UK should also "dramatically accelerate efforts to broaden the industry's links with emerging markets", such as China and India.

Other areas to focus on, says the report, are scaling the UK's fintech industry, revitalising the market for infrastructure finance and advisory services, accelerating innovation in London's insurance markets, and solidifying its place as the world's legal capital.

The UK's attractiveness to the world comes from its rich and varied history, and the prestige that comes from doing business here. That is something that will not change with a departure from the EU.

However, it is clear that the coming months and years will be demanding. There must be a focus on securing the best possible terms for all our leading industries, allowing the UK economy to flourish once it leaves the EU and continue to be the global leader for financial services.

KEEP ON COURSE FOR MIFID II

UK firms should continue to work towards MiFID II compliance

Despite the Brexit vote, UK-based firms should not deviate from their plans to comply with the second Markets in Financial Instruments Directive (MiFID II), which is due to be implemented in January 2018.

There are two main reasons for adopting this approach. One is that MiFID II is based, in part, on the G20 commitments and reform agenda stemming from the financial crisis that the UK is committed to.

The other is that the EU treaties provide for a two-year period within which the UK has to renegotiate its relationship with the rest of Europe across all sections of the EU's single market, including financial services. On the current timeline, MiFID II will have been implemented by that time.

Furthermore, Tracey McDermott, the then Acting Chief Executive of the FCA, confirmed in a speech in February that the objectives of MiFID II were consistent with the FCA's reform agenda and that the compliance process was too far down the road to stop.

For the UK's financial services to continue doing business in the EU after Brexit, however, it will need what's referred to as 'equivalency'.

To prove equivalency, UK regulators will need to petition their EU counterparts to certify that UK legislation and enforcement mechanisms are equivalent to those EU directives that protect citizens in member countries. In the case of MiFID II, this can be achieved by implementing MiFID II-like regulation in the UK that ensures greater transparency, better management controls, safer trades, and better understanding of customers and the public.

LEADING INDUSTRY FIGURES DISCUSS HOW THEIR SECTORS ARE COPING WITH BREXIT AND WHAT NEEDS TO BE SECURED IN FUTURE NEGOTIATIONS

Martin Bamford CFP™ Chartered MCSI is a Chartered Financial Planner and Managing Director of independent financial advisers Informed Choice
London is the financial centre of the world, making the UK the envy of other nations. We have a history of and appetite for innovation, which will help as we find our own feet once we exit the EU. London is the undisputed European leader in fintech, with a supportive regulatory environment and ready availability of talent.

The UK is also a centre for Islamic finance, with more than a dozen banks supporting these transactions. With London being the first city outside the Islamic world to host the World Islamic Economic Forum, this presents another opportunity for growth in the future.

What I hope we see now is politicians and other commentators talking up the economy and our position on the global stage. Once the new Government has established a clear direction, the markets should respond accordingly and the finance sector can then get on with the business of growth and investment.

I would love to see the EU regulation on providing key investor information documents (KIIDs) scrapped. I would also like to see the Financial Services Compensation Scheme (FSCS) protection capped at €100,000. KIIDs add tens of pages to the size of the reports we provide to our clients, but do little to help with investor understanding of fund risks or objectives.

The fact that the FSCS protection limit is set in euros results in changes to the sterling level of protection and interferes with consumer understanding of the scheme. It also prevents the Government from setting a higher compensation limit, where appropriate, on certain classes of investment. After leaving the EU, the UK should have more flexibility to create rules that are beneficial to UK investors.

Chris Macdonald is group Chief Executive Officer, London, for wealth managers Brooks Macdonald
Twenty years ago, we had clients who were either young and wanting to build wealth, or older ones who had already built or inherited wealth, so were reasonably sophisticated. Now the only thing that our clients have in common is that they have capital, whether it has been built up through the rise in house prices, inherited or brought in from overseas. At the same time, the abandonment of defined benefit pension schemes means that a great wall of money is going into pensions, particularly into self-invested personal pensions.

56% of UK professional services exports go to Europe, 25% go to the US*

This has led to a seismic move to managing money by risk other than by market. The FCA has been very strong on the suitability of recommendations given to clients, and supportive of this methodology.

Regulation that has been developed by the FCA, such as the Retail Distribution Review, is being adopted elsewhere in the world: we are leading the world in regulation.

Another factor that has contributed to the UK's success in wealth management is the pound, which has been a major currency outside the euro, dollar and yen. Our time zone and where we are positioned geographically also helps.

To ensure we continue to benefit from these things, it is vital the Government and regulators eliminate uncertainty. For example, MiFID II is due to be implemented in January 2018. Some of it is very sensible, and I would like to see about 80% to 90% of it being adopted.

The FCA needs to get to grips with it, decide which bits we need to legislate for and put it in place early in 2018. To bring in the whole of MiFID II in 2018, then replace it with UK legislation in 2019, would be horrendous for clients.

Layla Bunni is Partner at Clintons law firm, specialising in employment law
Part of the UK's success at being able to legislate properly in matters relating to employment law comes from the EU. This includes discrimination rights, collective consultation obligations, transfer of undertakings regulations, family leave, working time regulations and duties to agency workers. We have been good at applying and tailoring it to

FLOATNG FREE

Having a free-floating currency is helping the UK to absorb the impact of Brexit

In the immediate aftermath of the UK's Brexit vote, the plunge in the value of the pound was big news. It was sterling's greatest daily drop (8%) against the US dollar since the devaluation of 1967 – and seemingly clear evidence of the nation's instant descent into economic turmoil after voting to leave Europe.

Yet on closer inspection, how sterling and the UK's financial markets responded to Brexit appears to demonstrate the benefits of using a free-floating currency as a stabiliser.

The decline in the FTSE 100 on the Friday after the Brexit vote was modest compared with previous falls. In fact, the 3.1% decline in the benchmark was not even the sharpest fall seen this year. Despite the political turmoil triggered by Brexit, the pound acted as a safety valve for the worst of the concerns over the UK's future, with the nation's financial markets working exactly as they should.

It works like this: if exchange rates are allowed to change, they change in the appropriate direction, given the nature of changes in the variables affecting the exchange rates.

For example, when overseas demand for a country's exports declines, output also declines and the country's currency depreciates. This depreciation helps to improve the country's export performance by making the country's goods cheaper to foreigners.

If the same initial shock were to happen under a fixed exchange rate system, then because the exchange rate cannot change, the country must reduce the money supply, which further decreases the output. The former approach is a classic example of how a flexible exchange rate can act as an automatic stabiliser for a nation's economy.

the needs of our workforce in the UK: to the extent that if it does not suit our needs, we try to find a way around it.

For example, the Working Time Directive was designed to protect lower-paid workers so they cannot be made to work around the clock. It limits the working week to 48 hours on average over a period of 17 weeks, but this is not practical for everyone in all walks of life. So the UK negotiated for employees over the age of 18 to voluntarily opt out of the maximum working week if the nature of their job meant that they were likely to work more than 48 hours a week on average.

How the European Directives have been interpreted and implemented into legislation by the UK and other EU member states has been the subject of European case law over the years. The decisions from the European Court of Justice have had a significant bearing on how we should apply our EU legislation.

There has been a lot of panic about what will happen now, but the law is what it is. Much of our legislation, such as the Equality Act 2010, may have come from Europe, but it's our law now.

There is no employment legislation in the pipeline as such that will be affected by the decision to leave the EU. And while there may be changes and new laws introduced as we go forward, it will not happen overnight. It will take the UK Government to change the law, and it is likely that EU law will continue to exercise a significant influence, even once we have left the EU. Even if changes do occur, the Government will need to deal with those changes in piecemeal form and will certainly be mindful of how the unions might react if any of those changes are likely to be to the detriment of employees.

"There is no employment legislation in the pipeline that will be affected by the decision to leave"

Employment lawyers will still be kept busy, but that will be through dealing with the effect that leaving the EU has on the economy and UK businesses.

Andrew Gray is PwC's UK regional financial services leader

Many within the financial services industry had believed that the UK would vote to remain in the EU. Nevertheless, firms had put in place contingency plans for the immediate outcome


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of a vote, particularly those businesses that have significant market exposures and would be subject to risks around market volatility or lack of liquidity. I think it's evident by the lack of a crisis at any particular organisation that most firms had put in place appropriate plans and managed through the immediate consequences of the result.

We are working with a number of clients to understand the impact of these scenarios on the business model and their customers, as well as the ability to procure services from suppliers.

For many firms the pan-European implications become significant, especially when passporting restrictions are considered. Another key consideration is in relation to employees where immigration factors may also form a critical part of the assessment.

A number of firms are taking active steps to increase their optionality of business around different scenarios without incurring significant costs until necessary. For example, if you already have a subsidiary in another EU country, look to reposition that subsidiary for potentially broader use in your business. Take sufficient steps to understand what is possible and the specific future steps and time frame to protect the business.

However, it is possible that some changes will take a significant time, so early planning is essential.

With regard to our own business, I don't see that there's going to be a fundamental change in the nature of what we do. Immigration is something we are looking at. We do move people around the world to service our clients, both on a short-term and long-term basis. We will need to explore how to serve our clients in the locations they operate, and do so in a cost-effective way.

Rob Checkley leads the Compliance Assurance team, Financial Services, for Grant Thornton UK

It is often overlooked that the UK is, and has been for many years, a model for strong corporate governance and rigorous risk control. Our most profitable companies – particularly in the financial services sector – have shown how balance and discipline together with a good measure of innovation can help turn strategy and vision into reality. The UK's tradition of effective risk management has grown on the foundations of its national culture, an excellent education system, rational regulation, and the broad exposure the UK enjoys in world markets.

Since the credit crisis, much of our regulatory agenda has been led by Europe-wide initiatives such as Basel III, MiFID II, the Fourth Anti-Money Laundering Directive and the European Market Infrastructure Regulation. Once Article 50 is triggered, the UK may exercise greater regulatory latitude, but to abandon completely the major schedule of structural reform would be painful and expensive for businesses already suffering from regulatory fatigue.

So the market is seeking continuity, stability, and options for maintaining a competitive position in European markets. And critical to maintaining sound corporate governance standards will be retaining the enormous wealth of talent we have in our workforce – home grown or from overseas. Overly bureaucratic or exclusionist policies may drive away the skills that successful control and risk management is founded upon and lead to a very harmful 'brain drain'.

Furthermore, regulators must ensure that equivalency regulations are adopted so UK firms can conduct passport-regulated activities and business across the EU. Ensuring the path remains clear for us to work on common terms with our existing European partners will be critical.

Henry Talbot-Ponsonby is Co-Founder and Managing Director of UK venture capital firm VCP Advisors

UK financial services firms were not at all prepared for Brexit, but no worse than any other specialism. While some may have positioned their portfolios to profit from Brexit, with so much uncertainty about what it would mean even if it happened, I doubt many, if any, boards dedicated significant time to contingency planning, even if they say they did. Even now, the biggest banks are still talking in general terms about what it might mean for their business models.

Overseas clients provide 30–40% of funds managed by UK investment management firms*

Subject to common sense prevailing in the negotiations, I see very little changing for the UK's financial services post-Brexit. In terms of the private equity and venture capital industries, I think the biggest impact will be the passporting of our services throughout Europe under MiFID, and the ability of funds to be marketed from the UK around the single market.

Scale aside, the UK private equity and venture capital industries are on a par with the US, the global leader in terms of sophistication. The best general partner will see Brexit as a great opportunity and investors globally will be seeking out those general partners.

There are certainly opportunities for our industry, depending on the situation. For example, easier access to global markets while still retaining full access to the single market. This is something that we are hoping will come from the negotiations over the coming years.

In terms of what we're looking for from these negotiations, we want a continuation of the MiFID II passporting regime. We also want the UK to still be able to passport funds under the Alternative Investment Fund Managers Directive (AIFMD).

On a wider scale, London must retain its role as the leading place for euro clearing. Finally, a special work visa regime for London financial services needs to be secured.

Dr David Blake is Professor of Pension Economics at Cass Business School

The historical basis for the success of the UK financial services industry is laissez faire, with limited government interference. This freedom to innovate explains why it grew to be such an important part of our post-industrial economy. The continental model, by contrast, is contract-based with a lot of government regulation.

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[The UK will continue to attract talent and investment] by being willing to be open and encouraging both innovation and a business environment with low corporate taxes.

Global fintech financing has risen sevenfold over the past three years to more than £20bn for 2015*

The UK needs to maximise access to the single market. To achieve this, it should negotiate a free trade agreement (FTA) with the EU. An FTA can allow for tariff-free entry of goods (in both directions) between the UK and EU. Members of an FTA can also choose the level of standard tariffs imposed on non-members of FTA. This would allow the UK to charge lower tariffs on goods where there is no significant UK industry to protect.

If no agreement is reached after two years, then trade with the EU takes place under WTO rules. Each party levies its standard external tariff on imports of goods from the other party. Given the current £90bn trade deficit with the rest of the EU, the UK would levy tariffs on imports much greater than those collected [from those countries]. There is therefore a strong incentive for all parties to pre-negotiate a trade deal before triggering Article 50.

The UK can continue passporting goods and services under existing regulations and directives. This simplifies the basis for the FTA. Provided neither party changes the relevant rules, passporting would continue after exit. Such a provision would give both parties the right to change the rules in a relevant area, though a rule change might affect the continued passporting entitlement.

[In terms of our education system] one thing that needs to change is the fact that non-EU students are counted in the UK's immigration statistics. This places unnecessary restrictions on recruitment. It would also help if the government allowed international students to get some job experience in the UK after graduating. Other countries have found this to be a very useful way of recruiting the most talented students.

*Source: TheCityUK report *UK financial and related professional services: meeting the challenges and delivering opportunities*

Ikon

Changing suits

THE EVOLUTION OF GROUP SHAREHOLDER ACTIONS OR 'CLASS ACTION' STYLE LITIGATION IN THE UK

SHANA TING LIPTON

Class actions in the US are arguably commonplace, with some high-profile cases making headlines in recent years – including AIG and Bank of America (BoA). In particular, the number of US securities class action filings in 2015 was the largest since 2008, the year of the global financial crisis.

BoA and AIG's class actions – each respectively settled out of court – were based on claims that shareholders had been misled. In the former case, this was purported to have occurred in relation to the financial standing of Merrill Lynch prior to its acquisition by BoA; in the latter, with regards to sub-prime mortgage exposure. In 2012, BoA settled for $2.43bn – among the largest securities class action recoveries of all time. Last year, AIG's settlement was approved; the payout – nearly $1bn – the largest investor-led class action settlement in which no criminal or regulatory enforcement actions were sought out.

Further afield in the EU, no unified class action mechanism exists which applies across member states – only non-binding recommendations. Similarly, the UK's legal system does not have a class action regime where securities litigation is concerned. However, a mechanism known as a group litigation order (GLO), introduced in 2000, is becoming the go-to system of redress for shareholders bringing collective actions against the companies and financial institutions that allegedly cause them to suffer loss. Its flexibility, cost savings and efficiency have benefits for parties on both sides.

GLOs were introduced as a result of Lord Woolf's *Access to justice* final report. This identified the insufficiency of existing collective redress mechanisms in the UK – particularly in dealing with big-ticket group litigations (product liability and the like). One such mechanism – which still exists but is now rarely used – is the same interest representative claim, in which one or more claimants to proceedings can represent other claimants with the same interest. The hurdle for such an action is, however, high, with a strictly applied test required to establish 'same interest'. In contrast, the newer GLO can be pursued if there are common or related issues of fact or law – a broader test and a significantly easier requirement for prospective claimants to fulfil.

Although only 94 GLOs have been granted by the courts since they were first made available, a small number of securities cases among them have recently made news – signalling a rise in class action-style claims in the financial services realm. These include shareholder actions against RBS, Lloyds Banking Group and, most recently, Tesco.

The RBS case – which aims to recoup up to £4bn in investor losses – is premised on allegations that the financial institution's rights issue prospectus misled investors. The £6bn Lloyds claim is also based on a misleading prospectus – in particular, statements in the HBOS takeover prospectus (claimants state they were not given necessary information about HBOS finances and other details ahead of the acquisition). Tesco's investors are issuing proceedings against the supermarket giant, maintaining that accounting irregularities hiked up its share price.

Such group securities litigations are chiefly brought under the Financial Services and Markets Act 2000 (FSMA), which offers a remedy for misstatements and omissions in prospectuses. Since October 2010, redress for false or misleading statements to the market more generally has been available as a result of issuer liability expansion in UK law as required by EU law – with regulator findings of such breaches also acting as triggers for group shareholder cases (for example RBS, which is being sued for breaches of section 90 of the FSMA 2000).

"You could cut cost by pooling the interests of relevant parties and splitting the costs"

GLOs enable institutional and/or individual investors or groups of shareholders with separate claims to join them so they can be managed collectively. This differs from US class actions, which involve a 'lead plaintiff' stepping forward on behalf of the others in the class as their representative.

JUDICIAL DISCRETION

In the UK, sometimes it is the court, rather than the parties, which decides that separate claims should be consolidated if it deems it proportionate and efficient to run them together. This judicial discretion is in part what makes GLOs so nimble and flexible, particularly compared with more rigidly structured US class actions. "A lot of it can be devised as you go, depending on the claim," says Osma Hudda, Partner at US law firm Gibson Dunn in London.

A first step for such claims may involve lawyers looking to assemble parties, and reaching out to discretionary fund managers who can pursue the action on behalf of their investor clients, says Julian Chillingworth, Chief Investment Officer of Rathbone Investment Management in London.

Philip Rocher, Senior Partner in US law firm Gibson Dunn's London office, adds that as the securities class action space heats up, a US-style litigiously proactive 'plaintiffs bar' has been establishing itself in the UK. "There's been a phenomenon in the last three or four years of some of the US firms that have offices here just looking for claims like that," he says. Such group claims notwithstanding, the media flurry around corporate malfeasance is already on shareholders' radars, long before law firms express interest in representing claimants.

Lawyers and investors are not the only ones alert to such developments. Chillingworth adds: "We are always aware of our stewardship to our clients. As discretionary managers, where we think there's a case to answer, we won't wait to be approached; we will be proactive." But with custodians under an obligation to pursue such claims on behalf of small shareholders, internal costs and efforts could conceivably be substantial. Chillingworth, however, notes optimistically: "You could cut cost by pooling the interests of relevant parties and splitting the costs."

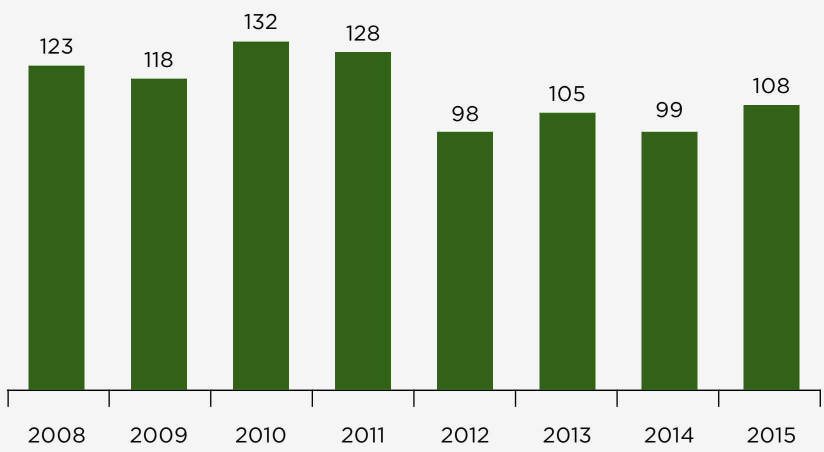
GLOs can be funded in different ways depending on circumstances, for example via 'no-win no-fee' arrangements or contingency fees. After the event, insurance can mitigate the cost risks for investors, should the claim be unsuccessful. Third-party funding, popular in the US, has been gaining steam across the pond, and often sees hedge funds invest (by way of finance) in a litigation in exchange for a share of its proceeds. The Tesco group action is being funded on behalf of its disgruntled investors, by Bentham Europe – which debuted in Britain in 2014 as a joint venture with American hedge fund management firm Elliott Management Corporation.

OPTING IN

The costs of a GLO are front-loading in contrast to those of its US counterpart. And, where US class actions are opt-out (claimants are automatically signed up to the action), GLOs operate on an elective (opt-in) basis. UK lawyers must actively identify members

FIG 1. NUMBER OF SECURITIES CLASS ACTIONS CASES SETTLED IN THE US COURTS

There is a backlog of cases still to be settled in the US federal court system totalling almost 650, but with new cases being added all the time.



Source: Cornerstone Research

of a group of claimants and put each through the requisite registration and client care process – putting a strain on resources from the start.

The number of claimants can range from hundreds (Tesco) to tens of thousands (RBS). Court consent is required to manage the claim as a GLO, and can be obtained on the basis of common or related factual or legal issues between separate claims. Once approved, a group register, featuring details of the claims, is opened and the GLO is publicised – often through newspaper adverts and action group websites devoted exclusively to the claim – in order to target additional claimants. A deadline is set before which new claimants can be added. This 'window' provides an element of certainty for defendants.

GLOs can take two or three years to be resolved – assuming they are not settled out of court early on – particularly before the deadline has passed. "The larger the claimant pool, the more worrying it is for the respondent and it changes the dynamic. People may want to settle," says Hudda. Damage to reputation can be another catalyst for early settlement.

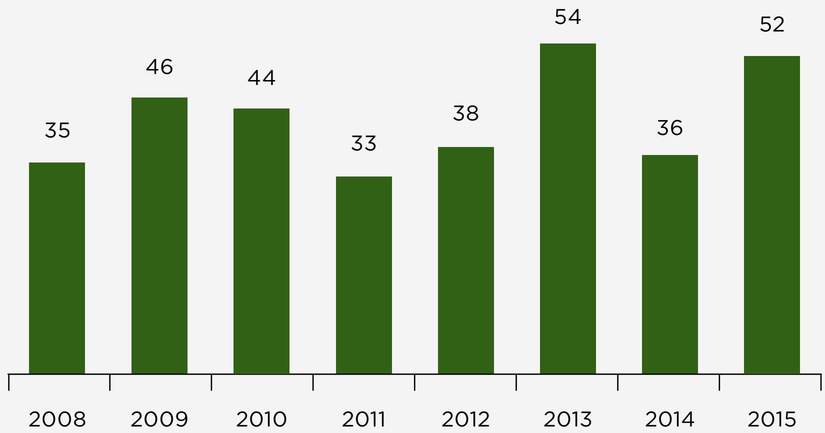
Unlike the notoriously sky-high damages awarded in the juried US class actions, judge-ruled group litigations in the UK can only yield compensation for the actual loss investors suffered as a result of the company or institution's misstatements or omissions. And, under UK law, the loser of a lawsuit pays the winner's costs. "This has always been seen as a check on what we in England regard as some of the excesses of the class actions in the US," says Rocher. Plaintiffs' attorneys in US class actions are typically paid a percentage of funds recovered on behalf of their clients that, on average nationally, amounts to 25% of the total.

"It's a way of providing some sort of efficiency and consolidation of those cases"

Stewarts Law London Partner Andrew Hill, who is acting for certain international institutional investors and shareholders bringing claims against Tesco, believes there are benefits for both sides: "The grouping of cases does have the benefit from the claimants' side of effectively pooling their individual losses." Individual shareholders acting alone may not be inclined to litigate after doing the cost-benefit analysis,

FIG 2. AVERAGE SETTLEMENT VALUE PER SECURITIES CLASS ACTION CASE ($M)*

*Excluding settlements over $1bn, IPO laddering and merger objection cases



Source: Cornerstone Research

whereas there is strength in numbers, making GLOs a potentially attractive investment to third-party funders. The GLO structure also offers a streamlining process for the defendant. "Rather than having a whole host of ad hoc claims being brought, it's a way of providing some sort of efficiency and consolidation of those cases," he adds.

ADDED INCENTIVES

One fairly recent incentive for pursuing a GLO in the UK – rather than a class action in the US – is the outcome of the 2010 US Supreme Court case of Morrison v National Australia Bank, which constrained foreign investors' ability to seek redress in the US courts. "Investors who might have invested in a British company like Tesco around the world don't have the recourse that they might have previously had in US courts," says Hill, "so they do have to look outside the US and come to the courts in England or Australia or Germany – wherever the loss might have been caused".

Another recent legal development – although currently limited to the competition law space – may be a harbinger of an emerging UK class action regime more broadly: the passage of the Consumer Rights Act 2015. This established an actual opt-in or opt-out class action system, available when a group of consumers has suffered a loss on the basis of anti-competitive behaviour such as price-fixing.

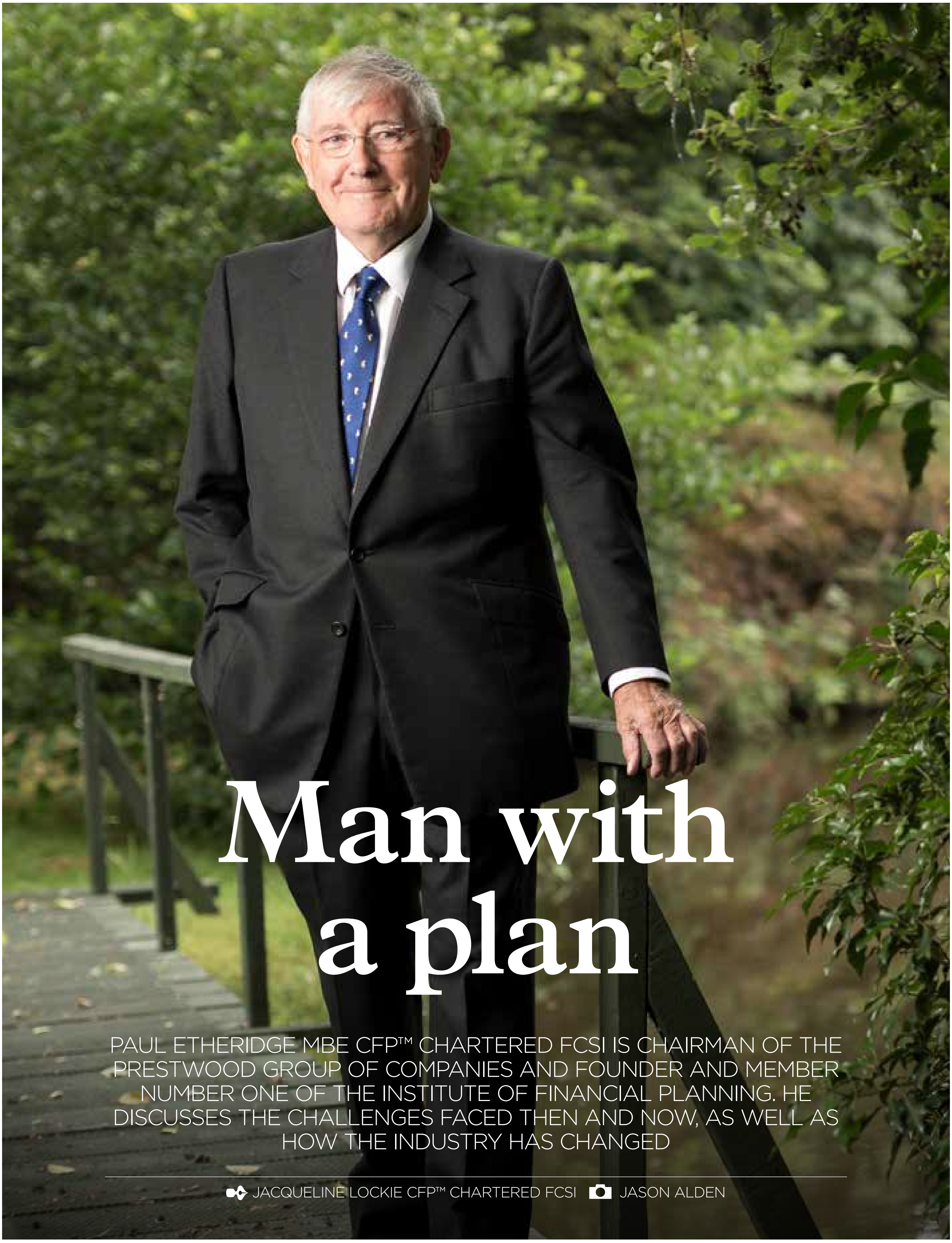
"There's an interesting question about whether or not institutional investors would fall within the definition of 'consumer' under the Act and get the protections and be able to use the mechanisms that the Act provides for," notes Hill. He says he sees potential for future group securities class actions under this broader interpretation of the law.

Hudda suggests that this shift in the competition arena could open up a UK class action system in other areas like financial services, but senses this may occur incrementally, sector by sector.

"Maybe the financial sector will be next," she says. "You can see it happening more in that way, rather than a wholesale need to have something like the US class action model."

It remains to be seen – as the RBS, Lloyds and Tesco cases progress – how promising GLOs will be for shareholders launching securities litigations. "We're in the early stages of the development of this area of law in the UK," says Hill. "I don't see it decreasing. We think it's going to continue and provide a source of redress, in the relevant circumstances, for investors."

"Undoubtedly we are very aware that in the last few years they have increased and I think they will continue to increase," concludes Chillingworth.



Man with a plan

PAUL ETHERIDGE MBE CFP™ CHARTERED FCSI IS CHAIRMAN OF THE PRESTWOOD GROUP OF COMPANIES AND FOUNDER AND MEMBER NUMBER ONE OF THE INSTITUTE OF FINANCIAL PLANNING. HE DISCUSSES THE CHALLENGES FACED THEN AND NOW, AS WELL AS HOW THE INDUSTRY HAS CHANGED

JACQUELINE LOCKIE CFP™ CHARTERED FCSI JASON ALDEN

With a career spanning six decades, Paul Etheridge is not short on achievements. A quiet and unassuming man but one who is clearly passionate about financial planning, he took perhaps the industry's biggest step in a lifetime to form the Institute of Financial Planning (IFP) in 1987, and support it financially. Since launching, it has transformed how clients receive financial advice in the UK. "I was uncomfortable with the way things were going and so I felt strongly that I, and a few others, needed to do something significant to help improve the quality of advice being given to members of the public in the UK," explains Etheridge. Therefore he used the financial resources from the Prestwood Group of Companies to establish the IFP to enable financial planners to come together, learn from and support each other.

FIRST STEPS

Etheridge started his career at the age of 16, training in general insurance with the Royal Insurance Company. Despite being impressed by his employer's desire for high standards, Etheridge decided to leave. "Unfortunately the cost of travelling 25 miles each way to and from work each day was eating into my income. I needed more money to make ends meet. Eventually I handed in my resignation with the intention of applying for a short service commission in the army. Three days later at a meeting with my manager I was told that 'by pure chance' a vacancy had arisen in the Royal's head office investment department, and, if I passed the interview, my salary would be doubled. He described this as a wonderful opportunity, so I moved to Liverpool to work. In those days the department was split between Liverpool and London."

"We always look forwards not backwards"

Despite learning a lot in the following few years, Etheridge moved on and joined the Towry Law insurance broking group, based in London. "In due course I was appointed Managing Director of the Midlands company office," he says. "I was responsible to the Hon Cecil Law, the founder of Towry Law. Cecil was very able and I learned to greatly respect him. He made no bones about telling staff that if they achieved what was expected of them they would do very well financially, but if they didn't meet expectations they would not remain with the company. I spent seven years at Towry Law, but didn't want to be based in London. I left amicably along with two others, and we started Prestwood to give comprehensive advice to clients. Initially, we worked out of a mobile home."

In 1975 Prestwood launched as a comprehensive financial planning service. In a bid to make the process less labour intensive, Etheridge teamed up with a software developer, called Philip Congrave, to develop the first lifelong cashflow modelling software in 1984, thus providing a tool to help advisers offer a comprehensive lifelong financial planning service.

The Prestwood advisory business uses the cashflow software to provide a fee-based financial planning service, a model that Etheridge is a great advocate of. "We wanted to be fee-based from the outset when we started 40 years ago. I can remember only one objection to fees in all of the years of being fee-based."

Prestwood charges an hourly fee, with a minimum fee to be paid monthly for the firm's financial planning services. While some are doubtful of the model, Etheridge says that by getting results, the clients they are seeking will be swayed. "People say to me that clients won't pay fees but I've proved that is not the case. What matters is that they are given excellent value for money. Clients have to see the value in what they're going to get for their money and if they see that value then they will pay happily for it."

FORWARD THINKING

Etheridge emphasises the importance of looking to the future. He does not believe in having review meetings. "All our client meetings are planning meetings. We always look forwards not backwards." He does however believe in demonstrating value, providing a full breakdown of charges that clients have paid him for his advice in every meeting.

These charges reflect the total fees charged to the client over the entire time of the financial planning relationship. Over the 40 years since starting Prestwood, he continues to see a few clients to this day and keeps up-to-date technically to maintain his CFP™ designation and membership.

Etheridge holds strong views on financial planning, based on years of evidence garnered from talking to hundreds of advisers and clients. One of his main concerns is around fees and profitability. He explains that planners need to work backwards to work out how much to charge: they need to consider how much they want to earn and how many hours each year they want to work, and take into account the staff, platform, premises and other associated costs. If you put all that into the mix, then planners can work out their hourly rate. Depending on the amount of time a planner thinks a certain piece of client work will take (that comes with experience), the planner can give any given client a good idea of cost to them.

"Most advisers don't start off on the right foot at all," he says. Etheridge has spoken in seven countries about financial planning over the last 40 years, discussing with advisers why they continue to have unprofitable clients. This is mainly because advisers need to have better criteria on which to decide whether to take on a new client, he explains. "In discussion it often appears that almost the only criterion advisers had was that the prospect was breathing at the time!" From where his business is based in the West Midlands, "within a 20 mile radius there are five million people living and working," he says, making the point that there are, and always will be, plenty of high quality clients for everyone. But some planners start off advising people who are thought to be profitable, or at least might be in the

PAUL ETHERIDGE MBE CFP™ CHARTERED FCSI

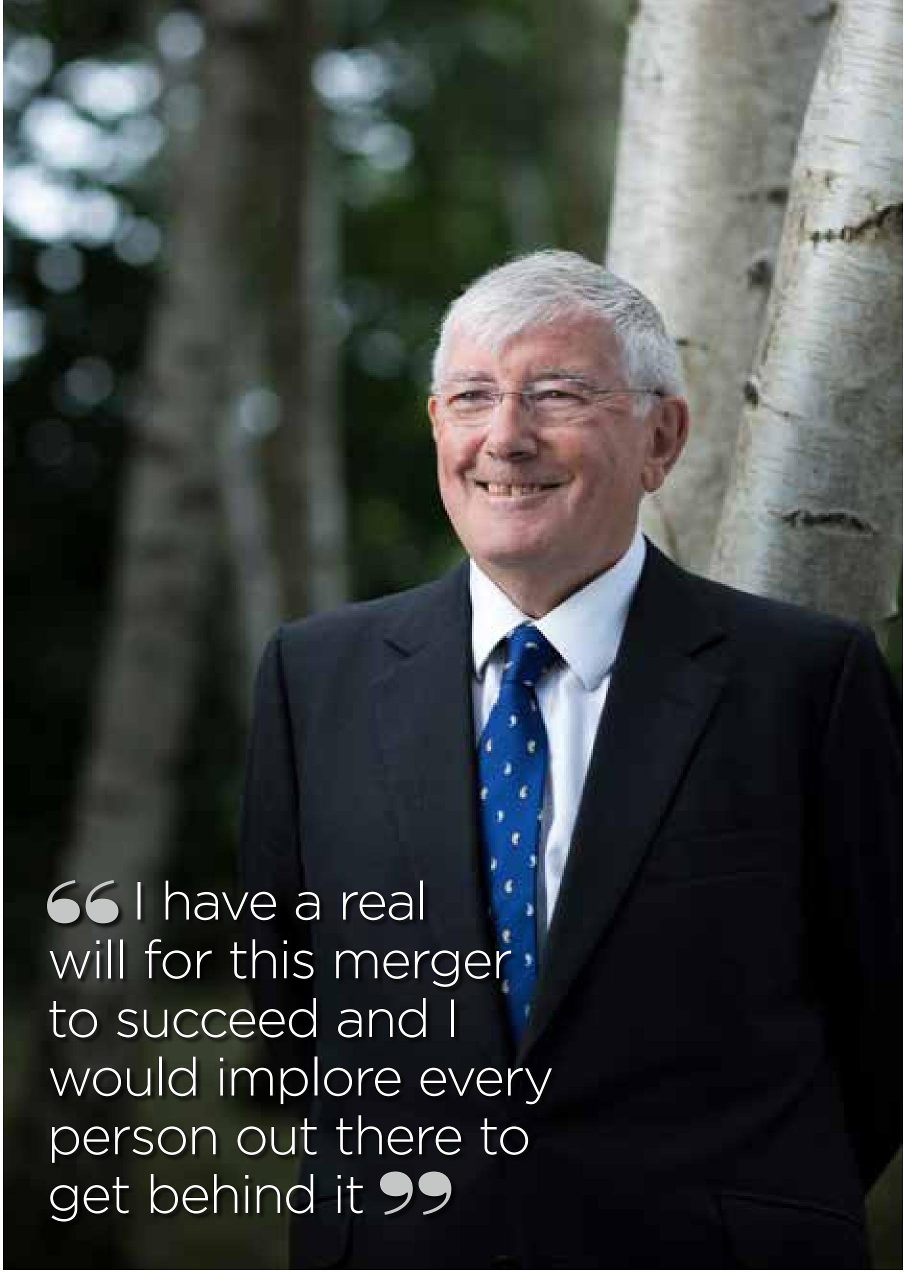
1975 – PRESENT FOUNDER AND CHAIRMAN OF THE PRESTWOOD GROUP OF COMPANIES, INCLUDING PRESTWOOD SOFTWARE

2000 – 2005 PIA RULES COMMITTEE AND PIA AND FSA SMALL BUSINESS PRACTITIONER PANELS

1967 – 1975 MD OF TOWRY LAW MIDLANDS COMPANY OFFICE

1956 – 1968 ROYAL INSURANCE

1960 – PRESENT TERRITORIAL ARMY



future, and these planners end up with a mix of clients who they like, but for various reasons, aren't profitable. This is partly due to a lack of regular analysis by the planner, he says, emphasising the importance of maintaining an ongoing relationship with the client. In his business all appointments for planning meetings are made one year ahead, at the previous planning meeting. Every client always has a date in the diary for their next planning meeting. This demonstrates to them the promise that their service will be ongoing.

A HIGHER PLAN

Prior to becoming member number one of the IFP in 1987, Etheridge had been a member of the International Association for Financial Planning, but found a reluctance from UK advisers to join as it was perceived to be an American institute. He called a meeting to discuss the formation of a UK institute, and found that there was more interest in the idea than he had anticipated. A working committee was immediately formed to take the idea forward. Initial donations were dropped into waste paper bins as attendees left that meeting. Prestwood provided subsequent financial support, topped up by those willing to pay in advance for lifelong membership.

The IFP developed a strong community spirit over the years, with members forming bonds and lifelong professional relationships. In 1995 the IFP became the awarding body for the CFP designation.

"Paraplanners and planners need to work together for the best client outcome"

Etheridge continues to plan ahead and tries to identify issues that will be faced by financial planners. "Looking forward it is important that we get the message out there that dealing with wealth is not just about dealing with money and numbers; it is also about relationships," he says.

He has plenty of ideas and views on how he would like to see the CISI move financial planning forward. He believes the CISI's network of branches around the country can help to encourage the growth of CFP professionals through offering after branch discussions over meals or post-session drinks that would foster good relationships. "I, and many other IFP members, have a real will for this [CISI and IFP] merger to succeed and I would implore every person out there to get behind the merger and contribute to ensure its success," he explains.

He is also a vocal advocate of the importance of paraplanning and puts much of his own success down to his paraplanner and son, Richard Etheridge, a key member of his team. "There are three parties in our working relationship: the client, the planner and the paraplanner. Paraplanners and planners need to work together for the best client outcome. Everyone has different skills and those skills should complement each other for the benefit of the client."

Etheridge holds concerns that many exam structures in the UK are not about showing individuals how to do financial planning, but about imparting technical knowledge and testing that knowledge. He believes that the merger can continue to show its members how to actually do financial planning. "This year's Financial Planning Conference will be a watershed for financial planning members to see if we can keep the spirit and friendship that we worked so long and hard to foster."

Outside of work, Paul has a wide variety of interests. He joined the Territorial Army in the 1960s and harbours a love of cars. "I bought a Bentley Continental GTI although I have to say in haste that I only kept it 18 months because I only did about 1,300 miles in it. I have gone back to my old Bentley that is 20 years old and is my favourite car."

Perhaps it is fitting to his views on financial planning to have chosen a vehicle of sufficient quality that it still keeps him moving after two decades.

Getty

THE BIG BANG WAS ONE OF THE MOST MOMENTOUS EVENTS IN THE HISTORY OF UK FINANCIAL MARKETS

EDWARD RUSSELL-WALLING

The Big Bang: 30 years on

The Big Bang transformed UK financial markets, restoring London's pre-20th century role as the capital of international finance. By ending price-fixing and admitting foreign players, it boosted competition. It also introduced electronic screen-based securities trading, and the financial services sector went on to experience fantastic growth. Yet some believe the changes paved the way for the 2007 financial crisis.

The story began in 1979 when the Office of Fair Trading (OFT) proposed an investigation into the "restrictive practices" of the London Stock Exchange (LSE). This was in line with the new Thatcher Government's belief in free market principles and its determination to modernise and internationalise the City of London.

Chief among these practices was the system of fixed minimum commissions. Another was the single capacity rule, which drew an unbreachable distinction between stockbrokers and stockjobbers. Brokers were agents who acted for their clients in return for commission, while jobbers acted as principals, making markets, providing liquidity, and making their money from the spread between buying and selling. The separation allowed brokers to put their clients' interests first at all times, ensuring no conflict of interest.

Both jobber and broker had to be independent and not part of any larger financial organisation. Their partners had to be elected members of the LSE in their personal capacity, with unlimited liability. Foreigners were excluded from LSE membership. If the firm traded as a corporate entity, all directors had to accept unlimited liability, which effectively barred big banks. “The problem was that these restrictions in practice ensured that the stock exchange was woefully under-capitalised,” recalls Nigel Lawson, Chancellor of the Exchequer from 1983 to 1989, writing in *Big Bang 20 years on* for the Centre for Policy Studies.

He notes that, while the City was a world leader across a whole range of financial markets, such as foreign exchange, in securities it was in danger of becoming a backwater. “There was no way in which London could remain a world-class financial centre without a world-class securities business,” he said. “So the sooner genuine reform came, the better.”

“Before the Big Bang, the big thing was to have institutional [rather than private] clients”

In the end, Trade and Industry Secretary Cecil Parkinson and LSE Chairman Nicholas Goodison agreed that the OFT would back off if the exchange reformed itself. Fixed commissions would be abolished and single capacity would be replaced by dual capacity, allowing jobbers (now market makers) and brokers to coexist under the same roof. These became known as dual capacity firms, and were able to sell shares and bonds to investors, while also trading them as principals. Others also included lending and merchant banking (now investment banking) to create financial supermarkets. “Everyone wanted broking skills,” remembers Senior Adviser to Deutsche Bank, Scott Dobbie FCSI(Hon), who was Chairman of the CISI from 2000 to 2009. “The big banks felt that they had to have jobbing as part of their one-stop shop or they would lose out.”

GOING DIGITAL

LSE membership was opened to corporates, and individual members were eventually split off into the Securities Institute, which then became the CISI in 1992. The other momentous change that took place, though much faster than the LSE had anticipated, was the wholesale migration of trading from the open outcry trading floor to electronic screens.

Rather than being phased in over time, the decision was made to implement all of these reforms on the same day – hence the ‘Big Bang’. The day was 26 October 1986.

This all added up to a giant welcome mat at the City’s front door, and for two years before the big day there was a scramble for firms and talent as heavyweight banks from the US, France, Germany and Japan waved their chequebooks and bought their way in.

When the big day dawned, brokers took an immediate income hit. In those days Dobbie was a partner with brokers Wood Mackenzie, which was bought by Hill Samuel, a UK merchant bank. He reports that the firm’s commission rate effectively halved on day one. “Turnover increased quite a lot, and share valuations went up,” he acknowledges, “so it was not as big a disaster as it might have been.”

The new regime took some getting used to, according to Ian MacDougall, a retired former Extel-rated analyst, who at the time was with brokers W Greenwell (acquired by Midland Bank, now part of HSBC). “There was a lot of confusion,” he remembers. “The vast majority of the broking side had very little understanding or experience of market making.”

“It’s the only time I have ever seen competition and prices go up at the same time”

Success in the new age required three things, MacDougall says. “You needed the right owner, who was prepared to wear some losses. You needed the right people, because with market making it was suddenly possible to make or lose a lot of money very quickly. And you needed the right technology, because if yours was slower, you got left with all the duff stock.”

Now that competition had been unleashed, institutional investors were able to drive dealing commissions down to the bone. That made them one of the Big Bang’s winners. Another group of winners was more of a surprise, as the first CISI Chairman Graham Ross Russell (from 1992 to 2000) explains. This was the private client broker (since restyled as wealth manager), whose commissions did not suffer in the same way. “Before the Big Bang, the big thing was to have institutional business,” says Ross Russell, who had been a partner at brokers Laurence Prust. “Private clients were very much a sideline.”

When Laurence Prust was bought by Crédit Commercial de France in 1985 (itself later bought by HSBC), they could have had the private client business for nothing, Ross Russell says. “But they didn’t want it. Eventually, the private side merged with Rathbones and today it’s worth more than the rest of the firm put together.”

BIG BANG

1979
OFT proposes investigation into “restrictive practices” at the LSE

1983
Margaret Thatcher’s Government and LSE agree to settle wide-ranging anti-trust case

1984
Gower Report into investor protection published, calling for new regulatory body

Getty

Commissions may have gone down since the Big Bang, but floating a company has become considerably more expensive. The costs of an initial public offering as led by an investment bank are many times more than the old-style underwriting costs associated with flotation. "It's the only time I have ever seen competition and prices go up at the same time," says Sir Alan Yarrow, Chartered FCSI(Hon), current CISI Chairman.

US INVASION

Another unintended consequence was that UK banks did not, as Prime Minister Margaret Thatcher had hoped, come to dominate the new City. They enjoyed mixed fortunes at best, while it was the ("cut-throat", according to one Big Bang veteran) US banks that ultimately had the lion's share of success.

"They had years of experience, and they hired the best people," Dobbie explains. The UK has had to settle for what ex-Bank of England Governor Eddie George called the Wimbledon effect – lacking the best players but hosting the best tournament.

It was the highly motivated – and motivating – Americans in particular who changed the character and culture of the City.

Getting in at 9.30am, having long boozy lunches and then signing a few letters before heading home – a lifestyle some senior types still enjoyed – was replaced by breakfast meetings and Perrier water.

They bid up the pay of corporate financiers, traders and analysts, as they competed for skills. They also introduced a much more legalistic attitude to business. "Although regulation is of course much tighter now, almost everyone sailed in the middle of the safe harbour before the Big Bang," Dobbie says. "Ever since, the investment banks have always tested the edge of the harbour."

Hand in hand with this has come the rise of compliance, replacing the old 'my word is my bond' culture of putting the client first. Ross Russell notes that, as small firms disappeared, individual responsibility for good behaviour has been replaced by corporate responsibility, which does not work quite so well.

"US banks had years of experience and they hired the best people"

"Within the old Stock Exchange, the culture within the firm was the main factor ensuring that it didn't take on doubtful business," he says. "Now we are in the age of the compliance officer, whose role is to ensure compliance with more and more laws introduced by industry regulators – sometimes possibly at the expense of fulfilling the spirit behind the law."

Sir Alan agrees that the Big Bang was very important in making London a global centre. "But we must accept that not all of its outcomes were good and that some must be changed," he insists.

The Big Bang caused a change in compensation whereby individuals were encouraged to put their personal interests before those of their clients, Sir Alan says. "They didn't take the risk, but they took the return, and that's a type of theft," he believes. "We as the City must put that right and, indeed, we have been doing so for the last seven years."

SIB

Securities and Investments Board

1985
Securities & Investments Board (SIB), precursor to the FSA, founded

1986
On 27 October, new rules come into play, heralded as the 'Big Bang' of deregulation

1989
Thatcher hails City as "a thriving centre of commerce and finance, bringing advantage to the whole of our country"

Crunch time

THERE IS A LIQUIDITY CRUNCH IN THE PROPERTY SECTOR. OPEN-ENDED PROPERTY FUNDS ARE ONCE AGAIN IN A STATE OF CHAOS FOLLOWING LARGE OUTFLOWS. WHAT CAN THIS TELL US ABOUT THE STATE OF THE ECONOMY?

DAVID CRAIK

Within a couple of weeks of the UK's surprise Brexit vote on 23 June, a plethora of financial services firms, such as Aviva, Standard Life, M&G Investments and Aberdeen Asset Management, had closed their open-ended commercial property funds and applied a wide range of market value adjustments or dilution levies.

M&G, for example, suspended trading in its £4.4bn fund as it noted a 'marked' increase in the number of investors rushing to withdraw funds for fear that the value of commercial property was set to dive. M&G said at the time that 'gating' the fund would better protect the remaining investors by stopping any other withdrawals and redemption requests.

WHAT CAUSED THE CRUNCH?

Investors sensing imminent commercial property price collapse made the quick decision to get their money out as soon as possible, a situation that may also have been aggravated by the shift to centralised investment propositions by many wealth managers.

This put pressure on the fund management companies to respond to their requests and provide them with their cash. As ever, too many investors at one time wanting redemption caused a cash crunch, as commercial property assets are not easy to sell at short notice, especially during a period of economic uncertainty.

The funds were therefore suspended to protect the value of the funds and other investors and to give fund management companies time to make appropriate sales.

In an early August press release, the group said this would allow it to raise cash levels in a controlled manner so that asset disposals could be achieved at reasonable values. "M&G aims to reopen trading in the fund as soon as practically possible – once conditions in the commercial property market become more normal and the fund manager has raised sufficient cash in the portfolio," it said. "Progress on cash levels has already been made with the disposal of seven assets since 5 July."

Aberdeen lifted its suspension after only a week as it no longer felt the pressure to sell its properties quickly, but the flagship retail property funds of M&G, Standard Life and Aviva remained suspended at 26 August. In a July update, Aberdeen said: "The UK open-ended property funds sector was particularly affected following the referendum, as investors' concerns about the impact on property values in London and elsewhere increased, and these concerns were exacerbated following the decision by competitor funds to suspend dealing. Aberdeen was well prepared for such uncertainty, with a high level of cash held within the UK Property Fund, the only Aberdeen fund with exposure to these issues."

This crunch showed investors that what were marketed as open-ended liquid funds, where they could redeem their money at their own choosing, were in fact illiquid. It calls into question whether illiquid assets such as commercial property should ever be placed in an open-ended fund.

Naomi Heaton, Chief Executive of residential fund provider London Central Portfolio, believes more needs to be done to protect investors.

> *"UK open-ended property funds were particularly affected by the referendum"*

"Open-ended commercial property funds are at odds with the liquidity of the assets they invest in. Large offices with single tenants are particularly illiquid as they are big investments which need to be sold on and that may be difficult in a tough market. Commercial property will be more affected than residential if there is a downturn, because residential is more reliant on global wealth and more long-term investors," she says. "You may be forced to sell at a significant discount to market. It is a risk for investors and it is something we saw back in 2009 as well.

"I am surprised that these kind of structures were allowed to continue. Investors should have been made totally aware that they may not have been able to get their investment out when they wanted to. There is a huge desire from investors for liquidity and the chance to exit. The FCA should look at this lack of crystal clear information and whether open-ended funds are appropriate for volatile commercial property."

A GENTLE REMINDER

Indeed, in July, the FCA issued guidance that reminded fund managers of their obligations to investors and looked at how

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open-ended funds are structured. The note said: "If a fund has to dispose of underlying assets in order to meet an unusually high volume of redemption requests, the manager must ensure these disposals are carried out in a way that does not disadvantage investors who remain in the fund or are newly investing in it."

Heaton also has harsh words for fund management companies. She says these firms offer "empty promises" through calling their funds open-ended. "They say they are liquid," she says. "People think they have access to their money at any time but they do not."

Alan Miller, Founder and Chief Investment Officer of investment management firm SCM Private, says it is hard for investors to assess the inherent risk in these funds. "From one lens for liquidity you would say they are high risk but in the other lens for volatility they are low risk. Commercial prices change irregularly and slowly over time," he says. "There are plenty of funds which have legal warnings to protect investors but wouldn't it be better to have funds that work properly?"

Like Heaton, Miller does not agree with the fund groups' management of the post-Brexit scene. "The fund groups and the regulators have not properly addressed the liquidity issue in these funds. The behaviour of the fund groups after Brexit was abhorrent in that they did not treat their customers fairly," he says. "Are the chief executives fit and proper persons for these roles? They totally ignored the Brexit result. Where were they? Do they have newspapers or were they on a sunbed somewhere or cryogenically frozen? They did not re-price the funds materially to reflect the falls in liquid property stocks or temporarily suspend them immediately. They did nothing and only acted after a run on the funds took place. Something has to be done or they will do it again and again."

"Fund groups and regulators have not properly addressed the liquidity issue"

He sees this spreading into other areas. "You have potentially issues in some of the strategic bond funds invested in high yield bonds which at times of stress can be very illiquid. Also with funds with exposure to small companies. If a high-profile manager leaves and you have a high number of redemptions, would the funds be able to cope with that? It is not just property," he says. "Simply having some cash buffer gives some kind of protection but it is that mismatch between liquidity and the illiquid assets which is the fundamental problem."

Rory McPherson, Head of Investment Strategy at Psigma Investment Management, picks up the point. "There are other dressed-up illiquid assets, such as unlisted infrastructure, invested in areas such as prisons and toll roads, wrapped up in an investment trust and private equity assets where there are lock-down periods. Fundamentally these should not be for people who want to take their money out when they can," he says. "They should not be held as part of a daily liquid portfolio."

UNCERTAIN TIMES

The spread of the liquidity crunch clearly reveals the UK's current nervous economic climate. Investors are twitchy, anxiously casting their eyes around equities, bond prices and commodities for signs of pressure and strain. What will the Brexit referendum vote and continued uncertainty over the timing of the UK's exit from the EU mean for individual economic sectors and the nation's balance sheet as a whole? (See our Brexit feature, pp.16–20, for discussion of this question).

Commercial property prices and the demand for new buildings and office space are strong indicators of economic health. A drop in asset prices following the vote was a clear sign to many that the wheels of the economic recovery could fall off if private investment, particularly from abroad, seized up. Open-ended property funds were one of the first clear signals that caution was now required.

Despite this, McPherson expects the open-ended property funds to remain. "People may take their money out when they realise they were buying illiquid proper bricks and mortar wrapped up into something which offered daily liquidity," he says. "There may be more disclaimers or health warnings in the future but I think there is enough information for investors to make an educated decision about going into these funds or not. You should look at daily traded volumes, whether the ownership structure is spread out among a number of investors or a couple of institutions. This will give you a steer on how liquid it will trade."

In the end it may be about how much risk an investor is willing to take. "With a property fund you might look at the cash buffer, but even then you don't know what the rate of withdrawals is going to be. When you go in you have to accept that when you come out you may not be able to and may not get the price you want," says Laith Khalaf, Senior Analyst at Hargreaves Lansdown. "If you are not willing to bear those risks then open-ended funds are not for you."

Avoiding a hive mind

GROUPTHINK IS NOT DESIRABLE IN ANY BUSINESS, YET MANY IN THE FINANCIAL SERVICES SECTOR STRUGGLE TO APPOINT STAFF HOLDING DIFFERING VIEWPOINTS. HOW CAN DIVERSITY AND INCLUSION IMPROVE DECISION-MAKING AND THE BOTTOM LINE?

GARETH FRANCIS

Consensus in a professional environment can be a hugely positive thing. Working towards the same goals, using an agreed strategy, can see a workforce become more cohesive and efficient. However, a common mindset is not always desirable. 'Groupthink' is defined as the practice of thinking or making decisions as a group, resulting typically in unchallenged, poor-quality decision-making. A famous example of this phenomenon is the botched Bay of Pigs invasion in 1961. While planned by the Eisenhower administration, the invasion tactics were also accepted by President Kennedy's administration. They collectively failed to raise questions on the intelligence presented, leading to one of the most famous military failures in US history.

THE FTSE DIVERSITY PICTURE

- 45% of FTSE 100 companies are failing to hit diversity targets (Equality and Human Rights Commission)
- Gender-diverse boards are outperforming male-only peers by £430bn (Grant Thornton)
- Five female CEOs are currently in FTSE 100 companies
- Four FTSE 100 CEOs are non-white (Audeliss)
- 19 banking and finance companies
- 8.1% of board members of these are non-white
- 26.7% are female

(Green Park Leadership 10,000 report, 2015)

THE BOOST TO GAIN

But can this collective single-mindedness be avoided? One possible way is through diversity. *Diversity matters*, a 2015 study from McKinsey & Company, finds that businesses in the top quartile for gender diversity are 15% more likely to have above industry median financial returns. Companies in the top quartile for racial diversity are 35% more likely. When focused on the UK, the benefits of gender diversity become even more apparent.

The study says: "The correlated benefit is an increase of 3.5% in earnings before interest and tax for every 10% increase in gender diversity in the senior executive team (and 1.4% for the board). That is, UK companies experience more than ten times the impact for their efforts in gender diversity than US companies do, even after reaching the 22% tipping point."

Sandra Kerr, Race Equality Director at Business in the Community, says that this is because the more diversity in a company, the wider the insights that can be accessed. "There's less risk of blind spots because you have a wider range of perspectives and reduced costs associated with groupthink decisions," she says. "Bad groupthink decisions are very costly if they're made. You can make a groupthink decision in minutes, but it will not reflect the different perspectives that need to be considered for the diverse stakeholders."

The moral argument for a diverse workforce is clear – the majority of leaders know that no one should be discriminated against because of their gender, race, sexuality, disability or any other reason. And with the improvements being seen, it is clear that more organisations have taken steps to build a more inclusive workforce. However, many are failing to grasp that there is an equally strong business case to boost inclusion.

THE CHALLENGES FACED

Paul Cowan is an independent global executive coach. He has spent more than 20 years in the global talent development space working with senior leaders from renowned brands like Dell, Amazon and Standard Life. He says while diversity is of course desirable, this alone will not provide new ideas. "It's really about inclusivity. For example, one of the challenges we have in financial planning is that we need to get more female talent into senior positions. But if the female talent that reaches these higher positions think in the same way then that's not inclusive either."

"The challenges we have in financial services are around innovative thinking"

Cowan suggests that there are steps to be taken around talent development and acquisition. Organisations must seek to encourage different ways of thinking while identifying whether they are looking for too many employees from the same pools of talent, such as universities or competitors. "The more diverse the workforce, the greater the opportunity you have to drive performance in the business. The challenges we have in financial services are around innovative thinking. Many organisations recruit the same type of people in an industry


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that is long tenured. That breeds a certain mindset. A workforce with different appearances, different backgrounds, different life experiences will bring different thinking into your organisation."

In finance, Cowan says recruiting staff from less obvious talent pools has become even more difficult, due to changes in regulation. For example, the FCA's Approved Persons Regime requires firms to assess the fitness and propriety of those being placed in certain controlled functions. The aim of the regime is to remove liability from the FCA or functions that carry potential risk for UK customers, placing responsibility back on the businesses themselves. This has narrowed where firms are able to look for candidates. Those that are suitable will often come from similar professional backgrounds, such as other more junior regulatory positions.

STEPS TO TAKE

So what steps can businesses take to fight groupthink? Luckily for an industry that revolves around numbers and analysis, data is a great starting point. Finding out the levels of representation within your organisation, as well as in your interview processes, can reveal where the gaps are and why they are not being filled. If certain groups are failing to make it past certain interview stages, or beyond certain levels in the organisation, development opportunities can be put in place to correct this. Helping colleagues identify unconscious biases through training can often see a boost in representation throughout an organisation. However, an open approach is required. If boards are transparent with data and commit to diversity objectives, they are more likely to see improvements.

"They bring fresh thinking and challenge certain approaches you are taking"

Another good option, particularly for larger organisations, is to put in place employee network groups. Many organisations have these to help minorities identify and support each other, but they are also a great opportunity to involve more diverse thought processes in business decisions. "Engage them with your strategy. Our benchmarking shows that employees who do that have a greater uplift in representation of ethnic minorities throughout the workplace and in management positions. These groups add a different perspective to your strategy. You can tap into their additional insight into changing demographics," says Kerr.

Another alternative is to form a shadow board, made up of a diverse selection of members of your organisation, reflective of your customer base. "They challenge certain approaches you are taking. They can also help future-proof the business, looking at products and services to ensure they are fit for the future and that they will land well with different demographics."

THE DANGERS OF GROUPTHINK

In a 1972 study, social psychologist Irving Janis identified eight symptoms of groupthink. They are:

- **Illusion of invulnerability**
  Creates excessive optimism that encourages taking extreme risks.
- **Collective rationalisation**
  Members discount warnings and do not reconsider their assumptions.
- **Belief in inherent morality**
  Members believe in the rightness of their cause and therefore ignore the ethical or moral consequences of their decisions.
- **Stereotyped views of out-groups**
  Negative views of the 'enemy' make effective responses to conflict seem unnecessary.
- **Direct pressure on dissenters**
  Members are under pressure not to express arguments against any of the group's views.
- **Self-censorship**
  Doubts and deviations from the perceived group consensus are not expressed.
- **Illusion of unanimity**
  The majority view and judgments are assumed to be unanimous.
- **Self-appointed 'mindguards'**
  Members protect the group and the leader from information that is problematic or contradictory to the group's cohesiveness, view, and/or decisions.

Companies can go further still, opening up business issues to colleagues across the organisation, from CEO to graduates.

Staff that are lower down the organisation may not be as blinkered as those in leadership, says Cowan. "They might not be as constrained. At the top end of organisations, other considerations can get in the way of good ideas. Avoid hierarchical structures in favour of a flatter approach, that will help avoid groupthink. When your organisation is a hierarchy, all you're doing is creating a culture where people won't challenge the status quo."

IN 2015, IFP FELLOWS CONDUCTED RESEARCH INTO ASSUMPTIONS MADE WHEN FINANCIAL PLANNING FOR CLIENTS, WITH A VIEW TO HELPING PLANNERS IDENTIFY VARIABLES AND REFINE CALCULATIONS. ROBERT LOCKIE CFP™ CHARTERED FCSI GIVES SOME EDITED HIGHLIGHTS OF THIS RESEARCH

ROBERT LOCKIE CFP™ CHARTERED FCSI

IFP Fellows' briefing paper: Assumptions

Read the full paper at cisi.org/assumptions

However diligently and effectively the financial planner has gathered the necessary data about their client's circumstances, attitudes, expectations and objectives, it is inevitable that some things will be unknown. Some of these will be, as Donald Rumsfeld memorably put it, "unknown unknowns", while others will be "known unknowns". While it is possible to model the former armed only with enough imagination, the latter comprises those items that may be highly influential to the success or otherwise of the plan but which are nevertheless difficult to predict accurately.

The CFP™ certification standards require candidates to make assumptions for price inflation, earnings inflation, investment returns as well as "any other relevant assumptions", some of the latter obviously dependent on the particular circumstances of the client but others will be universal. Importantly, the standards also require that any assumptions meet the test of being "reasoned and reasonable", and while the former is a matter of fact (they are reasoned or they are not), their reasonableness is usually determined by the quality of the candidate's reasoning behind each one.

The precise method used is less important than the robustness of the approach

While historical data can provide a useful foundation for deriving assumptions, it must be stressed that in financial planning, assumptions are used in a forward-looking sense and thus the maxim that "past performance is not necessarily a reliable guide to the future" is particularly relevant.

PRICE INFLATION

Retail Prices Index

Making an assessment of the likely direction of future inflation, such as by looking at the Retail Prices Index (RPI), is an endeavour to which economists in both the public and private sectors devote considerable effort and resources. The financial planner can make use of the collective knowledge (and guesswork) of these experts and, by the application of some simple financial mathematics to freely available market data, avoid the need to become an expert at inflation forecasting themselves.

Consumer Prices Index

Although the Consumer Prices Index (CPI) has been used for macroeconomic purposes to provide a comparable measure of inflation across EU member states since 1996, until recent years it has been of limited relevance to financial planners as it excludes mortgage interest payments and other housing-related costs, such as council tax.

CPI-linked gilts do not exist as at August 2016 (despite consultations on the subject, the Treasury has proved reticent to issue them due to the anticipated impact on both the existing RPI-linked gilt market and the calculated liabilities of pension funds), although CPI-linked bonds have been available from other issuers since May 2015. One option would be to deduct the difference in Bank of England (BoE) Monetary Policy Committee (MPC) targets (ie, currently 0.5%, being 2.5% for RPI less 2% for CPI) from the assumed RPI rate until such time as a superior method becomes evident; thus if the RPI rate assumption were 3%, the CPI rate assumption would also be 0.5% lower, ie, 2.5%.

Expenditure

One of the lesser known issues with the RPI is that in order to avoid skewing the data with statistically insignificant 'outliers', the buying patterns of certain groups of consumers are excluded from its calculation.

These outliers comprise what are defined as very high and low-earning households (the top 4% of households by income and pensioner households where 75% of their income is derived from state pensions and benefits).

RELATIONSHIPS OF OTHER VARIABLES TO INFLATION

It is generally the case with numeric assumptions that the relationship between them matters more than the absolute values of the numbers. However, when applying inflation to a nominal measure, the geometric rather than the arithmetic method is preferable, as it recognises that the change in spending power of an investment (for example) that returns 15% per annum when inflation is 10% is not the same as that of an investment returning 7% when inflation is 2%, even though the arithmetic difference between the investment return and inflation rate is the same (5%) in both instances.

The geometric method is a little more complicated but more accurate, particularly when rolling the assumptions forward over long periods, as is the case with financial planning. This method uses the formula:

$$\left[\frac{(1+\text{nominal return})}{(1+\text{inflation})}\right]-1$$

Thus, using the same figures as above:

$$\left[\frac{(1+0.05)}{(1+0.02)}\right]-1 = 0.0294\text{, ie } 2.94\%$$

While the difference of 0.06% is not huge over a single year, when compounded over several decades, and particularly if the absolute numbers are larger (even if the arithmetic difference remains the same), the effect can be material. For example, the purchasing power of an asset worth £100 that increases at 5% when inflation is 2% over 30 years rises to £243 using the arithmetic method and £239 using geometric (a difference of 2%). However, at rates of 15% and 12% respectively, the arithmetic method still gives £243 but the geometric now gives £221, a difference of 10%.

EARNINGS INFLATION

Average earnings data is collected by the Office of National Statistics (ONS) and the historic series goes back to 1963 in the form of the National Average Earnings Index (NAEI), although the current measure (since 2010) is Average Weekly Earnings. This reveals that, on average, earnings have generally, although not always, increased at a faster rate than prices. However, this masks a number of issues which are relevant to a financial planner, as the point of making an assumption for earnings increases in a plan is to formulate an idea of how the client's own future may look.

The wider picture of the experience of the working population as a whole will not affect the ability of the client to achieve their goals (beyond the extent to which it is reflected in the price of the goods and services on which they spend their resources) but the rate at which their own earnings increase will.

For example, a recently qualified professional in a City firm may reasonably expect to receive double-digit increases in their compensation over the next few years, whereas someone in their sixties in a relatively unskilled job (or, in periods of financial constraint, many of those in the public sector) may be lucky to achieve pay increases which match price inflation.

LIFE EXPECTANCY

According to the ONS, a 65-year-old male currently has a one in three chance of living until age 90 and, on average, a man and woman aged 65 can expect to live another 21.2 years (to 86) and 23.9 years (to 88) respectively. This is projected to increase for men and women respectively to 27 (to 92) and 29.5 (to 94) years by 2062. However, these are averages. For the healthiest element of the population the increase is projected to be 35.7 for men and 37.9 for women, ie, well in excess of 100. Financial planners might usefully wish to consider the likelihood of their clients falling within the healthiest cohort, as an extra eight years of drawing on a portfolio (particularly when this may be while funding care costs and therefore potentially at a higher level than normal expenditure) could have a significant effect on its sustainability.

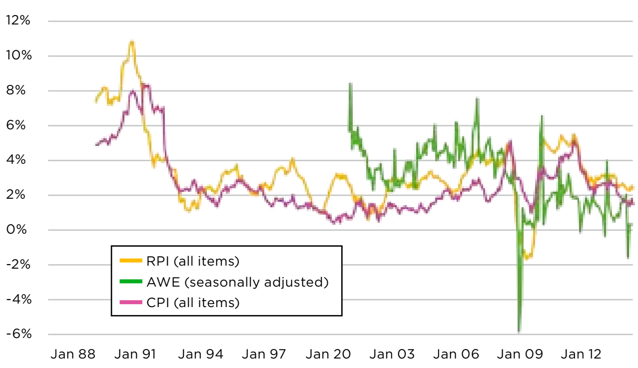
While some planners run life expectancy to around 100, others go even longer, to 120 in at least one instance. However, while this might seem to be a cautious assumption (only one person has ever apparently reached age 120), the outcome could be the opposite if the cost of making their capital last for several additional decades implies that they would need to take significantly more risk than they wish and/or scale back their goals in order not to run out of resources in what might still be a fairly unlikely scenario. It is also worth noting that the assumptions made about life expectancy can have a material impact on the outcome of the planning process.

INVESTMENT RETURNS

At its simplest, the investment universe can be split into debt (lending) and equity (owning). Based on Modigliani's research (and logic), it is reasonable to assume that the latter (which is riskier) should have a higher expected return than the former, as no rational investor would opt to own a risky asset if it were expected to deliver the same return as a safe one.

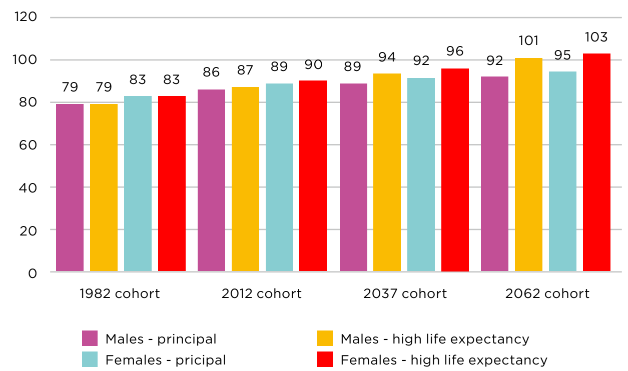
From there the choices increase. Some favour a geographically-based approach to dividing the investable universe, some a thematic one, some – including, apparently, successive UK financial services regulators – a tax one (pension funds and ISAs having higher assumed returns than taxable accounts) and others a framework derived from the multi-factor model research propounded by, among others, Fama and French.

FIG 1. ANNUAL RATES OF INFLATION



Source: Bank of England

FIG 2. LIFE EXPECTANCY



Source: ONS

One way of translating these into a coherent structure is to start with the assumed inflation rate and add various risk premia to this according to the asset classes being employed. For example, by adding a premium for the 'risk-free asset' to this, a starting point for the basic low-risk asset (whether cash or short-dated high-quality government debt) is obtained. Further risk premia are then added to this assumed risk-free rate for each of the preferred asset classes, whether they be developed market equities, emerging market debt, US equities, technology companies or real estate funds.

Such an approach brings the advantage of relating the return assumptions for each asset class to both the inflation and risk-free rate assumptions, whereas calculating each assumption individually can lead to some anomalous relationships if some are revised in isolation. It is also easy for the client to understand the changed return assumption if the basic inflation assumption is revised in the future. Figure 3 below illustrates the concept.

The precise method used is less important than the robustness of the approach and the extent to which there is validated academic research to provide some support in the event that the selected methodology is ever challenged (whether by a client or a judge).

PROPERTY AND OTHER ILLIQUID ASSETS

Most investors probably have a strong view that property is an asset class that has delivered high and fairly stable returns over the long term; in short, an ideal investment. However, it is important to distinguish for financial planning purposes between several types of property: notably the family home, rental residential property and commercial property.

In many cases, if the client already occupies their 'forever' home, the future return on the family home will be of no relevance to the financial plan beyond the contribution it makes to the estate value on death. However, if there is an expectation to trade up or down at some point in the future, the future value of both the current and future home will have an impact on the plan, as there will be either an increase or a decrease in the value of other assets at the point when the transaction occurs.

While historical price data is available from sources such as Halifax, Nationwide and the Land Registry, this only goes back to 1983, 1973 and 1995 respectively. The ONS has a series going back to 1930 but this reveals that despite an apparently impressive increase of 42,400% between 1930 and 2015, prices really only took off in the 1970s – in the 40 years from 1930 to 1970 they rose by a comparatively small 743%. When inflation is taken into account, the total return in terms of purchasing power increase falls to an annualised 2.7% over the whole period, which is only slightly higher than the 2.3% real return between 1930 and 1970. The full series is shown on the (log-normal scaled) Figure 4 below, with inflation data from Barclays Capital.

THE RISKS OF CONSERVATISM

It is often tempting, when constructing a financial plan, to opt for a relatively high rate for those variables that impact unfavourably on the plan (such as inflation and, somewhat counter-intuitively, life expectancy) and to take the opposite approach with the factors which have a positive impact (investment returns). While this is superficially attractive as a 'worst case', there is no free lunch in financial planning and there will inevitably be an impact of such decisions elsewhere in the plan.

SPURIOUS PRECISION AND CALCULATION OVERCONFIDENCE

The increasing availability of technology has allowed financial planners to carry out cashflow modelling in ways of which practitioners in the past could only dream, and spreadsheets are able to produce calculation outputs to a high degree of precision. However, a spreadsheet has no idea what the symbols it processes mean; if it is asked to deliver outputs to a dozen decimal places, it will do so with no awareness of the value of that to the end user of those outputs.

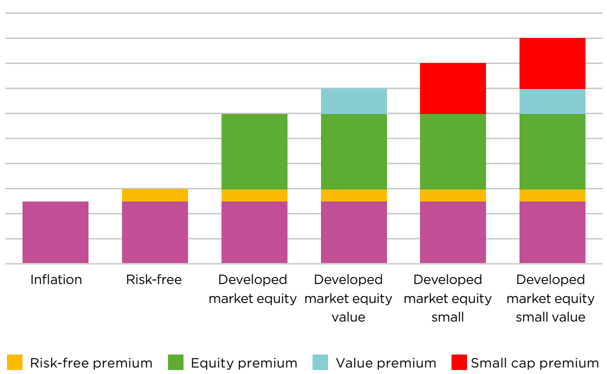
Given the inevitable errors in almost all the assumptions made, any more than one or two decimal places is therefore unlikely to confer materially greater validity on the results of a calculation, although where the decimal places are in a rate used to escalate or discount another variable over a long period, they can have a significant impact on the magnitude of such results.

IN CONCLUSION

This article highlights the three most significant assumptions that may be of interest to those conducting the financial planning case study component of the Diploma in Financial Planning (level 6) – the route to become a CERTIFIED FINANCIAL PLANNER™ professional.

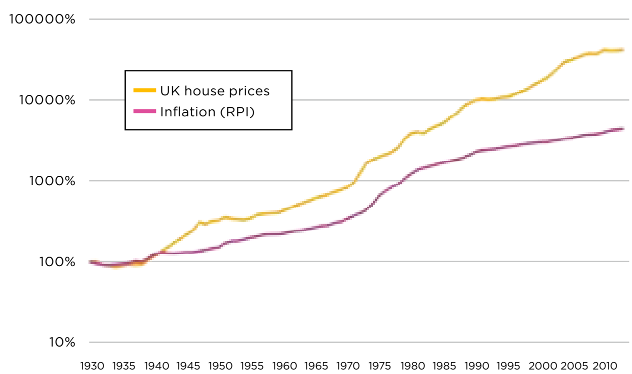
Please see *The Review* online at *cisi.org/assumptions* for the full paper that discusses these and many other assumptions.

FIG 3. INVESTMENT RETURN ASSUMPTIONS



Source: ONS

FIG 4. HISTORICAL UK HOUSE PRICES AND INFLATION



Source: ONS/Barclays Capital

CHANGE: REGULATORY UPDATE

It is now two months since the EU referendum with its changes to our lives and to financial regulation. We are also two months from the US presidential election, which may do the same or even more. So compliance has to operate on different levels – continuing with business as usual while planning for the worst – and hoping for the best.

This edition describes some key developments in financial regulation which senior managers should know. These include both big projects, such as the revised Markets in Financial Instruments Directive (MiFID II) and the Senior Managers Regime, and the less well-known FCA and Prudential Regulation Authority (PRA) initiatives which may well affect you, such as the asset management review and how the supervisors look at the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA).

Christopher M. Bond

Christopher Bond, Chartered MCSI, *Change* Editor

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

Top regulatory developments

1. Planning for Brexit

Much has been said about the possible impact of access to EU customers and counterparties by UK firms in different sectors. The three main scenarios are (a) continuity of full reciprocal access by agreement – currently thought unlikely; (b) more limited access based on the Swiss model, varying between individual financial sectors; and (c) basic World Trade Organization non-discriminatory access – which is more weighted towards goods than services (under which the UK would be a third country under EU rules for equivalence purposes). There are other ideas too, such as an alliance with Switzerland – and possibly some Nordic and Eastern European countries – on joint negotiations with the EU on financial services.

Since negotiations with either the Commission or EU governments are unlikely to start until 2017, little reliable information on these models will be available until then. There is also the uncertainty of whether existing and new EU nationals can work in the UK (one estimate is that they make up 11% of the estimated 360,000 City workers) – quite apart from the psychological message that they are not welcome. So all firms need to develop contingency plans for the worst case – while hoping for the best.

The danger is that these plans will develop momentum in an information vacuum, and that new activities will be set up in the EU or – worse for London – that existing activities and staff will be transferred to show that a new EU base is real and not artificial. The only certainty is that the UK will not leave the EU before 2019.

The FCA has told firms that it is business as usual, including preparing for the start of MiFID II in January 2018, but it has asked many firms individually what their Brexit preparation plans are, and whether they will relocate some or all of their business to the EU. Firms will be affected differently under each of these three scenarios depending on their sector, products, group structure and customers. See box over page.

Some firms with EU customers already have companies elsewhere in the EU (eg, asset managers in Luxembourg or Ireland), and others plan to establish them to serve EU customers. Smaller firms may stop doing EU business, eg, advising EU expats.

More widely, the financial services trade bodies, TheCityUK, the European Financial Services Chairman's Advisory Committee and the Financial Services Negotiation Forum have all set up working groups to consider specific Brexit issues, and to pass these to the Treasury which is centering the financial services Brexit position for EU negotiations.

Firms have the opportunity to make their individual concerns known to the Treasury directly or through these groups. These concerns include plans for the transition between the current and future regime, since the two years exit notice under Article 50 may be too short in practice.

Much of the Brexit impact is clear, but some points are less obvious, such as:

- the need for new access and data protection agreements with non-EU countries, since the EU ones will no longer apply (the US has already warned on this)
- access to EU payment and clearing systems and to markets
- there may be perception from customers that UK firms are at a disadvantage to EU-based competitors for EU investments
- the possible hostile attitude of individual EU countries (for example in grey regulatory areas, such as firms doing business with professional counterparties without a formal passport)
- the impact on UK bank ring-fencing of the disapplication of EEA deposits in bank capital
- the extra regulatory capital needed by UK branches of EU banks (one estimate is €40bn)
- possibly paying for visas for EU staff, not being part of the Capital Markets Union (see the Commission's July statement on progress on this)
- the difficulties in influencing the making or reviewing of new EU laws appropriate for wholesale markets and non-bank distribution
- lack of access to important market, transaction, price and credit data
- future policy decisions by the ECB on banks as the eurozone integrates
- possible relaxation of UK supervision to make the UK more attractive.

2. What are the regulators' views of conduct risk?

The PRA and the FCA joined relevant firms (mainly banks) in making intensive preparations for the start of the Senior Managers and Certification Regime (SMCR) in March this year. Apart from firms developing the practical aspects, such as in handover certificates and changing hiring procedures, there are important questions on how the regulators will monitor firms' progress and how the SMCR relates to conduct risk.

The starting point in answering these two questions is the priority given to the conduct of firms and individuals. The Chairman of the FCA (John Griffith-Jones) believes that conduct will be very important. He believes that conduct in the wholesale markets cannot be kept separate from that in the retail markets, and that the SMCR and conduct risk initiatives have not yet affected the public's view that nothing much has changed in the world of finance (an example is the book *Swimming with sharks: my journey into the world of the bankers* by Joris Luyendijk). Therefore, changing culture is a key priority.

However, supervisors' approach appears to have changed. For bankers the conduct principles under the SMCR overlap with and largely crystallise the regulators' expectations of firms and individuals – removing the focus on a separate conduct risk policy and programme. For non-banks, particularly both sell-side and buy-side wholesale firms, conduct risk remains important until the SMCR starts to apply to them – planned for 2018. But there is a subtle shift here – many regulatory staff have been trained in the application of the SMCR – and will see conduct risk from that viewpoint. The concept of a corporate responsibilities map and of individual role descriptions under it will be at the back of supervisors' minds when considering how firms answer previous Acting CEO of the FCA Tracey McDermott's five questions.[1]

These answers apply equally to retail advisors. The FCA's head of retail (Jonathan Davidson) recently said that the SMCR was an important part of how the FCA influences good culture. (He also said that while proportionality to the size of the firm is key, the FCA will expect all firms to demonstrate clarity, accountability and transparency of senior managers: "Our expectations around conduct, whether the firm is large or small, remain high").[2] Firms should note this and consider how they will introduce the SMCR.

The next milestone (October) for implementing the SMCR is the first annual date for notifying the regulators of individuals' breaches. Firms' policies may vary widely between listing everything to only larger ones.

3. The MiFID II and PRIIPS challenge for providers and advisers

One important part of MiFID II requires product providers both to design their products for a particular segment of the retail market, eg, age or region or income, and to check that the distributors have achieved this. Distributors must provide information to providers for them to do so. The practical problem is that distributors may not have the relevant information, particularly execution-only platforms. After lengthy negotiations, the amount of data requested by providers has been heavily reduced. Distributors are also reluctant to provide the information in case providers who sell direct misuse the data, so a neutral third party is needed.

The related packaged retail investment and insurance-based investment products (PRIIPs) regulation causes particular concern to both providers and distributors. The European Parliament has stopped the implementation of PRIIPS (and the Key Information Document (KID) under it which tells investors about products in a consistent manner) on its planned start date in 2017. There will now be further negotiations with the industry.

More generally on firms' preparations for MiFID II, the FCA has encouraged firms to continue despite the referendum, and it continues to be active on MiFID II in Europe (particularly on the conduct of business rules). Firms hoped to have more time to prepare for the start of MiFID II after its postponement until January 2018. Sadly, the European Securities and Markets Authority (ESMA) has made limited progress in finalising the difficult outstanding detailed rules, such as on bond pre-trade price transparency and product costs and charges disclosures, so firms will only have a short time to prepare for these new rules, assuming a 2018 start date. The FCA has equally seen its hopes for making its final rules and guidance based upon ESMA's standards and guidance delayed for these and other reasons.

1. https://www.fca.org.uk/news/wholesale-conduct-risk
2. https://www.fca.org.uk/news/getting-culture-and-conduct-right-the-role-of-the-regulator

However, firms need to plan for the big changes to markets, dealing and asset management under it on the basis of the existing MiFID II Directive and regulation and ESMA standards and guidelines.

4. What should the FCA do about fund 'gates'?

The recent series of property funds imposing 'gates' on investors from selling, highlights the liquidity weakness of some retail fund products in the length of time it takes to sell the underlying assets. Commentators have urged a variety of approaches – from ensuring that such funds operate in a way that is transparent to investors (and their advisers) on purchase and is fair to both redeeming and continuing investors (where early sellers may receive more than remaining ones), to restricting their sale to retail customers altogether as too risky, and even to fund managers having a duty to inject liquidity into the funds. Andrew Bailey, Chief Executive of the FCA, said: "The FCA will continue to liaise with the funds as they keep the situation under review."[3]

Property funds are only one example of retail funds that buy potentially illiquid assets but offer daily sales opportunities – exchange-traded funds (ETFs) being the prime example, particularly bond ones. If there is a mass exit from fixed income investments for any reason, liquidity could quickly disappear – with the same problems as for property funds – but on a much larger scale.

The regulators have not extended their review to bond ETFs, but may do so as a systemic risk. (This places the government in an awkward position in selling its gilts.) Multi asset products are another example – indirectly through their investments in gated property funds.

5. Competition and the asset management Industry

We now have a clearer picture of the regulators' use of their recently acquired competition powers in financial services. The FCA's head of competition (Mary Starks) made the important point that the FCA will now add a markets based view to its supervision of individual firms, which brings in both consumers' and innovative entrants' perspectives. She appreciates that introducing more competition into markets or sectors will disadvantage some existing firms – possibly leading to them to leave – reducing competition.

Another challenge is to ensure that the distribution of benefits of competition are fair and reach the targets for which they are intended. Note also the Competition and Market Authority's apparently tougher line on mergers, including in financial services.

A good example of the FCA's approach can be seen in the current competition study in the asset management sector, specifically on how fund providers deliver value and how willing they are to control costs along the value chain – given its many intermediaries who together receive 2.56% of portfolio value annually, according to a recent study by Grant Thornton. To start with, the FCA has sent firms wide data requests, described by one adviser as "onerous. It is a large amount of data in a short period of time. It is ambitious for firms to provide it in this amount of time and for the FCA to absorb it." (In fact the FCA has recently said that due to the volume of data, it will delay its preliminary report from this year until 2017.)

6. The regulators focus on firms' liquidity

In the past the focus was on firms' capital adequacy. The 2008 crisis exposed the weakness of the Basel requirements for banks' liquidity. That was addressed by Basel III and the EU Capital Requirements Directive and the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements, as well as strengthened capital adequacy rules. What is new is the UK regulators' focus on non-banks' liquidity, including in stress scenarios. This is in part driven by the EU adopting a new framework for regulators' supervisory regulatory evaluation process. The FCA has indicated that it will apply the new procedure beyond banks to Capital Requirements Directive IV (CRD IV) market makers, broker/dealers, investment managers, and to non-CRD advisers, arrangers and commodities brokers. This has already resulted in increasing the FCA prudential category of some firms.

Some investment management firms have already experienced the FCA's more active calling in for review of their ICAAP and ILAA documents, with capital add-ons under Pillar 2 – in some cases reported to be twice their current capital. The better news is that insurance and diversification can be used in part in place of capital to meet the requirements – otherwise it is retention of profits and cutting dividends.

Firms should be prepared to answer questions on their ICAAP and ILAA, and perhaps to increase their capital.

7. Have you reviewed your whistleblowing procedures?

From September 2016, new rules will apply to banks and PRA-designated investment firms on whistleblowing procedures. Those firms have already appointed a whistleblowing champion under the SMCR, who will be responsible for overseeing the steps the firm takes to prepare for the new regime. See box for more information.

1. Appoint a senior manager as the whistleblowers' champion.
2. Put in place internal whistleblowing arrangements able to handle all types of disclosure from all types of person.
3. Put text in settlement agreements explaining that employees have a legal right to blow the whistle.
4. Tell UK-based employees about the FCA and PRA whistleblowing services.
5. Present a report on whistleblowing to the firm's board at least annually.
6. Inform the FCA if the firm loses an employment tribunal with a whistleblower.
7. Require the firm's appointed representatives and tied agents to tell their UK-based employees about the FCA whistleblowing service.

Once the new rules have been in effect long enough to assess their effectiveness, the FCA will consider whether to apply similar requirements more widely, such as to stockbrokers, mortgage brokers, insurance brokers, investment firms and consumer credit firms. In the meantime it is likely that the FCA will consider it good practice for these other firms to review their current procedures against the new requirements. The CISI has given interactive training sessions to the staff of many firms on 'Speak up' as part of their preparations.

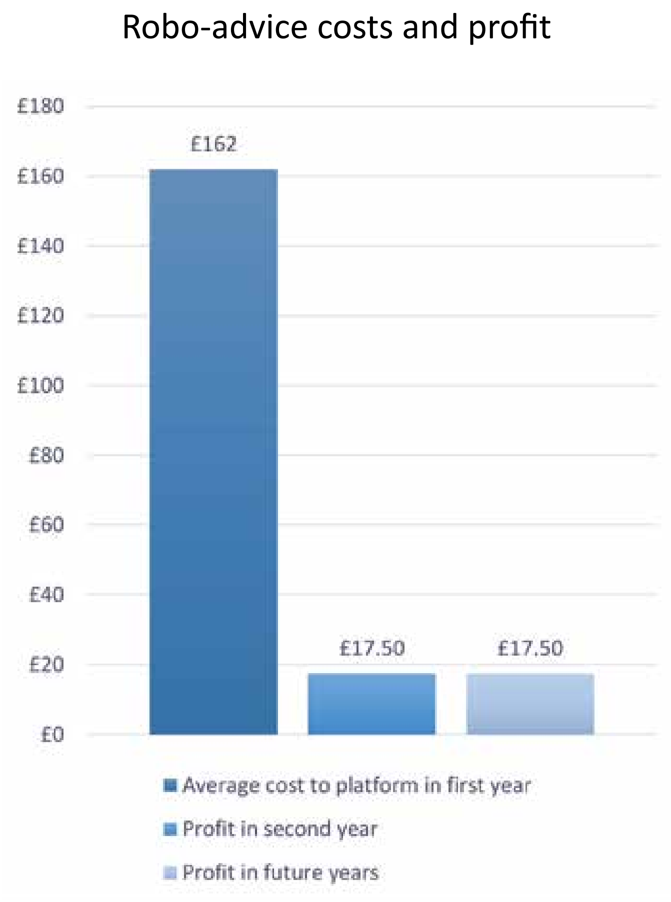
3. https://www.fca.org.uk/news/fca-issues-guidance-following-property-fund-suspensions

The FCA itself has been taken to task by the Complaints Commissioner for its internal procedures in dealing with whistleblowers to it, particularly in its categorisation of them as 'non-routine' when they apply for an Approved Person role at another firm. The FCA has reviewed these procedures, and has published an explanation of them ('How we handle disclosures from whistleblowers', [4] which describes the work of the specialist unit set up to respond to these). The regulator has also been questioned on its use of information from a small business lobby group which it did not treat as a whistleblower because the whistleblowers had already disclosed their identities to their employers – so confidentiality did not apply.

8. What are the latest enforcement trends?

Here are some headline developments:

- The FCA's detailed description of its expectations on compliance officers to prevent misleading promotions, and to stop the marketing of products that fail to reach their target audience (Peter Francis Johnson of Keydata).
- The FCA's expectation that an alternative investment market nominated adviser (AIM Nomad) or main market sponsor should challenge statements and forecasts made by issuers in public documents (Quindell/Cenkos).
- The substantial payment made by State Street in the US for adding mark-ups to charges to pension funds for dealing in foreign currencies without disclosure.
- The criticism by some MPs of the FSA and the FCA in their handling of their HBOS investigations, leading to calls for the enforcement division to become independent from the FCA's other divisions (as the Crown Prosecution Service is from the Police) because of perceived conflicts of interest.
- The Inquiry by the Treasury Select Committee into whether the PRA should publish "information … consists both of material that banks provide to supervisors … and of instructions, directions and advice that supervisors issue to individual banks … Shareholders, holders of debt securities and depositors do not have access". Under current law the regulators cannot publish confidential information from or about firms except under limited gateways. However, some commentators argue that it could publish information in summary form without a law change.
- The strong recommendation by the Complaints Commissioner, Andrew Townsend: "While the FCA continues to deal with the majority of complaints competently and fairly, I have seen examples of an unwillingness to face up to and to admit shortcomings, and delays in awkward cases." The number of formal complaints has increased recently.
- The latest survey of leaks before UK public takeovers were announced shows that the share price rose unusually in 13 or 20% of the events. This is below the 2009 figure but more than in 2014.
- More problems for the FCA in identifying individuals by implication in final disciplinary notices issued to others without giving them the chance to comment first (Julien Grout). Another such case is going to the Supreme Court (Macris).
- An individual fined £110,000 for presenting a false Statement of Professionalism under the RDR.



9. In brief

- The regulators' policy of relating employee bonuses to performance has finally gained some traction with firms, not only with salary increases and lower bonuses, but also with some firms dropping bonuses altogether in favour of larger salaries and stock options.
- The lengthening time for the FCA to process new firm authorisations. Now six (retail applications) to 18 months (more complex ones), and forecast to take longer. However, the time taken for variations of permission for existing firms has marginally improved from 19 to 15 weeks, except for complex ones which have increased from 38 to 44 weeks – compliance departments please note.
- The encouragement of robo-advice by the FCA's launch of a separate unit (Advice Unit) to help firms which deliver fully or partly automated advice at lower cost to "unserved or underserved" retail customers. This covers both existing and new firms which need to apply to be selected for help (first quota full; watch out for future invitations). A report from IRN Consultants suggests that pure robo-advice firms may struggle economically – average cost to platform in first year £162 per customer, profit in second and future years £17.50. Others predict explosive growth of such services, like execution-only platforms.

Views expressed are those of the author and should not be interpreted as being those of the CISI or anyone else.

4. https://www.fca.org.uk/your-fca/documents/how-we-handle-disclosures-from-whistleblowers
5. http://fscc.gov.uk/wp-content/uploads/Annual_Report_2015-6.pdf

CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT
REVIEW OF FINANCIAL MARKETS
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THE AGE OF INFRASTRUCTURE

More money will be spent on infrastructure in the next 40 years than in the last 4,000. No surprise then that in the intensive business preparation meetings leading up to this year's G20 summit in China, infrastructure investment was one of the key issues under debate. The politics, the insults, the swaggering took the headlines at the event, but progress towards preparing and structuring complex infrastructure programmes, particularly public-private partnerships (PPPs) to help bring private sector and institutional capital to bear on key development opportunities in both mature economies and the rest of the world, was where the intellectual action was buzzing.

In this important field, worth some $60–70tn in new investments over the next 15 years, according to the most common range of estimates, financial practitioners are – for once – probably ahead of the thought curve. That is not least because, in a world of very low yields, infrastructure can provide refreshingly high returns to long-term investors, particularly for the pensions and insurance communities. So it is a subject of strong focus for the biggest investment firms, and many more are joining in.

In this special issue of *Review of Financial Markets* (*RoFM*), we bring together expertise from academia, finance, government and the professions to focus on three specific aspects of current thinking on infrastructure finance: the risks and benefits to investors in UK infrastructure, based on a recent seminar on this theme run by the CISI with the Association of Chartered Certified Accountants; the thorny issue of profit rates in sectors with substantial areas of non-competitive supply, in this case a particularly fascinating analysis prepared for us by Matthew Rees, Chartered FCSI, on how the UK government manages profit rates in what is globally one of the biggest examples of non-competitive infrastructure spend: defence; and finally and nearer to home, particularly for members working in the investment administration arena, a timely analysis from a recent study funded by the CISI and others on Britain's paperless settlement system, CREST, of how to build and run a major infrastructure project well. And looking to the future, we are delighted to be participating in a new research project on renewables financing – see page 52.

The returns on and types of infrastructure investment

Internal rate of return (IRR) and cash yields remain the key indicators external investors – broadly lumped together as limited partners (LPs) – look to when assessing the performance of infrastructure funds. The weighting given to these varies by type of investor, but typically pension funds focus more on cash yield to service long-date liabilities with a steady cash return, while insurance-based LPs put more emphasis on IRR, in large part for regulatory reporting reasons.

Deloitte conducted a survey of this market in spring 2016, and found that both target and actual IRRs in infrastructure are now running at 10–12%, down by around 2% since they last did this work in 2013. This fall has been driven by success – simply put there are more direct investors in the market, pushing yields down.

Infrastructure investment spans a vast range: developed and emerging markets; greenfield and brownfield; public and private assets; differing stages of development. And there are plays in airports, communications, hospitals, housing, power generation and transmission, ports, railways, roads, schools, water and waste – the list goes on.

Almost all the infrastructure investors interviewed for the Deloitte survey had a preference for core assets, with the three most critical factors sought being the provision of an essential service to society, high barriers to entry and asset-backing. Yield generation was seen as slightly less important. Deloitte reckons this might reflect a move away from a traditional infrastructure long-term buy and hold model towards a more quasi-private model, with a view to sale.

Types of infrastructure investors

Three types of investors participate in this market: large US and European funds; mid-market funds; and direct investors. The biggest players typically have global mandates for euro and US funds and will be looking for deals needing single investments of £500m-plus. The mid-range funds usually target specific asset classes or geographies, and look for £100–500m investments. The direct investors are big institutions – insurance, pension and sovereign wealth funds – looking to invest directly in assets rather than through LP funds. The focus amongst this latter category is usually more heavily on cash yield, so they are likely to be found invested in major core assets in the most developed markets.

Typical investment profiles

Infrastructure investment varies widely, but typical characteristics include:

- large initial outlay and/or major ongoing capex needs for long-duration investments
- predictable and stable long-term cash flows, which may be inflation-linked
- key role of regulatory regimes – see article on defence contracting
- returns often uncorrelated with short- and medium-term economic cycles – again, see defence spending

Infrastructure finance and the developing world

The World Bank has played a central role in infrastructure investment over the years to generate growth, competitiveness, job creation and help with poverty alleviation. In the Bank's experience, investment in high-quality, sustainable infrastructure can provide basic services to households; lead to productive gains for industry; provide market access for agriculture; enable sustainable urban development; open corridors of trade for poor and landlocked countries to the global economy; and help progress towards a more climate-smart world.

However, much remains to be done: "Despite robust growth over the last decade," the Bank said this summer, "many people in emerging markets and developing economies still do not have access to reliable and affordable infrastructure services. This lack comes at enormous economic and social cost. Over 1.3 billion people – almost 20% of the world's population – still have no access to electricity. About 768 million people worldwide lack access to clean water; 2.5 billion do not have adequate sanitation; and 2.8 billion still cook their food with solid fuels (such as wood)."

George Littlejohn MCSI, *RoFM* Editor and Senior Adviser to the CISI

george.littlejohn@cisi.org

INFRASTRUCTURE INVESTMENT: THE RISKS AND BENEFITS TO INVESTORS

Dougald Middleton, Head of Lead Advisory, corporate finance for EY UK & Ireland

dmiddleton@uk.ey.com

Simon Reason, Director of Corporate Finance for the National Audit Office

simon.reason@nao.gsi.gov.uk

Tony Roper, Director of global investment management firm InfraRed Capital Partners

tony.roper@ircp.com

INTRODUCTION

Significant private investment is required in order for the UK government to achieve its aims under the *National infrastructure delivery plan 2016–2021*.

In an event in June co-hosted by the CISI and the Association of Chartered Certified Accountants (ACCA), experts from the industry (listed above) addressed the investment opportunities and challenges that infrastructure presents.

In addition, Matthew Rees, Director of Analysis and Reporting for the Single Source Regulations Office, participated in a Q&A session.

PUBLIC SPENDING ON INFRASTRUCTURE

Challenges faced by the government

UK government spending on infrastructure has fallen from a high of 11.5% of GDP in the 1970s to 3.5% as a percentage of GDP today, a situation that is mirrored globally. The Organisation for Economic Co-operation and Development cites public deficits and increased public-debt-to-GDP ratios as factors that have led to the reduction of public spending on infrastructure worldwide.

Public sector net debt in the UK currently stands at £1.6tn, having risen from £500bn in January 2007. In light of this, the government does not wish to take on further debt and is instead relying on the private sector to help fund infrastructure projects.

Attracting private sector investment

Governments have increased efforts to attract private investment in infrastructure. Private finance initiatives (PFIs), introduced by the UK government in the 1990s, have resulted in private sector investment exceeding public sector investment since 1997.

Since the government is spending less on infrastructure, there is an expectation that the private sector will provide the shortfall. More than half of the funding for the infrastructure projects outlined in the *National infrastructure delivery plan 2016–2021* will need to come from the private sector. The plan outlines details for £483bn of investment in over 600 infrastructure projects and programmes in all sectors across the UK, to 2020–2021 and beyond.

Despite the creation of government financial institutions, such as the Green Investment Bank, further thinking is required around how private sector investment could be encouraged.

CRITICISM OF GOVERNMENT

Poor forecasting resulted in the government taking on a disproportionate amount of risk in the early stages of PFI. This was particularly evident with the Eurotunnel, where incorrect forecasting on passenger numbers resulted in the government having to spend additional money.

Since the government is reluctant to give grants or allocate additional funds to infrastructure, it has started issuing loans. Nevertheless, it is not clear whether it understands the real risk of issuing these loans. Some experts argue that there are many cases where the government is unlikely to get its money back, referencing green energy schemes in particular.

The government has also been criticised for adopting an overly short-term approach to selling off assets in an effort to 'balance the books'. The sale of Royal Mail is cited as a prime example.

THE INVESTOR PERSPECTIVE ON INFRASTRUCTURE

Infrastructure is attractive to institutional investors since it provides index-linked returns that do not correlate to volatility in the market. Yields typically exceed those of both 20-year gilts and FTSE 100 companies. Investors can expect a return of 4–7% from yielding infrastructure assets while those looking for capital gain from a 'greenfield' asset (an asset that is yet to be built) could expect a return of between 8% and 12%.

This greater rate of return is accompanied by a higher level of risk, such as demand and construction risk, however.

DIFFERENT TYPES OF INFRASTRUCTURE ASSETS

Infrastructure is a very broad category that includes different types of assets that have different risks and generate different types of revenue for investors. Infrastructure assets can be defined as 'availability' assets or 'demand-based' assets.

- **Availability assets**

  Availability assets, such as hospitals and roads, tend to be procured under public-private partnerships (PPP). Investors receive contracted payments for the availability, or use, of the asset and its maintenance. For example, NHS trusts will pay for the use of hospitals that have been built through private funding. Since contracts are linked to inflation, they are well matched to the long-term liabilities of insurers and pension funds.

- **Demand-based assets**

  Revenue generated by demand-based assets, such as toll roads, is dependent on how much those assets are used. As a result, demand-based assets provide a more volatile revenue stream for investors. For example, if road users are not taking a toll road then the investor will not receive any revenue.

Similar assets with different revenue characteristics

Different demand-based assets can have very different dynamics, which impacts on revenue characteristics. In the case of airports, for example, Stansted has one dominant tenant in Ryanair, while Heathrow is a hub for a variety of airlines. Meanwhile, Exeter International Airport has very little traffic and so would be seen as more of a real estate asset.

Predictability of both cost and revenue are prime considerations for equity investors

There are parallels between infrastructure and property investment. Some investors will take on construction and demand risk in pursuit of capital gain, while other investors will buy a property that already has existing tenants in order to collect the yield.

Likewise, when investing in greenfield projects, investors are potentially taking on construction and demand risk. Infrastructure fund managers will aim to reduce construction risk by using a fixed price contract. Therefore, any project that is delayed or goes over budget would be the contractor's risk rather than the investor's risk.

Illiquidity of infrastructure assets

With pension schemes increasingly moving from a defined benefit (DB) to a defined contribution (DC) model, there is an argument that they require a greater degree of liquidity than infrastructure assets can provide. Some fund managers have addressed this issue by giving investors a 'listed' wrap. Investors can then have a liquid exposure to infrastructure in the form of equities while also being able to take a more illiquid approach.

Many pension funds and insurance companies are investing in infrastructure assets directly, however, which shows their focus is on liability matching rather than liquidity.

Lack of assets to meet investor demand

There are only a finite number of greenfield projects in development and 'brownfield' (existing infrastructure assets) available. So it is a challenge for fund managers to find viable infrastructure assets to invest in.

Two options are available to them:

1. Take on assets that push investors further up the risk/reward profile.
2. Close the fund to new investors until suitable assets become available.

Some fund managers take the first option while others take the second. For example, some fund managers view motorway services as an infrastructure asset (due to the process for obtaining building consent and the fact that a finite number can be built) while others argue that they are a retail asset with an unpredictable revenue stream. The additional volatility produced by unpredictable revenue can result in investors selling out of a fund.

Investors can look further afield

Exposure to infrastructure can also be achieved through schemes in Europe, Australia, Canada and the US. These schemes offer a similar level of risk and return to UK infrastructure schemes, albeit with additional foreign exchange risk.

Mega projects

Mega projects are typically defined as those that exceed £1bn in terms of capital value, while those funded through public-private partnerships range between £200m and £400m in value. Major projects also tend to have extended delivery periods. For example, the Thames Tideway Tunnel project (a major sewer pipe that is being constructed mostly under the tidal section of the Thames) is forecast to take ten years to complete.

Complex construction and procurement process

Given their size, it is not surprising that mega projects come with particular complexities. In contrast with many PFI projects, such as the construction of hospitals and schools, contractors on mega projects can be unwilling to agree to a fixed price contract or a fixed price contract with a limited variation.

Furthermore the project owners, such as the government, often give a lot of consideration to matters such as design, procurement strategy and parliamentary consent but insufficient thought to how the mega project is going to be financed and delivered. Yet poor planning and poor financial structuring in the early stages are one of the main reasons why mega projects fail.

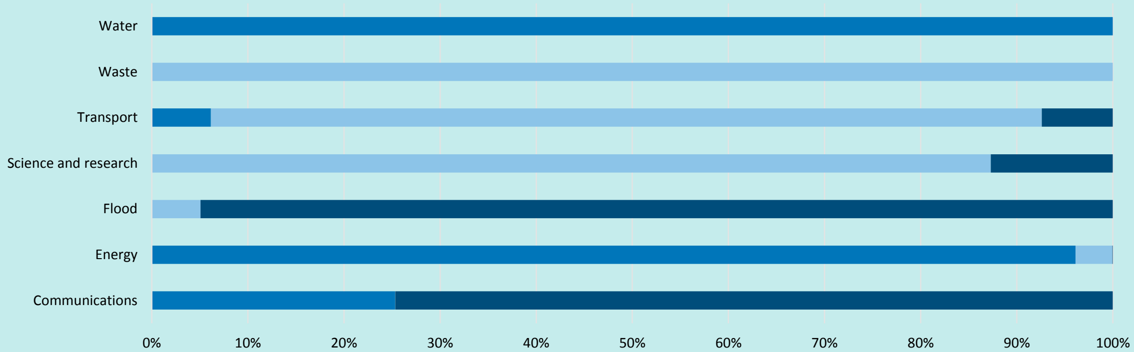
Many mega projects are overcomplicated and too prescriptive from the beginning. This is particularly the case with government promoted projects, where there can be too much of a focus on innovation. As a result, more standardised, existing engineering approaches are often overlooked. If the private sector wants to introduce an innovative solution at a later stage, however, that is more appropriate since the solution is the idea of the private sector and the private sector is taking on the risk of developing new engineering techniques.

Thames Tideway Tunnel: a financing challenge

Mega projects can struggle to secure funding from the private sector. In the case of the Thames Tideway Tunnel project, advisory firm EY had to substantially restructure the project in order for it to progress.

Initially the project was given a B sub-investment grade rating by Moody's rating agency – the bottom rating a project could have without actually being in default. The immediate goal was therefore to raise the project's rating to BBB or BBB+ in order to ensure the project was financeable. As an asset class, BBB infrastructure debt shares similar risk and reward characteristics with BBB corporate debt. This makes it a known investment risk for institutions such as insurers and pension funds.

Funding mix of UK national infrastructure pipeline



	Communications	Energy	Flood	Science and research	Transport	Waste	Water
Private	1,521	112,873			5,439		19,189
Public	2	4,504	136	4,762	76,425	484	
Public/Private	4,486	57	2,542	693	6,540		

Private Public Public/Private

Source: National Audit Office 2016 £m constant

Three achievements contributed to the Thames Tideway Tunnel gaining a BBB rating. First, construction risk was minimised because the contractors were incentivised through an alliance agreement to deliver the project on time and on budget. Second, the project made use of the maximum insurance that was available in the market. Finally, the government guaranteed financial and liquidity support in the event the project 'really went off the rails'.

During the project development, EY worked with the banks involved to carry out rating tests that monitored whether the desired rating was likely to be achieved. Rating tests are an important means of gaining the confidence of investors to ensure that a project is financed through to completion. As a result, it would make sense for rating tests to be built into the timelines of future initiatives of this scale so that they become a key part of the project development phase going forward.

Summary

While infrastructure investment delivers a degree of certainty to investors, particularly those that require inflation-linked returns and a steady revenue stream, different types of infrastructure assets have extremely varied risk profiles and revenue characteristics. Even those that, on the face of it, could be considered as similar assets can provide substantially different revenue streams.

Fund managers need to be aware that infrastructure investors require a degree of certainty so should resist taking on assets that are on the periphery of the asset class and that display a higher level of volatility. If investors are pushed higher up the risk/return spectrum than they are comfortable with, it can result in them selling their shares in the fund.

If the government wants to attract further private investment in infrastructure, it needs to find new ways to do this and also to simplify the procurement process for big projects.

Finally, sponsors of mega projects need to reassess the way in which they approach developments of this size to ensure they do not fail before they have even begun and that financing can be secured from the beginning of the project.

ACCA UK and the CISI would like to thank all those who spoke at the infrastructure investment seminar in April 2016 and who gave up their time to contribute to the development of this report.

PROFIT RATES IN BRITAIN'S £178 BILLION DEFENCE SECTOR

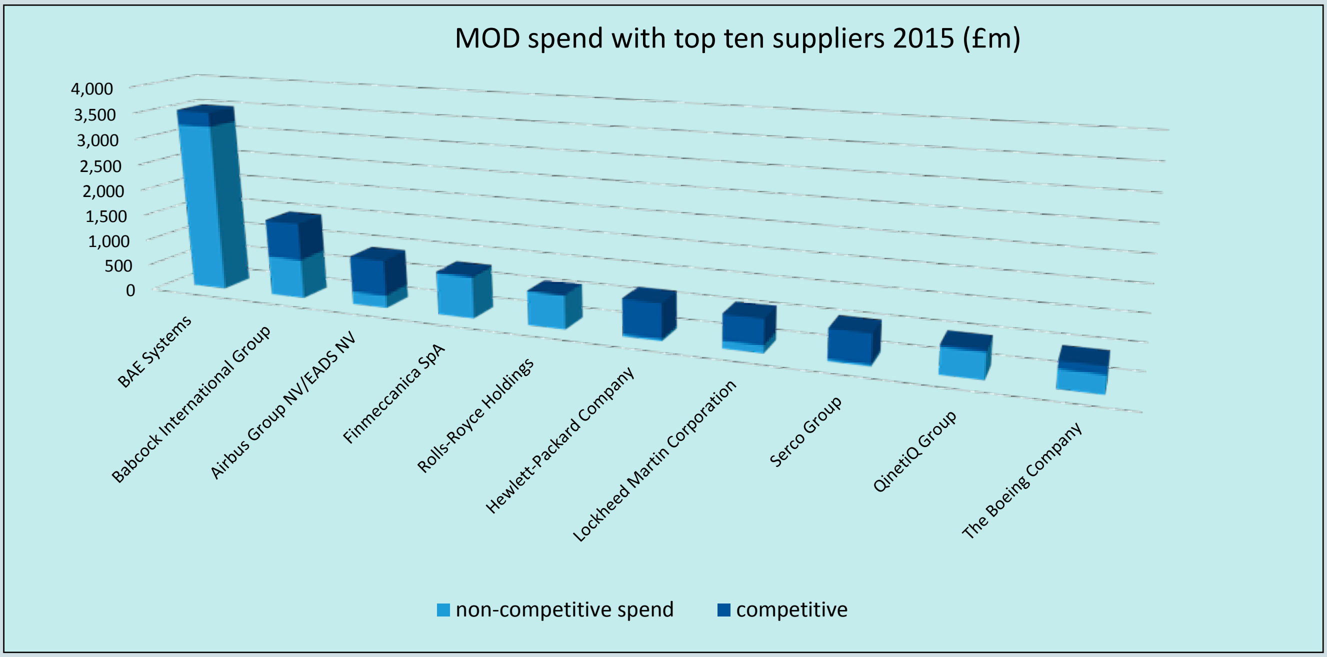
Matthew Rees, Chartered FCSI, Director of Analysis and Reporting, Single Source Regulations Office.

matthew.rees@ssro.gov.uk

In our second article on infrastructure finance, Matthew Rees, Chartered FCSI, of the Single Source Regulations Office (SSRO) provides an analysis of how profit rates are set in Britain's huge defence sector. The SSRO is responsible for recommending the profit rates applied to many of the contracts agreed between the UK Ministry of Defence and its suppliers. This is a difficult and sensitive area, where some supplies are made under competitive conditions, while others, because of the nature of the products – aircraft carriers and warplanes, for instance – have only one feasible supplier.

This analysis provides valuable insight for members in a number of areas:

- *corporate finance, analysing the financing transactions required to underpin many of these contracts, by their nature huge and long-term*
- *market professionals, to understand why these supplying companies tend to outperform their domestic markets*
- *risk managers, who may wish to understand how profit rates are set in the world of infrastructure spend*
- *wealth managers, who may face particular questioning from clients in relation to investments in this sector.*



Defence equipment budget and single source contracts

The UK government plans to spend £178bn on defence equipment over ten years,[1] and in July 2016 MPs voted to renew the UK's nuclear deterrent.[2] The Ministry of Defence (MOD) spent approximately £8.3bn on all its single source contracts in 2014/15, and in that period over half of new contracts signed, with a total value of £5.4bn, were placed on a single source basis.[3]

Single source contracts relate to the delivery and servicing of highly specialised defence capability for the UK's armed forces, mostly large-scale, technically complex, and involving a degree of commercial risk. Single source procurement is used for a variety of reasons:

- there is only a single contractor able to deliver the requirement
- there are strong reasons for maintaining national sovereign capability
- the required services have specialised or unique characteristics
- there are issues of national security.

The Defence Reform Act 2014 sets out the contract pricing formula that applies to single source contracts, and the concepts of Allowable Costs (AC) and the Contract Profit Rate (CPR) are explained in this article.

Pricing of single source contracts:

(CPR x AC) + AC

Where:

CPR = Contract Profit Rate

AC = Allowable Costs

The MOD's supplier base

The MOD spent £19.5bn with UK industry in 2013/14. The top ten suppliers represented 42% of total MOD procurement expenditure. BAE Systems is the largest supplier. In 2014/15 the MOD paid it £3.5bn.[4] The chart on the facing page (p.44) breaks down the MOD's spending between competitive and single-source contracts for the top ten suppliers.

Over the past ten years most of the MOD's main suppliers have outperformed the UK stock market (see chart below).

Defence Reform Act and the formation of the SSRO

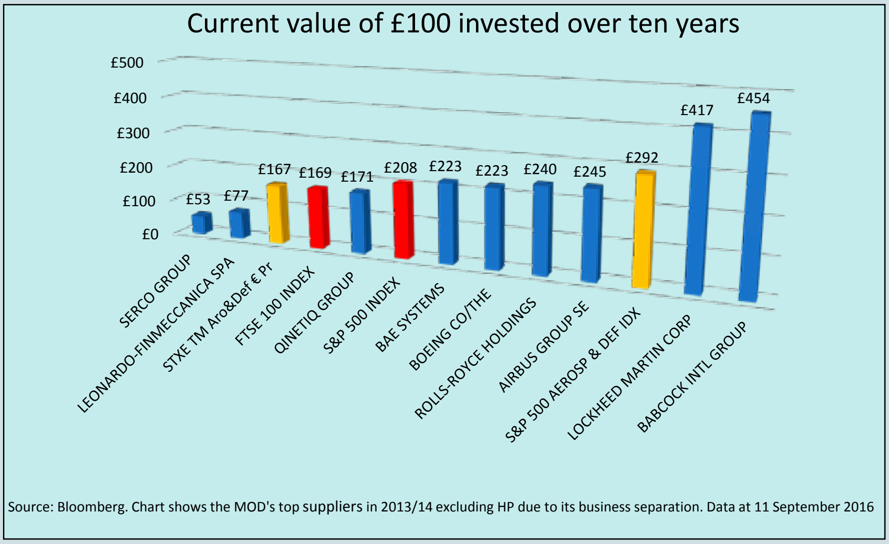
In 2011 an independent review by Lord Currie[5] recommended strengthening the arrangements for single source procurement. This led to the Defence Reform Act 2014 (the Act) which brought into force significant changes to the way the UK government procures defence equipment and services for its armed forces and established the Single Source Regulations Office (the SSRO), the independent statutory regulator of 'single source' defence procurement.

The Act specifies two aims for the SSRO: first to ensure that good value for money is obtained for the UK taxpayer in MOD expenditure on non-competitive 'qualifying defence contracts' (QDCs); and second to ensure that single source suppliers are paid a fair and reasonable price under QDCs.

The SSRO also provides opinions and legally binding determinations in response to referrals from the MOD, contractors and sub-contractors. In May 2016, the SSRO published the outcome of its first determination on two matters by Rolls-Royce regarding its contract with the MOD for the availability of Adour engines, which power Hawk jet aircraft.[6]

The SSRO's view is that all non-competed defence contracts should be subject to the single source procurement regime, to deliver the greater scrutiny, transparency and improved value for money that it offers. The Act exempts contracts which are government-to-government agreements, part of an international co-operation defence programme and related to land, buildings and intelligence activities.

In 2015, the SSRO identified over £58.8m of costs that have now been removed from contracts or are under investigation, from 20 of the 34 QDCs notified to it, compared to its annual running costs in 2015/16 of less than £5m. The MOD has estimated that savings of up to £200m a year could be achieved through the single source regulatory framework brought into effect by the Act. These substantial savings can be reinvested elsewhere in defence.



1. https://www.gov.uk/government/news/strategic-defence-and-security-review-178bn-of-equipment-spending
2. https://www.parliament.uk/business/news/2016/july/mps-debate-the-uks-nuclear-deterrent-18-july-2016/
3. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/534604/ARA_2015-16_28_June_2016_-_final_to_printer.pdf
4. https://www.gov.uk/government/statistics/mod-industry-trade-and-contracts-2015
5. https://www.gov.uk/government/news/review-into-single-source-military-equipment-contracts-published
6. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/523171/Determination_on_matters_relating_to_the_Adour_Availability_Contract_-_Final_redacted.pdf

Allowable Costs

The SSRO's Allowable Costs guidance[7] ensures the customer only pays costs that are in direct relation to the contract. Contractors and the MOD must have regard to this principle when entering into any contract where lack of competition could impact on the value for money to the UK taxpayer. The Act places the onus upon the primary contractor to demonstrate to the Secretary of State that costs are allowable. To be allowable, a cost must meet all three criteria of appropriate, attributable and reasonable. The following principles must be adhered to:

a. costs should be supported by adequate and sufficient evidence

b. costs should be assigned to contracts only once

c. actual costs are to be fully recorded and reflected in the books of account.

Examples of non-allowable costs:

- Faulty workmanship
- Contingency funding
- Sales and marketing costs
- Civil penalties and fines
- Entertainment
- Capital costs

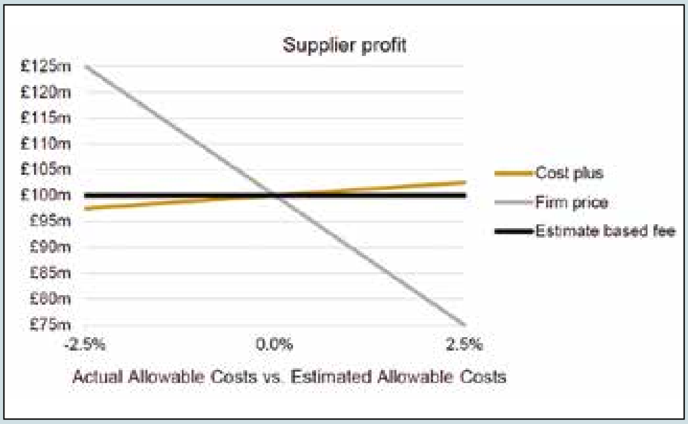
Examples of allowable costs:

- Rework
- Sunk costs
- Insurances
- Impairment of goodwill and amortisation
- Risk
- Employee benefits

Contract pricing methods and supplier profit

The Single Source Contract Regulations 2014 introduced six regulated pricing methods that single source suppliers are permitted to use when pricing contracts. A QDC can be priced using more than one method. The methods are set out in the table at the bottom of the page.

The chart below illustrates the impact of variation between estimated and actual contract price on supplier profit for three different contract pricing methods: cost plus, firm and estimate based fee pricing methods.



Method	Description
Firm	Allowable Costs are the costs estimated at the start of the contract. The profit earned by the supplier is calculated by applying the profit rate to the estimated costs agreed at the start of the contract.
Fixed	Allowable Costs are the costs estimated at the start of the contract, with an adjustment in accordance with a specified index (for example RPI) at a specified time or times. The profit earned by the supplier is calculated by applying the profit rate to the Allowable Costs at the end of the contract once the index change is known.
Cost plus	Allowable Costs are the actual costs incurred to deliver the requirement, established at the end of the contract. The profit earned by the supplier is calculated by applying the profit rate to the actual costs of completing the work.
Estimate-based fee	Allowable Costs are the actual costs incurred to deliver the requirement, established at the end of the contract. The profit earned by the supplier is calculated by applying the profit rate to the estimated costs agreed at the start of the contract.
Volume-driven	Allowable Costs are the cost per unit at the time of agreement, multiplied by the actual number of units produced by the end of the contract. The costs estimated at the time of agreement may be adjusted in accordance with a specified index (for example RPI) at a specified time or times. The profit earned by the supplier is calculated by applying the profit rate to the Allowable Costs incurred at the end of the contract, once the number of units produced is known.
Target	Target pricing sets an estimated target cost and target profit. The Allowable Costs are the target costs estimated at the start of the contract. The target profit earned by the supplier is calculated by applying the profit rate to the target costs. An agreed variation mechanism is used to adjust the price payable to the supplier, should the costs change from predetermined parameters. Cost savings or overruns against the target cost are shared between the contractor and MOD on a pre-agreed basis.

7. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/534520/Allowable_Costs_guidance_1_July_2016_-_Final_WEB1.pdf

Contract profit rate

The SSRO is required annually to review the figures used to determine the contract profit rate (CPR). Each January the SSRO provides the Secretary of State with its assessment of the appropriate baseline profit rate and capital servicing rates. The contract profit rate is derived from the six steps set out in Section 17(2) of the Act.

Step 1	baseline profit rate
	+
	-
Step 2	cost risk adjustment
	-
Step 3	profit on cost once
	-
Step 4	SSRO funding adjustment
	+
Step 5	incentive adjustment
	+
	-
Step 6	capital servicing adjustment
	contract profit rate

	Description
Step 1:	Baseline profit rate.
Step 2:	The cost risk adjustment reflects the risk of the primary contractor's actual allowable costs under the contract differing from its estimated allowable costs.
Step 3	Profit on cost once. This ensures that profit arises only once in relation to subcontracts within a contractor.
Step 4	The SSRO funding adjustment recovers 50% of the SSRO's costs from industry from 2017/18.
Step 5	Incentive adjustment where the Secretary of State determines that the amount should be increased so as to give the primary contractor a particular financial incentive.
Step 6	Capital servicing adjustment to add or subtract an agreed amount, to ensure that the primary contractor receives an appropriate and reasonable return on the fixed and working capital employed by the primary contractor for the purposes of enabling the primary contractor to perform the contract.

The SSRO has published guidance to explain the adjustments to the baseline profit rate explained in detail.[8]

In 2015 the SSRO reviewed the methodology[9] used to calculate the baseline profit rate to develop a more robust and transparent methodology than was previously used. This included a review of the previous methodology – the 'Yellow Book' regime – and was the most far-reaching since the 1960s. The review focused on the issues of comparability and how to benchmark profits on QDCs against profits achieved by more appropriate comparators from wider industry.

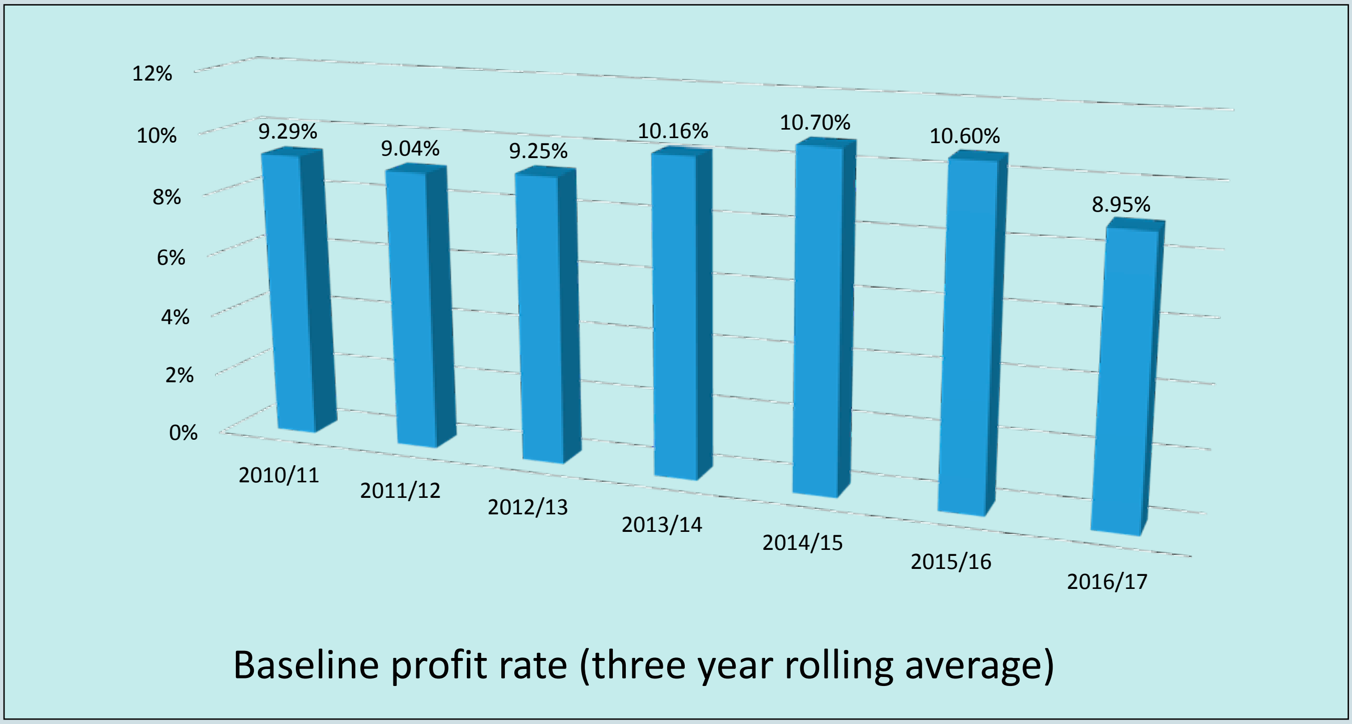


Chart shows the baseline profit rate at Step 1 (after the adjustment for capital servicing allowance). The chart does not include steps 2– 6.

8. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/531823/Guidance_on_adjustments_to_the_Baseline_Profit_Rate_23_March_-_FINAL_WEB.pdf
9. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/531746/Baseline_Profit_and_Capital_Servicing_Rates_Methodology_23_March_2016_v4.pdf

The SSRO developed a new methodology under which the rate is determined by considering the profit rates achieved by a more international and appropriate range of companies. Previously only companies headquartered in the UK were considered, including some with little or no relevance to the work undertaken by defence contractors. The methodology applied to contracts agreed in 2016/17 identifies comparable companies in two categories of activity: 'develop and make' and 'provide and maintain'. The SSRO has recently consulted on the introduction of multiple profit rates, including a rate for construction and ancillary services, and will make a decision about this in the autumn.

A three-year rolling average of the profit range for each set of categories is then determined, and the baseline profit rate is the average of the two. As in previous years, the profit level indicator used is net cost plus (also known as return on total cost).

Return on total cost: operating profit/cost of production

Where cost of production = revenue – operating profit (also known as EBIT)

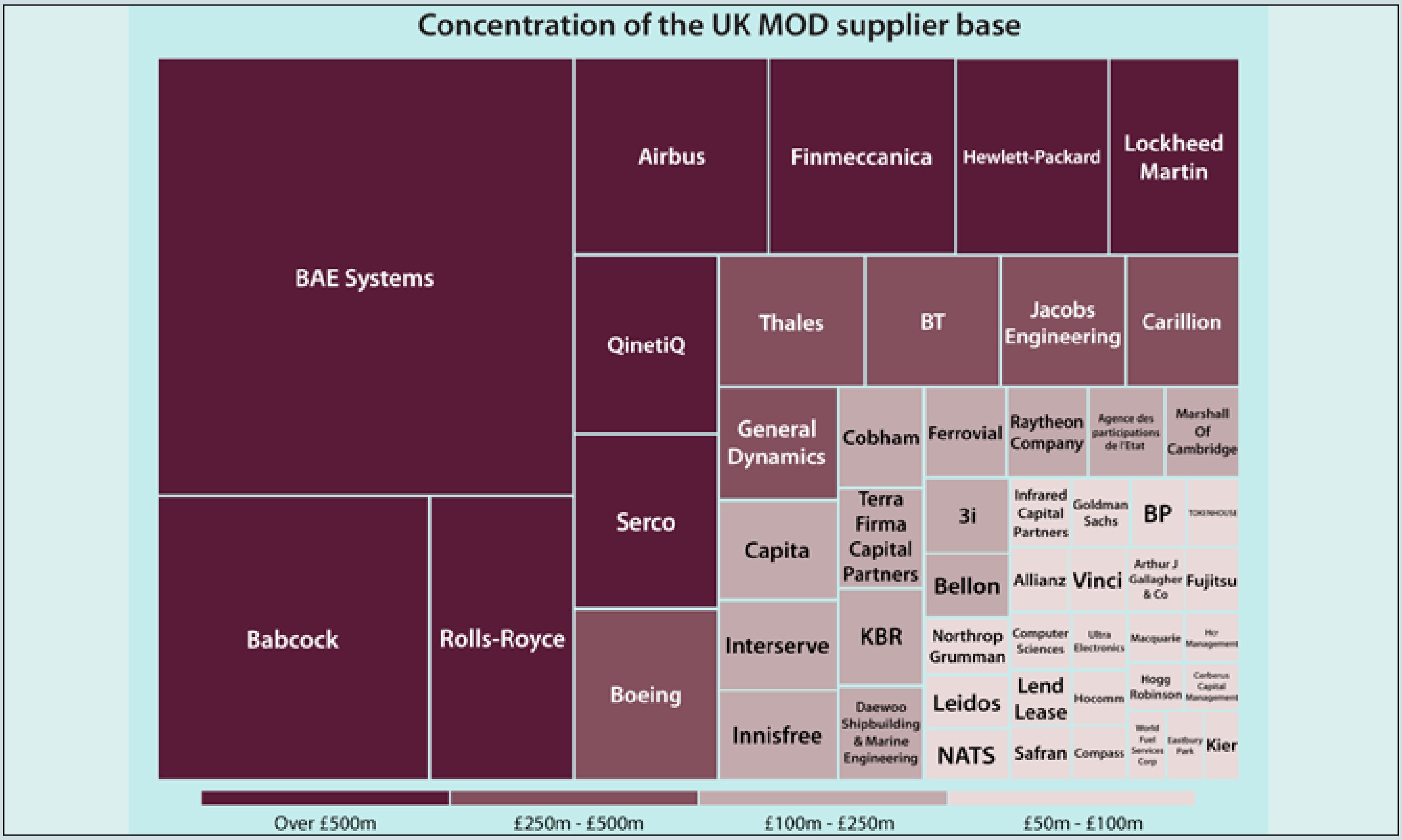
Having applied this new methodology, the SSRO recommended to the Secretary of State in January 2016 that the baseline profit rate for QDCs signed from 1 April 2016 should be 8.95%. The equivalent figure for 2015/16 was 10.60%. The rate is applied for the life of the contract to the estimated allowable costs. It is not retrospectively adjusted if the rate is assessed at a different rate in future reviews.

Alongside the baseline profit rate, the SSRO also publishes the capital servicing rates that apply at step 6, derived primarily from fixed income data. For 2016/17 these are: fixed capital servicing rate: 5.08% and working capital rates of 1.40% for positive working capital and 0.74% for negative working capital.

The SSRO has published an analysis of the planned contract profit rates reported to the SSRO for 30 QDCs/QSCs entered into within the period 1 April 2015 to 31 March 2016. This shows that on average, QDCs/QSCs reported a contract profit rate of 11.7% in 2015/16, and contract profit rates for individual QDCs/QSCs ranged from around 5% to just under 16%. The largest average adjustment to the baseline profit rate was for capital servicing, at an average of 1.2 percentage points.

Matthew Rees, Chartered FCSI is the SSRO's Director of Analysis and Reporting. He is also an independent NED at Gemserv Limited. He was previously Director of Corporate Finance at the National Audit Office, and has also worked for the Competition and Markets Authority. This followed a career in investment banking with major international institutions.

The CISI will be holding a roundtable discussion at the SSRO's office in Holborn in October 2016 for further discussion of the issues raised in this paper. For information and to book, please visit cisi.org/events



Concentration of the UK MOD supplier base

The MOD publishes an annual summary of the amount it spends with suppliers of military equipment and services; the darker the areas are towards the top left of the chart, the less competitive the tendering process and thus the need for tighter regulation. Many of the suppliers paid by the MOD and its various trading funds are subsidiaries of larger holding companies.[10] Some 335 organisations were paid more than £5m in 2015/16, compared to 365 in the previous year. The organisations that received more than £5m represent less than 2% of the 18,000 organisations paid in 2015/16, however they received 92% of the direct expenditure. Of the 335 organisations paid more than £5m, the top 20 received over half of the total procurement expenditure. As shown in the figure above, a total of 52 holding companies were paid more than £50m, and nine of these were paid more than £500m, unchanged from the previous year.

10. The term holding company refers to companies which are full or part owners of other companies (subsidiaries and joint ventures). Payments to joint ventures have been allocated to their parent holding companies in proportion to their equity holdings.

CREST: LESSONS LEARNED FROM AN INFRASTRUCTURE SUCCESS STORY

Dr Hermann Rapp, Senior Lecturer, Anglia Ruskin University

hrapp@bat.finance

Dr Cristiana Parisi, Assistant Professor, Copenhagen Business School

cp.om@cbs.dk

In 2015, the CISI, alongside BT, Euroclear, Swift Institute and Travers Smith, sponsored a major research programme into the history of CREST, Britain's paperless settlement system which is 20 years old this year, and specifically into the lessons to be learned from this success story for other, forthcoming projects of the same ilk. This excerpt, on the lessons learned, is taken from the first of a series of major reports being prepared by BISS Research, the project's manager, on CREST and its implications for good project management.

INTRODUCTION BY SIR ALAN YARROW, CHARTERED FCSI(HON), CISI CHAIRMAN

Thirty years ago, Britain's Big Bang brought sudden and massive change to the way the London stock markets work. Concepts that are now almost forgotten, like fixed commission charges and open-outcry trading – not to mention the stockbrokers and stockjobbers who ran the business – were replaced on the London Stock Exchange by electronic screen-based trading. Those changes helped consolidate London's position as the leading international financial centre, and Britain's financial services industry as one of the most highly-regarded on the globe.

The CISI was, at the time of the Big Bang, still part of the London Stock Exchange, sharing its two centuries of heritage. We are delighted to have contributed to the production of this history of a more recent market development – CREST, the paperless settlement system, which made its highly successful debut 20 years ago. As you will read in these pages, the CISI played an important role, which continues to this day. My esteemed colleague Scott Dobbie CBE FCSI(Hon), whom I was honoured to succeed as Chairman of the Institute, chaired CRESTCo during the critical launch phase; its equally highly-regarded first Chief Executive, Iain Saville CBE FCSI(Hon), is another former colleague on the CISI Board.

CREST's development has been one of many success stories that have cemented Britain's reputation for excellence in infrastructure projects, in financial services as with CREST, and in helping fund roads, railways, airports and much else across the globe, from Victorian days to our present global leadership in advising on and financing such transactions. Long may that success story continue. The CISI is delighted to play its part, equipping the next generation with the right knowledge, the right skills, the right behaviour – in short, true professionalism – to lead us into the future.

THE CREST PROJECT: WHY DID IT SUCCEED?

One of the most obvious responses that people give as to why CREST succeeded, is that it was because it followed the TAURUS disaster. [TAURUS was CREST's predecessor]. This has some weight, as it reflects the perceived urgency and the need for change, but is in no way the overall answer. It belittles the many difficult barriers that had to be surmounted, the genius of the design simplicity, and the enormous effort and skill of the project team and the support from many important areas of industry.

TAURUS cost the industry an estimated £400m, but in all likelihood it was much more. Fresh from this outlay, firms were asked to fund another project. So the first barrier was to gain market confidence that this time, investment would produce the desired result. The CREST team gained confidence through an extensive consultancy phase that was as personal as it was correspondent. It had to continually win the right from the industry to build the system, and give direction and leadership. Not all was plain sailing, as discussions and arguments with various industry sectors and individuals had to be won. This, over the time of the project, fell away, as the industry as a whole accepted CREST and the project team.

CORPORATE STRUCTURE AND COMMUNICATIONS

The corporate structure of the new company, CRESTCo, encouraged users to become stakeholders, which created a momentum to succeed and meet targets, and in the early days helped to quickly establish CREST. The structure had four subscription bands, allowing small firms to have a stake alongside larger ones. Thus, investing in the new system gave them a direct interest in its success.

This decision avoided one of TAURUS's many problems, where vested interests protected the status quo, rather than achieved an effective outcome.

CREST was very different from TAURUS. The relationship between the CREST project team and the industry and ultimately the CREST users was a textbook case of good relationship management, with communication flowing two ways and continuous action to move the project forward.

Interaction with industry was streamlined by Pen Kent, Iain Saville and the CREST team. Project communications with the City were highly controlled, but industry user groups were in direct contact with the core team and dissemination of information was carefully co-ordinated through rigorous internal CREST processes.

Unlike TAURUS, the initial CREST project team was small, consisting of Hugh Simpson, Paul Symons, David Wyatt, Caroline Lee, Mark Kirby, Peter Ross, Brian Goode, Ian Dowglass and Larry Webb, with a flat management structure working under Iain Saville and Pen Kent. They maintained absolute authority and control, creating trust in the markets.

The project culture within the CREST team was instrumental in its overall success and established a good model for future generations to follow. The CREST team established a behaviour pattern where they were able to interact with different industry groups and market sectors.

The development strategy, structure and support model was established very early on and then modified throughout, being transmitted to the clients by the team, who built a collective responsibility with the industry.

The innovation of solutions was dynamic, with regular whiteboarding sessions, written reporting and internal, as well as very frank external, discussions, where assumptions were assessed, challenged and criticism was encouraged. It was by creating this dynamism that individuals felt an important part of the overall solution design. In considering how CREST created and innovated, the five determinants of strategy, structure, support mechanisms, behaviour and communication can be used to explain how CREST's organisational culture led to innovation.

CREST DESIGN AND INNOVATION

The core proposal for CREST was laid out in the report of the Task Force on Securities Settlement to the Governor of the Bank of England in June 1993. The report analysed the situation and set criteria suggesting the design of CREST. The report outlined the core capabilities, but did not present detailed specifications. These had to be developed by the CREST project team, with frequent testing at progressively greater levels of detail with the market, before finalising the design of each business area.

The Central Gilts Office system (CGO) and the Central Money Office (CMO), both designed and operated by the Bank of England, had a strong influence on the initial design of CREST. Both systems were working successfully and this will have been in the minds of the creators.

CREST faced and overcame many challenges in providing functionality beyond that of the CGO and CMO to meet the requirements of the equity market. As a bonus, the clarity and simplicity of its design allowed CREST to be developed to support gilts and other financial money market products.

There was a marked difference from TAURUS, where the complexity of the design and over-ambition in its implementation were some key factors in its failure. CREST had as much ambition as TAURUS, but benefited from its easy-to-understand and focused deliverables for initial launch.

TESTING

Phased and careful testing at many levels is crucial for successful implementation and ongoing live operation. Bugs and faults found during technical, and then internal user testing must be rectified in an internal test environment, without being exposed to the full glare of users (especially since if found in a live operation, losses of money, confidence and risks can be substantial). A key risk is loss of confidence of the new system. Testing is an essential process in internal projects and system upgrades, but in the introduction of new industry-wide systems upgrades, the importance is magnified many times over. CREST was launched without users incurring any major disruption, and no losses. Its careful and thorough testing was key in achieving industry acceptance and success.

Testing can also heighten user understanding, reinforce training and assist with the introduction of new procedures. This was achieved in CREST through the co-operation of industry groups/firms and suppliers, all working towards the sound of the drum that CREST was, by this stage, beating loudly.

Weekends and various other times were set aside to test the network connectivity and connectivity with CREST users (financial services firms) and within their operations. Testing scripts were created for both industry sector and overall industry use, but also within users' firms and their system suppliers. Arguably this was one of the best tested projects of the last century.

Co-ordinating and managing the results of the tests was centrally managed by CREST alone, with some oversight by its regulator, then the Securities and Investments Board (SIB), which became the FSA in 1997.

Industry preparedness was a key issue to be addressed, and CREST devoted significant resources to helping struggling firms. Ensuring that each CREST user was adequately prepared to use CREST was important, but not vital. Some firms found they could not cope and outsourced their back office to those who could.

CREST did have some post-live problems, but these were successfully managed by CRESTCo and we could find no evidence during the research that any material losses were incurred. At one point the proposed live dates for extra securities to enter CREST were delayed; but the migration finished on time.

That fact that CREST succeeded as it did, is a testament to the quality of the test plans and the industry as a whole, and their willingness to work collectively towards a shared objective.

Although testing can't be flagged as a primary reason for CREST's success in completing migration, and subsequently in many other major deliveries of functionality, there is no doubt it was a very significant factor in establishing CREST and creating confidence across the industry in the new system and the new company, CRESTCo.

IMPLEMENTATION

Streamlining and improving efficiency and reducing risk were the core aims of CREST implementation. Moving from a certificated paper based environment to an electronic dematerialised environment was a significant benefit, but in addition, reducing the settlement cycle would help to reduce credit and operational risk. CREST was designed to handle a shortening settlement cycle, and in fact from the start of live operation, T+0 was available, and increasingly used for collateral-based transactions.

Prior to the introduction of CREST, the settlement cycle was originally based on a two-week account. In preparation for the implementation of CREST, this was changed to ten-day rolling settlement (T+10) in July 1994. A year later it was reduced to five days (T+5) and in 2001 to T+3. Nowadays, it is T+2, which was introduced in October 2014. This meant that the industry had to change its systems to accommodate rolling settlement. Implementation of CREST on an industry-wide scale was achieved through strong CREST leadership, detailed planning and co-operation of registrars/financial intermediaries and suppliers.

While reduction of the settlement cycle was achieved reasonably quickly, reduction in the use of paper certificates and transfer forms took much longer. During migration, CREST organised the admission of specified issuers entering CREST at regular intervals.

Many user firms created shareholder accounts in CREST to hold client assets as well as proprietary assets: either as a pooled nominee account, a pool with designation of the shareholder, or as a CREST 'sponsored account'. This provided control in the industry rather than a mass dematerialisation all in one go. Unfortunately, some might say, the government insisted that it was the legal right of shareholders to retain paper certificates if they wanted to, so while there was a vast reduction in paper share certificates, share certificates are still held by some shareholders today.

THE ROLE OF NETWORK COMPETITION, AND SWIFT

CREST decided to create competition regarding network suppliers, with the objective of providing choice for CREST users in order to reduce costs. An open licensing process was created, and the result was that two suppliers; SWIFT, owned by the banks, which operated a private network and Syntegra (BT), a commercial network, passed the stringent tests of security and performance.

It is likely that most firms in the stock broker/investment manager sector of the market had never considered network costs in their operation before CREST. Talisman costs might be the nearest and there is evidence in some quarters that connectivity charges to CREST, were actually less than for Talisman.

At the time of the CREST development, countries around the world were very protective of their settlement systems. Euroclear and Clearstream, using SWIFT, operated a connectivity network between separate jurisdictions. (Today, Target 2 Securities (T2S) is the eurozone provider to central securities depositories (CSDs) of seamless cross border settlements, and also has competing network providers.)

Long before the introduction of CREST, the SWIFT network provided a way of sending payment messages, authorising movement of funds. In the late 1980s, SWIFT opened up its network for securities messages. Messages were sent in ISO7775, which had been developed for payments. The result was chaos, with industry initiatives set up to resolve the problem. In particular, US and European ISITC worked to specify an industry solution, which emerged as ISO15022 in the early 2000s.

In the absence of acceptable standards, CREST specified its own proprietary DEX messages, which are still being used today. SWIFT had to adapt to this extra set of standards, as well as meeting standards related to security, resilience and performance. (Unfortunately, development to unify DEX messages with ISO15022 was never undertaken.) So at the time that CREST was being created, SWIFT would not have necessarily been an obvious choice. However, SWIFT's network had established levels of resilience and customer support that made the network very secure and reliable.

The CREST project presented SWIFT with the opportunity to extend their capabilities into the securities post-trade markets and gain new customers. The decision by CREST not to enforce its own monopoly connectivity was virtually unique in Europe; SWIFT had a rare chance to become a key component of a national settlement system.

Accordingly, SWIFT decided to bid for a licence to supply network capabilities for CREST, taking reassurance from the fact that many of their existing banking customers were CREST shareholders and users. Gaining the trust of the CREST team was seen as an important part of the bidding process by SWIFT.

Though almost all banks were SWIFT users for payments, the bank's customers through their custody and settlement services were not. Major custodian banks had created their own proprietary networks for their customers, often in parallel with SWIFT. This meant that custodians were either rekeying data into SWIFT, or using some automatic linking of the data and messages. Non-banks used Syntegra (BT), as SWIFT had not yet decided to open up its banking network.

CREST offered brokers and asset manager customers of custodians the opportunity to have a direct connection to CREST, and operate their own settlements via SWIFT or Syntegra.

Engaging in the CREST project pushed SWIFT into having a more entrepreneurial approach, leaving behind some of the usual internal thinking around risk. Bidding for a licence, cutting competitive deals for big clients, and working with CREST were significant risks, but ones that SWIFT was eager to take. It faced a steep learning curve, so specific people within SWIFT that had some securities knowledge and experience were assigned to the CREST project.

SWIFT worked closely with the CREST project team, but it was highlighted that the personal relationship created with Iain Saville was an important ingredient, enabling not only confidence at board level, but also operationally within the SWIFT and CREST project teams. This was especially relevant at moments of crisis and for dynamic problem solving.

As it turned out, SWIFT became a fundamental pillar in the CREST success story, by taking an implicit role in promoting and marketing CREST. Through its commitment to its success, SWIFT helped deliver widespread support for CREST and gave important backing to the CREST project team. This support would have added to CREST's momentum, building confidence in the industry of a dynamic development and certain success.

Today SWIFT continues to supply the underpinning network for international cross border securities settlement, along with payments and FX.

CREST'S LONG-TERM IMPACT

CREST has had a huge range of diverse impacts that changed not only processes and systems, but also some people's lives. Some are obvious, while some are not. The obvious ones are market actors; banks, brokers and investors. Less obviously, software suppliers and even postal workers. A more detailed analysis of the areas impacted by the introduction of CREST will be outlined in a further report in the CREST Research series. However, a summary table is given below that briefly outlines these impacts.

Political	• CREST enabled the UK to cement and retain its international dominant position as the leading financial centre in the European time zone. The economic value of CREST to the UK was incalculable.
Economic	• Efficiencies - Improved management of the financial position of participants. • Cost efficiencies. • Increased capacity and transaction volumes.
Social	• Provided necessary data and operational efficiencies that enabled good accounting practices, also brought accounting into the transaction process flow. • Creation of the oversight structure, benefiting the users, their bank and investors/clients. • Positive impact on London as a leading financial centre. • Improved working environment, especially for the back office employees. • New skill sets
Technological	• Post trade transformation, automating back office processes. • Direct –increased efficiency, reduced cost, increased security and reduced risk. • Indirect – when combined with other technologies, i.e. SWIFT, Syntegra, database technologies, increased the impact. • Driver for the new generations of software vendors and new technologies development based on CREST design. • Enabled new software houses to enter the market.
Legal	• Legal framework. • Corporate governance. • Regulations and standards.
Environmental	• Dematerialisation - massive reduction of paper.
Industry	• Industry impact manifested in all of the above and was immediate, due to the number of firms involved. • Increased capacity, increased efficiency, reduced settlement cycle, reduced settlement risk, operational risk, credit risk, reputational risk, increased safety in the settlement cycle risk.

THE RESEARCH TEAM

Dr Hermann Rapp

Hermann Rapp is an academic researcher and technologist with a research interest in banking technology, financial markets operations and project management leading the CREST Research. He has over ten years of industry experience in software, project management and banking. Since 2010 he has worked as a Senior Lecturer at Anglia Ruskin University in Cambridge and Chelmsford, and previously for other UK and European universities. He has presented his research at major European and UK conferences and is a fellow of the Higher Education Academy (HEA), and a member of the European Operations Management Association (EurOMA), and the British Accounting and Finance Association (BAFA). He is the editor of a forthcoming book to be published by Springer, about new technologies in the financial industry. His current research projects focus on information systems research, data standards for financial markets, business intelligence and analytics.

Dr Cristiana Parisi

Cristiana Parisi completed her MA in Accounting at the University of Florence, Italy, with first-in-class honours in September 2004. She received her PhD degree in Accounting from the University of Florence in April 2008. Her PhD project was conducted in collaboration with the Centre for Corporate Social Responsibility at Copenhagen Business School and was focused on the performance management of sustainability within a leading pharmaceutical company based in Copenhagen (DK). Currently, she holds an Assistant Professor position in Management Accounting at the Operations Management Department of the Copenhagen Business School (CBS) after being a Postdoctoral Fellow in Management Accounting at the University of Southern Denmark from October 2008 to June 2011. Her research interests lie in the area of management accounting and mainly focus on the conditions and consequences of the implementation of management control technologies within organisations.

B.I.S.S. Research

The research project was managed and produced by B.I.S.S. Research (BISS), an independent City think tank providing research, advisory services, training, benchmarking and analysis of industry issues, technology and services in the global financial services industry. BISS works with a number of leading universities and research institutes to facilitate research projects relevant to the financial markets. For more Information visit *bissresearch.com*.

Acknowledgements

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SURVEY: FINANCING RENEWABLE ENERGY INFRASTRUCTURE PROJECTS – THE GROWING ROLE OF ISLAMIC FINANCE

Policymakers and energy industry leaders around the world continue to search out equity finance for sustainable infrastructure energy projects and ways to improve energy efficiency and the production of renewable energy (RE). The International Energy Agency (IEA) estimates that more than $1.6tn was invested in 2013 in energy supply, a figure that has more than doubled in real terms since 2000, with a further $130bn invested to improve energy efficiency.

In addition, more generally, the energy sector stays attractive to investors, owing to a globally favorable business environment and proactive sustainable and environment regulatory changes. However, financing these capital-intensive projects undoubtedly remains a challenge. In this context, investors in the Middle East and Asia believe that Islamic finance has great potential to help fund some of the huge capital investment projects in energy and renewables sectors around the world.

Rationale and objectives of the study

These capital-intensive infrastructure energy projects, coupled with suitability of assets and their business nature, clearly present a real opportunity for Islamic financiers and investors to develop a value proposition model which will be able to offer competitive financing solutions to fund the financial capital requirements in both equity and 'debt' financing.

Deloitte's Islamic finance thought leadership team is conducting a major online survey as part of a wider industry-driven study which aims to unearth opportunities for Sharia-compliant investment and financing instruments in the energy sector. The survey attempts to gauge industry practitioners' opinions and market sentiment around the potential role of Islamic finance in providing a value proposition for developing alternative equity investing structures.

The study aspires to build a viable business case for Islamic finance in the energy sector and provide practical insights into possible future financing structures, contracts, business and Sharia limitations in the energy and renewable energy sector.

How to participate

For more information on the survey (which should take around ten minutes of your time online, and is entirely confidential) and details of how to participate and receive the results, please contact Dr Hatim El Tahir, Director and Islamic Finance Group Leader, Deloitte Islamic Finance Knowledge Centre, Bahrain, on heltahir@deloitte.com.

Everyday cliffhangers with the coastguard rescue

CHRIS WELSFORD, CHARTERED MCSI, DECIDED TO CONQUER HIS FEAR OF HEIGHTS AND RESCUE INJURED PEOPLE AT THE SAME TIME – BY JOINING A COASTGUARD CLIFF RESCUE TEAM

LORA BENSON

Chris Welsford, Chartered MCSI and Founder of Ayres Punchard Investment Management, often has to dash out of a client meeting to respond to a call-out to rescue people on the south coast of the Isle of Wight.

His duties as a volunteer Coastguard Rescue Officer for the Ventnor Coastguard cliff rescue team include search and rescue of missing persons (and their pets), often to support the police, reporting and monitoring pollution and other coastal hazards, and dealing with wreckage or dead whales and dolphins on the shoreline.

Chris joined the Ventnor Coastguard cliff rescue team in 2002, largely as a way to challenge himself: "I was at a party, and while talking to one of the guests who was on the team, they mentioned they had a vacancy. I have always been a little scared of heights and decided this could be the cure I needed. I've also been a first aider since I was a teenager and the whole idea of rescuing people injured on the shore seemed very exciting indeed."

Call-outs vary, from checking out a vessel in possible trouble, suspected ordnance or chemicals on the beach, to a full-scale cliff rescue following a fall, or even the recovery of a body. "We probably don't deal with as many fatalities as the police, ambulance and fire services locally because of the specialist nature of what we do, but a fall down a cliff is likely to result in serious injury or death and on average our team has dealt with two fatalities a year over the last 15 years.

"In addition we are trained to act as ground crew for the rescue helicopter. We can be called to the local hospital to assist with medivacs to the mainland, carried out by the Coastguard helicopter. I've had to organise helicopter landing sites out on remote beaches and adjacent to cliff tops, sometimes in quite bad weather", says Chris.

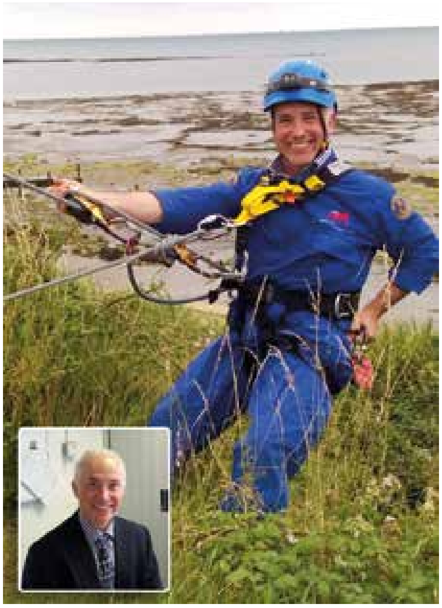
His pager is permanently on, and he can be called out any time. "All my clients are aware of this. It can be quite demanding if we get a number of calls in quick succession or during the night, which can make the next day at work quite hard, but it's definitely worth it."

Chris grew up in the Isle of Wight and went on to read Politics at the University of Southampton. His first job in financial services was in 1987 when he became a trainee client service executive. "Then in 1995 I'd decided I'd had enough of working for other people and left my job as a financial adviser and founded Ayres Punchard Investment Management," he says.

Although Chris might feel slightly inconvenienced sometimes when his pager goes off, he feels it's a real privilege to be trusted to respond to someone's call for help: "You never know what the outcome is going to be and that uncertainty makes life interesting. Doing something for my community is definitely part of it, but it is quite liberating and life affirming when you have to drop everything you are doing and respond to another person's call for help. It makes me feel good and puts some of life's more petty problems in context," he says.

"It's a real privilege to be trusted to respond to someone else's call for help"

The rescue incidents in which Chris is involved are traumatic for all. Sometimes they are completely life altering or terminal: "The most memorable jobs are often the ones where we have worked extremely closely with colleagues in very challenging conditions to achieve our objective. That leads to friendships based on mutual respect and shared experiences. Unfortunately these are sometimes body recoveries from



inaccessible spots and what most people would consider the worst jobs."

The team, of which Chris is one of 12, also provides education in local schools, clubs and other community organisations about how to stay safe at sea and along the coast. It is becoming increasingly difficult, says Chris, to find employers who are willing to release their employees for call-outs. "Most of the guys I work with are self-employed and those that aren't have to have very understanding employers." Chris's team currently has two vacancies for Coastguard Rescue Officers, and we hope any local employer having read this piece might consider supporting an employee, thereby putting something back into the local community.

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

Planning for multiple inheritances and early retirement

CEO OF ADDIDI WEALTH ANNA SOFAT OUTLINES A HOLISTIC APPROACH TO FINANCIAL PLANNING FOR COMPLEX FINANCIAL AFFAIRS

ANNA SOFAT

ANNA SOFAT BIOGRAPHY

Anna is the founder and CEO of financial services boutique Addidi Wealth. Until 2006 she was Managing Director at independent financial advisers Fiona Price & Partners, prior to which she was Business Development Director at Jackson Batten Financial Group.

Anna is a wealth manager and a financial planner.

CASE STUDY BRIEF

Luciana contacted Addidi Wealth after researching online for an independent financial advisory firm. Having seen our client testimonials she called us.

Born in Italy some 39 years ago, Luciana has lived in London for the past 15 years. She received a gift of £150,000 from her mother who lives in Italy. The funds were invested in accordance with advice from a high street bank. However, the bank ceased giving advice, despite taking 3% initial charge and 1% ongoing.

Luciana sees these funds as ring-fenced for her mother's needs, and the funds were originally invested for the long term to provide ad hoc income for her mother. As she no longer has an adviser, Luciana is concerned that the value of the portfolio has fallen and that this might cause the income payments to be eroded.

When Luciana first contacted Addidi Wealth, her main focus was a portfolio she had set up a few years ago with the help of her bank. The bank was no longer providing advice, and, having tried to self-invest, Luciana was worried that the portfolio would not be able to meet her needs. She was not able to think more holistically about her wider finances. So we agreed to review the portfolio and take on its management with a view to constructing a financial plan over the coming months.

Luciana's main need for the portfolio was to ring-fence it from the rest of her finances and ensure that the funds could provide for the ad hoc income her mother might require. Her Italian mother had gifted her the funds some years ago, but Luciana was finding that her mother needed help with expenses above her day-to-day needs. The timing and amount of withdrawals vary and when her mother passes away the fund will be left to Luciana.

Luciana completed a FinaMetrica questionnaire that showed her to be a cautious investor, but cash flow analysis showed that the returns required would not be met by a cautious asset allocation. After further discussions, we concluded that Luciana would be prepared to take a slightly higher level of risk for potential reward. This was to sustain and potentially increase the value of the fund, particularly as it was likely to be eroded over time by income payments to her mother.

Analysis of the funds in which Luciana was invested revealed that the current investment risk was high – much higher than Luciana is prepared to take. The majority of the funds were managed funds with high charges, but did include some passive index tracking funds. Overall the fund was spread over many assets in different global areas, which is what Luciana wanted.

A ROBUST SOLUTION

We advised Luciana to use a platform that would be denominated in euros, since payments would be made to her mother in this currency. We also recommended investing in an Addidi core portfolio that reduced overall cost, provided access to euro-denominated funds and a robust solution for her needs.

Luciana now is more comfortable in the knowledge that the fund is being managed, it reflects her attitude to risk, is denominated in euros and costs have been reduced. Any payments to her mother will be made efficiently with a minimum of administration.

Analysis of the funds revealed that the current investment risk was high

Following the initial work, Luciana introduced her husband Stefan to Addidi. Although we treat their finances on an individual basis, we felt strongly that we should have at least one joint meeting so we could ensure a holistic approach. Their financial affairs are complex – she is Italian by birth and will inherit assets in Italy; Stefan is from Portugal and will inherit significant assets from his parents. They have made London their home and also own a small property on the Welsh coast. While Luciana works for a regional university and has relatively straightforward finances, Stefan works for a UK-based subsidiary of an Italian company. He had obtained shares in the UK company without being aware that he would be taxed on these! This was being sorted out by the company accountant, but he was becoming aware that he needed to plan ahead.

Stefan wants to be able to retire from the age of 50. His income from his stressful job (which he nevertheless enjoys) vastly exceeds his expenses. However, he wants to plan to do something else with his life, perhaps ethical, by the time he is 50. He is 40 now.

We constructed a financial plan for both of them and reviewed their other arrangements. In the process, it became clear that Stefan was not making sufficient provision for his goal of retiring early, and both were aware that despite their high level of income, they appeared to be spending what they earned.

It was obvious that they did not have a strategy for what they should be saving

We agreed a plan with both of them which incorporated further funding into Stefan's pension through salary and bonus sacrifice. Stefan was about to get his bonus for 2015, so using carry forward, we were able to shelter much of it in his pension. This enabled both Stefan and the company to make significant National Insurance savings, much of which was reinvested into his pension.

We also took a hard look at their income and expenditure – it was obvious that apart from not going into overdraft, they did not have a strategy for what they should be saving. So using cashflow modelling and different 'what if' scenarios, we were able to demonstrate to Stefan how he may achieve his ambitions of not having to earn beyond age 50. This involved him saving his bonus each year (since this is surplus to their needs) and making further savings of at least £1,000–1,500 per month from his earnings. Savings are split between his pension, individual savings account and a general account which will maximise the tax allowances available to him and overall tax efficiency.

FORWARD THINKING

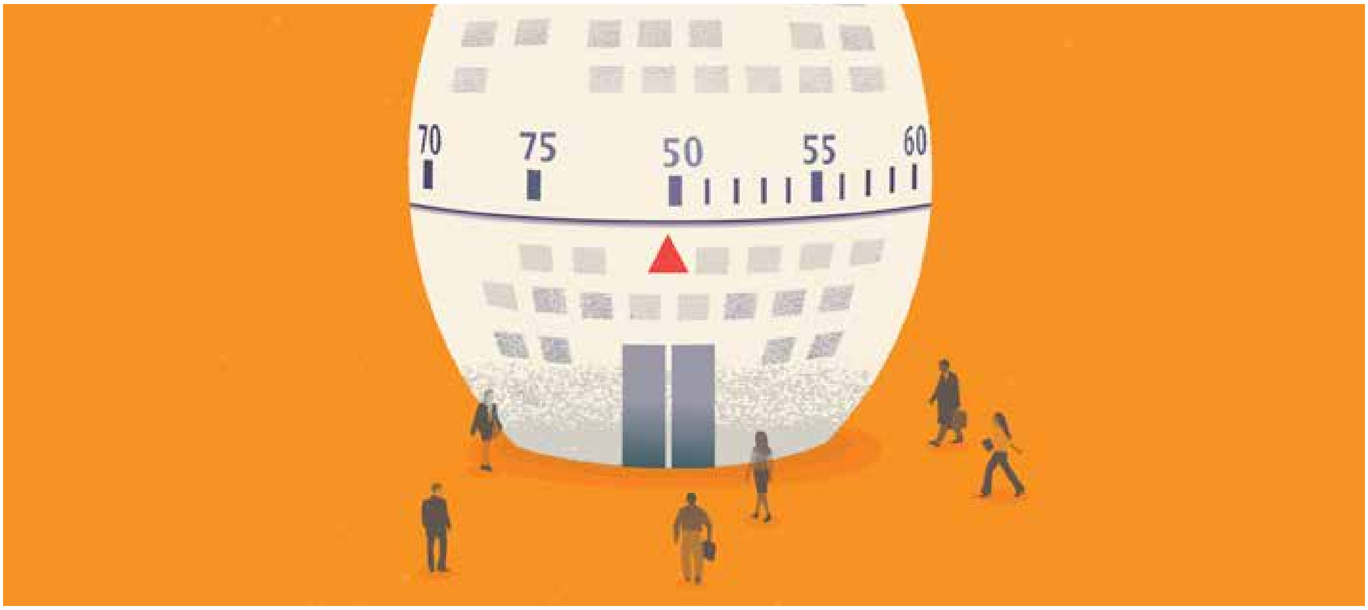
We also looked at his company. By this time he owned 40% of the UK subsidiary and was due to receive a further shareholding. The UK business also owned a subsidiary on the continent, and Stefan was beginning to think through the implications for himself if the UK voted to leave the EU. We were able to bring in our in-house accountant/business adviser to liaise with Stefan and his company accountant. They obtained a picture of company ownership structures, the numbers and the plans for the business going forward. Following extensive discussions and meetings (and the Brexit vote), it was agreed that at this stage, Stefan would not receive any further shareholding in the UK subsidiary (and pay a big income tax liability on the shares) as it was likely that the European company would need to become their main trading company and further work needed to be done.

WHAT HAPPENED NEXT

Both Luciana and Stefan now have clarity of their short and medium-term goals, a plan and some discipline for achieving these. Further work is pending on the business structures and also the longer-term planning around potential inheritance from Stefan's parents in Portugal and from Luciana's mother in Italy.

TAKEAWAYS:

1. **Luciana had an immediate need and we addressed that before commencing the financial plan. Do not delay advising clients on their immediate issues.**
2. **Bringing in other expertise adds value and helps to keep an overview of what is going on.**
3. **The clients have a goal (to retire by age 50) but no discipline to achieve it. Our objectivity has helped them on the path to achieve their ambitions.**
4. **Cashflow modelling helps simplify matters by providing an illustration of their journey.**



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MARLENE OUTRIM CFP™ CHARTERED FCSI, CHARTERED WEALTH MANAGER, MANAGING DIRECTOR AND FOUNDER OF ACCREDITED FINANCIAL PLANNING FIRM™ UNIQ FAMILY WEALTH, HELPS FAMILIES PLAN FROM ONE GENERATION TO THE NEXT TO ENSURE FINANCIAL SECURITY

Cradle to grave financial planning

Marlene Outrim CFP™ Chartered FCSI, Chartered Wealth Manager
Marlene is Managing Director and founder of UNIQ Family Wealth, drawing on 16 years' experience of owning a financial planning practice and over 20 years' experience as a CFP professional. She is also a chartered financial planner and a wealth manager, and only wants to work with those who are committed to achieving their lifetime goals and objectives.

Marlene was president of the IFP from September 2010 to October 2012. She has won several awards, including the New Model Adviser award for Wales in 2009, and Retirement Planner of the Year in 2008.

marlene.outrim@uniqfamilywealth.co.uk
029 20782330
uniqfamilywealth.co.uk

When did you become an accredited firm? What has happened since?
I started the business in July 2013 and applied straight away for it to become an accredited firm. We met the criteria in a pretty straightforward fashion. We did this automatically, just as you would apply for FCA authorisation, and it was a smooth process. I was already well aware of the process because I was President of the Institute of Financial Planning (IFP) in 2012 at the time that accreditation of firms was introduced.

We started with three financial planners, two of whom were CFP professionals. They had ISO 22222. The third financial planner is currently going through the CFP certification assessment and a fourth planner has now joined us. We also hold BS 8577 certification, which is a British standard awarded by Standards International to financial planning firms.

What has accredited firm status brought to your firm and why should others seek to become accredited firms?
It is a mark of approval of being a true financial planner. I am also a chartered financial planner, but I believe that it is not just about qualifications. Being a true financial planner means you put client interests first, following the six steps of financial planning and basing advice on cashflow analysis.

What other accolades and awards has the firm picked up in recent times?
We won a Retirement Planner award from Retirement Planner in 2014 and in February this year we won two awards at the Professional Adviser awards: Adviser Firm of the Year (Wales) and Best Client Engagement in the UK. We were also commended in the *Financial Times* awards this year, for linking clients' finances to health and welfare. Recently we have also been shortlisted for the Moneyfacts awards, and will find out in September this year whether we have been successful.

What sort of business is UNIQ Family Wealth and what services does it offer? What is your USP?
We offer financial planning, investment advice and asset protection for all of our clients, many of whom are families. Our unique selling point is that we help families cascade wealth seamlessly from one generation to another with a service from cradle to grave that ensures that each individual is financially secure. Every client has a financial plan and we are always on hand to guide them. Our mission is to help people manage their wealth better and in turn lead more fulfilling lives, with the purpose of 'a life well lived'.

How did you get into financial planning?

I was a probation officer in Cardiff for 13 years. I like dealing with people so the job suited me at first, when it was more counselling based, but as the Probation Service started to change, I found that it didn't suit me. I wanted to be my own boss, and had a combination of skills, including accountancy, as well as interpersonal skills. My first financial advice job was at Hill Samuel as a tied agent but I really didn't like it at all!

After that I quickly joined an independent financial advisory firm and enjoyed the independent bit. At that time I had no computer and was trying to do cashflows manually, which was a lot of hard work.

I was introduced to tapes recorded by Paul Etheridge, previous Honorary President of the IFP (read our profile of Paul Etheridge on pages 24-26), where he talks about the first meeting with a client, determining their personal and professional objectives. I was struck by his professional approach.

Someone else introduced me separately to Prestwood Software and their software for financial planners, so I contacted them and joined the advanced planners group. Paul was my mentor in the early years.

What do you think about the IFP/CISI merger?

I welcomed it because I was concerned about the future of financial planning in the UK and the IFP, especially after CEO Nick Cann CFP had a stroke. The IFP didn't have the resources to make financial planning grow.

My experience of the CISI is that it is trying to make it work. I was very happy when Jacqueline and Campbell [the CISI's heads of financial planning] were appointed because I believe that this offers continuity because they know what financial planning really is. I believe as planners we need to support them and give it time to develop. It will be interesting to see how it develops over the coming months and years.

How have you been affected by the Financial Services Compensation Scheme levy?

Not too badly actually. In our first year the cost was okay, but in the second year it increased by a third. This year the costs stayed the same. The problem is that we

have no notification of the amount of any cost increase until we get the invoice, and then we have to pay it within a month. In our second year this coincided with our corporation tax bill and other large bills, which gave us a bit of a headache; so we have planned for this now for future years.

We impress upon our clients that we offer a cradle to the grave service

What does a typical day look like?

I don't really have a typical day but I do have a structured week. On Tuesdays and Thursdays I see clients; every Monday the whole team has a meeting and we look back at what we have achieved, look forward and discuss any client meetings or issues that have come up, and we finish every meeting discussing the positive moments from the previous week.

I have a meeting every month with my planners and we have quarterly board meetings to which we invite individuals who we feel might be able to enhance our business. Wednesday is my free day. Sometimes it involves doing a little bit of work but sometimes I'm free to do whatever I want. My husband and I own and run a modern contemporary art gallery and I help curate the art and help with the publicity.

What do you think about Financial Planning Week this year?

I thought it was amazing! We had masses of referrals, mainly in our virtual London office. We helped many, and although some were not ideal clients, we did get three to four really big clients from the week. We impress upon them that we offer a cradle to grave service and we facilitate wills, trusts and lasting powers of attorney.

In addition, we go to two schools each year and give them our corporate piggybanks and talk to them about money (main picture). I am also part of the Wales Employer Group aimed to get youngsters to see that there is more in financial services than just banking & insurance. There are all sorts of different jobs, such as marketing and IT.

What are your key tips for other planners?

1. Plan and prepare for everything; don't just dive in.
2. If you say you put client interests first then make sure you actually do that.
3. Develop a great team around you. You cannot do it on your own.
4. Focus on your own unique abilities, identify what they are and don't do stuff that other people can do better.

JANET AND PAUL, ONE OF WISEACRE FINANCIAL PLANNERS' MOST VALUABLE CLIENT COUPLES, ARE DIVORCING. IS THERE AN ETHICAL WAY TO RETAIN BOTH OF THEM AS CLIENTS?

A clean break

iStock

Wiseacre Financial Planners has been established for over 20 years, and despite some ups and downs, its two partners Ben and Gary generally regard themselves as being successful. Their client base is quite mixed, and while they have a number of older clients who require a disproportionate amount of attention for the fees that they pay, the partners feel that is simply a part of the price of being well known for accessibility.

One day Ben receives a phone call from Paul, one of his most highly valued clients who, with his wife Janet, controls assets of about £25m. Ben is surprised when Paul asks to meet him but, unusually, neither at Wiseacre's office, nor at Paul's business, but at a well-known firm of solicitors. Ben wonders what the reason might be, and as an optimist guesses that Paul is involved in another business deal, which may involve rearranging or perhaps liquidating some of his assets.

On arrival at the solicitor's office, Ben is shown into a meeting room where Paul is already waiting, on his own and looking very solemn. After exchanging the usual pleasantries, Paul tells Ben that he has asked to see him because he and Janet have separated and they will be getting divorced. He has discussed this with the solicitor who, while having some knowledge of Paul's finances, felt that Ben as his financial planner would have a better grasp of what assets Paul and Janet have between them and who actually owns what.

Ben says that he is very sorry to hear this news and that it puts him personally and professionally in quite a difficult position. He and his wife had become friends with Paul and Janet, and it would be very difficult, on a personal level, not to take sides and, professionally, almost impossible. Ben cannot cut himself in half to represent both Paul and Janet dispassionately and objectively in advising how they might deal with their wealth, a large part of which comprises a successful and functioning business, in which they have both played a part.

There would be, in the immediate future, many conflicts of interest

Paul says that he appreciates there will be some difficulties, but he suggests that perhaps Ben could consider looking after Paul's side and Gary could look after Janet. Thinking of various immediate difficulties, Ben says he is not convinced, but tells Paul that he will discuss with Gary what he has learned, and together they will consider what Paul has suggested they might be able to do.

Gary is very surprised to hear Ben's news, particularly Paul's suggestion that Wiseacre might continue to help plan the finances of both him and Janet, provided that each one is handled by a different partner, and his initial thought is that it really will not work. He does not have an intimate knowledge of their affairs, but there would be, at least in the immediate future, many obvious conflicts of interest.

But while reviewing what might actually be involved, Gary also looks at the fees that they currently charge for this relationship and says to Ben, only slightly in jest, that the loss of this business would mean that he would have to choose between whether to keep his Mercedes or his personal assistant. They will not be able to afford them both.

So is there a way in which Wiseacre can protect some or all of its earnings, while acting with integrity, or must they accept that they can represent one party or the other, but not both? At the moment they have been led to believe that matters between Janet and Paul remain 'cordial', but when it comes down to apportioning assets, that may easily change and where might that leave Wiseacre then?

While accepting that having only just become aware of the situation and so, possibly, it is premature to be trying to make a decision, Ben and Gary sit down to consider some possible options. They decide first of all that they must adopt a high-level approach to doing what is right, so at this stage, they must disregard the structure of the couple's portfolios and the impact that changes will have on it and their initial objectives.

Their discussion leads them to identify the following four possible options:

a. Encourage Paul, who will probably be a better long-term proposition, to stay with Wiseacre while recommending that Janet be redirected to another well-regarded financial planner.

b. Recognising that Janet will be the party requiring more immediate care and attention, suggest that Wiseacre should offer its services to her.

c. Because of the impact that a loss of even half of these clients' business will have, they should do whatever they can to erect an effective 'Chinese wall' in order to retain both Janet and Paul as clients.

d. They must accept that they are likely to lose a significant level of income as a result of this news and should take steps immediately to recognise this. If part of this is dispensing with Ben's personal assistant, then that is a necessary step.

What would you advise?
Visit *cisi.org/cleanbreak* and let us know your favoured option. The results of the survey and the opinion of the CISI will be published in the December print edition of *The Review*.

FAT FINGER: THE VERDICT

This dilemma revolved around a company suffering a number of failures, resulting in it being required by the regulator to take remedial action. The CEO is induced by the Head of Compliance to sign a letter to the regulator confirming that the required actions have been completed, when this is not actually the case. A member of the project team responsible for instigating the changes becomes aware of this and wonders what should be done.

Readers were offered four choices:

A. Let matters take their course. Undermining senior executives, especially the CEO, would be career suicide. Anyway, the new processes will soon be up and running and the problem will disappear (0%).

B. Arrange to speak to the CEO and tell him what has happened (42%).

C. Arrange to speak to the firm's senior independent non-executive director (NED) (19%).

D. Use the firm's Speak Up telephone line (40%).

No one chose to take no action, which is positive although, as always, I do wonder whether if faced with such a situation in 'real life', some of us might not actually feel that keeping one's head down is the most sensible action to take.

By a small margin, speaking to the CEO was the most popular course of action. This is a situation which is in the CEO's line of responsibility and he needs to know from Toby, as a figure directly involved, what has happened.

Speaking to the firm's senior NED would be appropriate if the CEO does nothing, but he should be given the opportunity to take action first of all.

Using the firm's Speak Up line was only marginally less popular than speaking to the CEO and it does represent a defensible course of action.

However, we feel that as this is a matter which needs to be dealt with as a priority and involves the CEO, making him aware of it as soon as possible is the most appropriate course of action, notwithstanding that one might be fearful of the consequences.

Fotolia

Social investment: using head and heart

FAMILY OFFICES AND HIGH-NET-WORTH INDIVIDUALS ARE INCREASINGLY TURNING TO SOCIAL INVESTMENT FOR ITS FINANCIAL AND SOCIAL/ENVIRONMENTAL GAINS

MARK SALWAY, DIRECTOR OF SOCIAL FINANCE, CASS BUSINESS SCHOOL

Social investment is an easy concept to grab hold of, but difficult to define. Effectively it uses more 'commercial style' investment tools to solve social issues.

The key thing is that money is used to create both a social and financial return. The capital is then paid back with a suitable return to compensate for the investor's risk. Alternatively a 'blended rate' is determined whereby the financial return is adjusted for the social return it creates.

In the US it is more often called 'social impact investment', and sees its roots in the pioneer spirit of philanthropists who believe that investment tools can help to solve social issues that giving alone cannot. The latest *Financial Times* yearly report *Investing for global impact 2016* shows that whereas three years ago family offices and high-net-worth individuals were learning and taking advice, they are now making their first social investments in their portfolios.

We are starting to see a wide range of mainstream and investment banks (eg, Barclays, J.P. Morgan), as well as social banks (eg, CAF, Unity Bank) growing this market.

We are also seeing the creation of new investment funds (eg, Big Issue Invest, Bridges Ventures, Impetus-PEF) which are focused on creating social investments. And the creation in June 2013 and subsequent growth of the Social Stock Exchange, where investments have been launched and are now being traded.

Each social investment must be underpinned by clear metrics (social as well as financial) and an intentionality to be transparent about the social value created, and report openly about this. The difficulty comes with valuing the social return on investment, and as the box on the right shows, this is both complex and open to interpretation.

A range of ways of pricing in this social return on investment are developing, and also a range of different investment tools: equities, quasi-equities, bonds, social impact bonds, crowdfunding and loans.

It is also clear that social investment is breaking down the legal barriers between charities, social enterprises and commercial organisations. Investors are becoming less hung up on the legal form of the organisation they are investing in and are instead becoming more focused on the social return on capital generated.

EXAMPLES OF INVESTMENTS

- **The Gym Group:** One of the most successful social investments to date has been the Gym Group. It provides quality, affordable gyms to local communities and

MEASURING SOCIAL VALUE – THE COMPLEXITY

As an example, consider a well being dug in Africa. The inputs to build the well are bricks, digging, time and labour.

The output from the well is fresh water and better health for the community.

The outcomes from this are that the community don't have to walk far for water, so has more time for education and commercial activities and farming.

The impact is greater life choice for communities, and greater GDP.

has grown from one in 2008 to over 80 gyms across the UK. It grew through using social investment capital from Bridges Ventures and other social investors who were positive about the health impact.

- **Hackney Community Transport (HCT):** One of the 'pin-up' social investments so far has been Hackney Community Transport – a social enterprise that helps communities get about. HCT raised £10m from a range of social and mainstream investors facilitated by impact investment bank ClearlySo.
- **Clean Team Ghana:** Water and Sanitation for the Urban Poor (WSUP) and Unilever teamed up to invest in toilets in slum areas. Local people pay for portable toilets, and the waste is taken away to generate electricity and fertiliser. Commercial organisations wouldn't take on the risk, and the government didn't want to fund this.
- **www.Lendwithcare.org:** A crowdfunding platform that allows lenders to lend money to those in the developing world. Initial capital and investment was put up by the charity CARE International UK. It has now lent over £10m to the poorest.
- **Scope:** Was the first charity to raise a retail bond for funds. It raised £2m and was listed on the Euro MTF Stock Exchange Luxembourg to pay for its charity shops.

PROGRESS SO FAR: SUPPLY AND DEMAND

Reports to date highlight that currently there are some 3,500 separate social investments across the UK with an aggregate value of £1.5bn, around 47% of those sitting within charities. The market is growing rapidly at 30–40% per annum.

Social investment is breaking down the legal barriers between charities, social enterprises and commercial organisations

Big Society Capital has issued around 15% of all funds to date, but as a wholesaler does not invest directly and places capital with social investment finance intermediaries (SIFIs) to build the social investment market on its behalf. The market continues to develop and SIFIs have developed funds focused on a wide range of themes – ranging from ex-offenders, adoption and rough sleepers to health and ageing.

BIG SOCIETY AND THE REFUGEE CRISIS

Big Society Capital (BSC), a first of its kind, was originally set up by Britain's Cabinet Office and launched as an independent organisation with a £600m investment fund in April 2012. The capital came from dormant bank accounts via an independent reclaim fund and four leading UK high street banks.

BSC's Head of Strategy and Market Development Simon Rowell believes there is a role for social investment to play in providing long-term support and integration for migrants and refugees into Europe – more than one million in 2015 alone – many of whom have been forced to flee violence and instability and now live in poor conditions in refugee camps. This has created an unprecedented set of political and social challenges.

Last September, David Cameron's Government committed to rehome 20,000 Syrian refugees by 2020, direct from UN camps. In May this year, he responded to public and political pressure to commit the British government to take in more unaccompanied Syrian refugee children from Europe. "This was welcome news for many hoping for the UK to do more to support the waves of most vulnerable across Europe," says Rowell. "However, serious questions remain for how Britain will achieve these targets, as well as the broader group of almost 170,000 refugees and asylum seekers. How will local authorities cope with this increased need?

In a recent paper, *Investing in integration – how can social investment be used to promote integration of refugees and asylum seekers?* Rowell has explored if and how social investment could play a role in addressing the needs of refugees and asylum seekers, and to flush out some bigger ideas.

"What is encouraging from my investigation," he says, "is that there are already emerging examples of innovative financing approaches used to address challenges of vulnerable migrants, some currently being deployed in the social investment market in the UK, but also by our international colleagues. For instance, in Canada the Immigrant Access Fund guarantees loans to migrants to seek accreditation for higher qualifications they would have held in their home country to seek higher wages and better contribute to their new country. In the UK, Commonweal Housing has used social investment to purchase housing for migrants with insecure immigration status and no recourse to public funds.

The introduction of social investment tax relief (SITR) is also likely to facilitate more people using social investment as a tool. UBS released the first SITR fund in 2015 and others look set to follow.

Turning to demand, how is social investment impacting the sector and what is demand looking like? Here there is less research and information. Some research from Cass Business School highlights that charities and social enterprises want more capital and will look to take on 12–15% more borrowing and social investment in the next five years (around £5bn).

However, a recent symposium highlighted that understanding of social investment is the key barrier that needs to be overcome if social investment is going to become more meaningful. There are also some concerns about the ethics of profiting from social issues. If social investment is only seen to generate profit for third-party commercial organisations, it risks alienating social organisations.

IS SOCIAL INVESTMENT THE FUTURE?

Will this be a passing fad or a new asset class for investors? We wait to see.

One thing is certain, however: the market is growing and moving forward using head and heart together, as investors and social organisations embrace this new way of working – blending financial and social returns to create something powerful for the future.

Further information

Mark Salway, Director of Social Finance, Cass Business School.
mark.salway@cass.city.ac.uk

Fund aggregators

INVESTORS LOOKING TO PICK THE BEST FUNDS COULD BE HELPED BY NEW ONLINE CROWD AGGREGATION SERVICES THAT POOL THE OPINIONS OF ADVISERS AND OTHER INVESTORS. CAN SOCIAL MEDIA HAVE AN IMPACT ON THE WORLD OF INVESTMENT?

ANDREW DAVIS JOHANNA WARD

I had a fascinating conversation a few weeks ago with an Israeli fintech entrepreneur who is trying to create a TripAdvisor equivalent for the world's mutual funds. In an era when the really big flows are going to passive managers such as Vanguard – whose fees are heading towards zero – and talk of consolidation among active houses is growing louder as pressure intensifies to cut theirs, here was someone who stood out simply by suggesting that active management might have a worthwhile future.

It's already clear that many investors are giving up trying to pick winning active funds on the basis of past performance because the results are so uneven and deciding to go passive instead, effectively swapping the possibility of beating the index, and paying the cost of trying, for the certainty of matching it at rock-bottom prices.

Oren Kaplan, the entrepreneur I spoke to, argues that the collected opinions of investment advisers and professional fund selectors provide an alternative means of choosing actively managed funds, in much the same way that TripAdvisor reviews bring the wisdom of crowds to bear on hotel and holiday accommodation.

Investment advisers rate funds through his service, SharingAlpha, on three broad criteria: investment team, strategy and fees. The site, which contains data on more than 100,000 funds tracked by Morningstar, then combines the advisers' individual ratings (which they can update) to produce an overall ranking for each mutual fund.

However, rather than simply publishing an average of all the scores given to a particular fund, the technology behind the site gives greater weight to rankings from more successful fund selectors – based on how well their previous ratings have turned out in practice. Fund selectors can opt to make their ratings public and therefore enable them to be compared with others', or to keep them private and use the service as a way to monitor their own success rate.

"A service like this could allow anyone to see how the wider community of advisers and fund selectors rate a particular fund today, and how that rating is changing"

It's an interesting idea. For a start, a service like this could ultimately allow anyone to see how the wider community of professional advisers and fund selectors rate a particular fund today, and how that rating is changing. Second, it will allow individual advisers to build up a record of picking funds (and fund portfolios) and to show how successful or otherwise they have been, relative to the rest of their profession. Therefore it's possible that advisers could find they have a way of showing how consistently they can add value through their fund recommendations compared with their competitors, while fund providers will be able to demonstrate how highly-rated their products are by the advisory community.

Of course, it's still very early days – the service is only a few months old and will only become really useful when it has large numbers of users who have built up a record of selections over a reasonably long period. It's also possible that no very clear picture will emerge from all the adviser ratings. Perhaps most advisers will turn out to have a fairly modest success rate, making any individual recommendation from them less valuable than users might hope, and the service more useful for picking funds based on collective wisdom than for demonstrating the superior success rate of any individual adviser. And maybe the act of making transparent the collective thoughts of a large number of fund selectors will start to erode the edge that the best of them currently enjoy, providing another example of the way that by observing something we may change the outcome. If money flows to funds because their ratings are rising, that may bring forward the point at which their performance starts to decline.

But these are questions for the long term, assuming SharingAlpha gains sufficient traction. The point at this stage, to my mind, is that although this venture may not have the right answers, it is asking a lot of the right questions. How do advisers make clear to clients and potential clients in a readily comparable way the value that they add?

How should individuals who want active management think about selecting funds if past performance is such a poor guide? And perhaps most important, how will rising generations of investors who have grown up with social media and are therefore inclined to trust reviews and opinions provided by others like them – rather than supposedly expert authorities – decide where to put their money?

This early attempt to bring the ethos of social media and the wisdom of (reasonably expert) crowds to bear on the conservative world of investment advice may be a great success or it may end up as a footnote. But I strongly suspect that this will not be the last service of this kind that we read about and that for the rising generation of investors, the habits formed through social media will influence every aspect of their lives, including their approach to investing.

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