

the review

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

CISIORG/REVIEW

JULY 2019

CISI
CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

REVIEWING THE IMPACT
AS DEMATERIALISATION
COMES TO THE FORE

WHAT MAKES AN
EFFECTIVE MANAGER IN
THE WORKPLACE?

TRACKING THE
TRANSITION AS SONIA
REPLACES LIBOR

A healthy approach

WHY THE FINANCIAL SERVICES SECTOR CAN'T AFFORD TO IGNORE THE MENTAL WELLBEING OF ITS PEOPLE ANY LONGER



welcome

“Our special report examines the stigma around mental health in the workplace, providing case studies and pointers of where to go for help”



One of the most shocking statistics from our recent survey on mental health in the financial services sector is that only 46% of the 3,686 respondents would feel comfortable talking to their manager about poor mental health. Our special report (pp.17–23) examines the stigma around mental health in the workplace as a follow-up to this, providing case studies and pointers of where to go for help. As Lora Benson, CISI head of media says on page 22, “We don’t pretend to have all the answers, but possibly one of the most powerful ways we can influence a change in the stigma of mental ill health in the workplace is to tell stories.”

Nigel Jones, co-founder and former chair of the City Mental Health Alliance, agrees with the importance of creating a culture of openness in the workplace, saying that the CMHA’s vision is “a healthier working environment in the City”. Read his story on pages 24–27.

Other highlights include a look ahead at two significant developments: the transition of the London interbank offered rate to the Sterling Overnight Index Average over the next two years (pp.31–33); and the dematerialisation of share certificates from January 2023 (pp.34–36).

We also chat to Manager Tools CEO Mark Horstman and others about how to be an effective manager. Mark’s team has compiled a webpage of resources on the subject, especially for CISI members. Read the article on pages 37–39 for more details.

Our regular slots this quarter include an insight into Sandra Dailidyte, Chartered MCSI’s powerlifting hobby on page 14 (her personal best is 175kg and counting); investment in solar energy (pp.56–62); and an ethical dilemma about CPD (pp.44–45).

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

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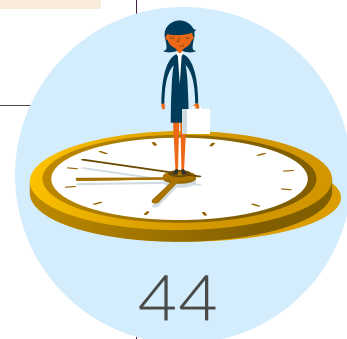


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CISI.ORG/REVIEW

CHECK OUT THE ONLINE EDITION OF *THE REVIEW* AND THE WIDER CISI WEBSITE FOR EXCLUSIVE WEB-ONLY CONTENT

100110
011001

Watch



George Kinder CFP® played a formative role in the creation of life planning in the mid-1990s. In our brief video outline, he talks about why he created it, what it is and what we can get out of it. Watch: cisi.org/kinder Read: cisi.org/georgekinder

MOST COMMENTED ON

Grey matters ethical dilemma: In his shoes
cisi.org/shoes

Does the way you work put client data at risk?
cisi.org/clientdata

Tokenisation: Crypto is preparing for prime-time finance
cisi.org/crypto

Learn



MINDFULNESS
Distinct pass numbers: 154

Q2 MOST READ

Getting to grips with MiFID II costs and charges
cisi.org/mifid2costs

Vulnerable clients: Protecting those who need it most
cisi.org/vulnerable

How to deal with a busy workload
cisi.org/workload

Read



ASK THE EXPERTS: WE NEED TO TALK ABOUT KIDS
Ian Sayers, chief executive of the Association of Investment Companies, on key information documents
cisi.org/kids

EVENTS

FINANCIAL PLANNING ANNUAL CONFERENCE
29 September to 1 October
Hilton Birmingham Metropole
Book on to the CISI's flagship financial planning event of the year at cisi.org/fpconf19



To read more, visit cisi.org/review

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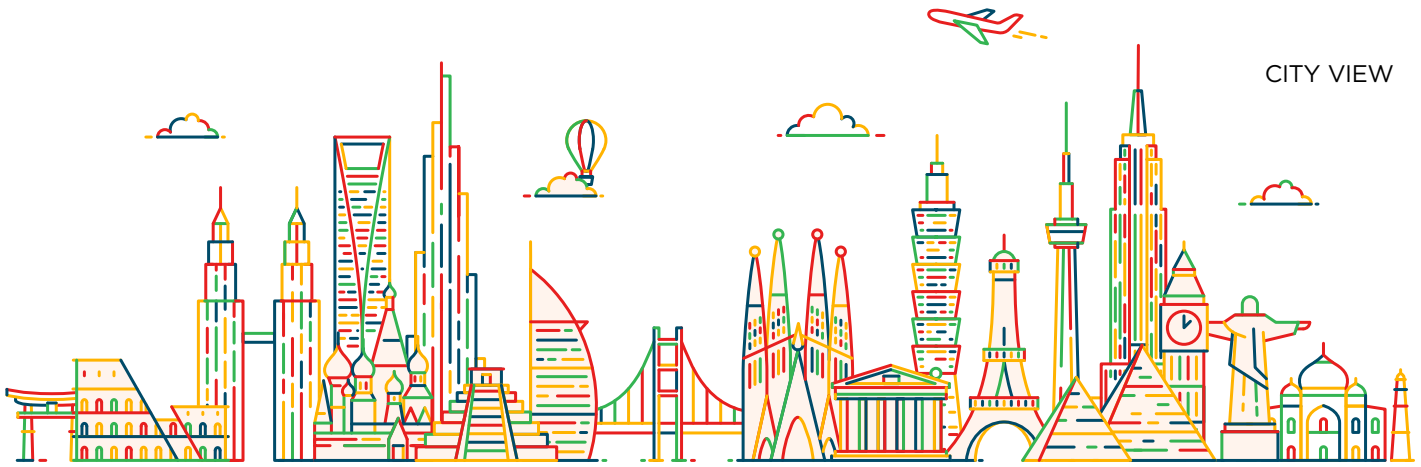
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10% off all Apple Mac products at Compu b



The Register is dead, long live(ish) the Directory

THE REPLACEMENT FOR THE REGISTER OF APPROVED PERSONS IS A WELCOME DEVELOPMENT, BUT ANOMALIES NEED ADDRESSING

The UK FCA's decision in 2017 to abolish the register of approved persons in the face of criticism of the Approved Persons Regime was an overreaction and more akin to throwing out the proverbial baby with the bathwater.

Not only was abolishing a public register contrary to the international securities regulator's example of best practice, it was strongly criticised by firms, press and even within the FCA itself, as being detrimental to the consumer as well as its own enforcement teams.

As a result, the CISI and the Chartered Banker Institute worked on a proposal to replicate, and modernise, the register using blockchain technology to allow the form to automatically self-complete. Proposed new fields included the level of membership and type of qualification held by an individual.

The idea garnered considerable support, including, ironically, from the FCA. However, the proposal finally foundered when large banks declined to participate.

// AS A CONSUMER, YOU NEED RELEVANT INFORMATION ABOUT YOUR POTENTIAL SPECIALIST //

The FCA then had a rethink and in July 2018 consulted on its new replacement proposal for the register: the Directory.

A record number of our members responded to the consultation. The FCA received 500 replies, 99% of them supporting the concept of the Directory. Many respondents brought up the need to recognise those who are members of a professional body.

The good news is that the regulator listened and amended its original proposal. In future, the Directory will list a person's membership of a professional body.

This is a major step forward as it publicly recognises that individuals who are members of a professional

body should be valued more highly than those who are not members. So far, so good.

However, the FCA now needs to go much further. The Directory needs to specify which level of membership the individual holds alongside their specific qualification. This will allow the consumer to make a better judgement about the individual with whom they are potentially engaging.

Imagine if you were seeking medical advice for a specialist area. As a consumer you need relevant information about your potential specialist. It is likely that you would be more confident about seeing a consultant who is a Fellow of the relevant branch of medicine and possesses the specialist qualification in the field you are seeking.

This is the same for consumers of financial services, who would benefit from knowing the level of membership of their potential consultant and whether their adviser is suitably qualified.

The FCA has argued that there isn't sufficient conformity of grades amongst the professional bodies for it to ensure clarity for the consumer. However, we suggest that if over 30 global airlines can come up with a common four-tier membership system, then six UK professional bodies should be able to do the same.

Eliminating disadvantage

There is one other anomaly that needs addressing. Banks, insurers and their appointed representatives will be on the Directory from March 2020. However, other firms, including wealth managers and financial planners not working for a bank, will not appear until December 2020. This means that for nine months, these members will be at a disadvantage since they won't be showing on the Directory. The FCA says it is responding to feedback that the smaller firms might not be ready, but the simple solution is to accept any entries from those firms from March rather than wait until December. ●

AROUND THE GLOBE

The CISI's international network of offices looks after 45,000 members worldwide

38%
female award winners this year, compared to 28% in 2018

CISI.ORG/AWARDS2019

UNITED KINGDOM

Chief executive officer: Simon Culhane, Chartered FCSI



Our 26th annual awards ceremony and drinks reception, held at Mansion House, London, celebrated outstanding achievement amongst 68 CISI global finance students.

Susan Clements, CISI global director of learning, congratulated the achievers, saying: "Their awards are testament to their hard work and commitment to learning and also to the support of their community of family, friends and firms. We wish them every success in the next phase of their careers."

Read article and watch video highlights at cisi.org/awards2019

SENEGAL

Senior international manager:
Praneet Shivaprasad

In partnership with the Union Monétaire Ouest Africaine (UMOA) Securities Agency (UMOA-Titres), we have launched the CISI-UMOA financial certification programme for regional market players. The ceremony was held on 25 March in Dakar, Senegal. This programme will include two French modules: Fundamentals of Financial Services and a new bespoke module on Bonds.



RWANDA

International manager: Lisa Elo



We've partnered with the Rwanda Capital Markets Authority (CMA Rwanda) to launch a qualification-led licensing programme to enhance and promote professional standards in the financial services sector in Rwanda.

At the launch event in April, the acting executive director of CMA Rwanda, Eric Bundugu, said: "We are partnering with Financial Sector Deepening Africa and the CISI to support capital market practitioners to advance their knowledge and promote ethics and integrity in financial services in Rwanda."

Our partnership with CMA Rwanda follows a partnership in 2017 with FSD Africa, through which a financial literacy programme has been established to deliver skills developments for capital markets professionals across Rwanda. To date, over 500 students have been trained and certified through this partnership.

View the launch event at bit.ly/RwandaCMA

IRELAND

Client relationship manager:

Deirdre Heffernan

Our fourth Ireland awards ceremony was held at the Royal College of Physicians in Dublin on 4 April.

Awards were presented to seven individuals for results achieved during 2018, with one of the winners, Noel McMonagle, receiving two awards on the night.

Read the story at cisi.org/irelandawards2019

View the photo gallery at cisi.org/irelandawards19



18%
growth in CISI UAE
membership in the
past year

CISI.ORG/UAE-18

KUWAIT

Regional director Middle East:

Matthew Cowan, Chartered MCSI



Program (PQP) – a three-part qualification that follows best international practice, qualifying the recipient to work in international financial institutions.

The project leading to the PQP is called the Qualifications Examinations Project for Registered Employment Positions.

CISI CEO Simon Culhane, Chartered FCSI (pictured top, second from right, with the KCMA PQP team), said: “These enabling activities will help transform Kuwait’s capital markets and create an investment environment that attracts global investors and builds confidence and trust.”

In April 2019, we announced a collaboration with the Kuwait Capital Markets Authority (KCMA) to promote a project that leads to the Professional Qualifications

AUSTRALIA

International manager: Lisa Elo



We have partnered with the Australasian financial services professional body, FINSIA, to provide an ethics test for Australian bankers and securities professionals.

FINSIA CEO Chris Whitehead, pictured above with CISI CEO Simon Culhane, Chartered FCSI, said: “FINSIA’s purpose is to raise standards of professionalism with the intention of rebuilding trust in the Australasian financial services sector. There is no better time to launch the Integrity Matters programme with conduct and decision-making being placed under the microscope post Royal Commission.”

Simon said: “We share FINSIA’s view that ethics education, based on the real-life dilemmas in Integrity Matters, can play a part in helping individuals and organisations recognise and respond more effectively to the challenges which can arise in balancing stakeholder interests. Such programmes contribute strongly to organisations’ culture change programmes, as they have done in the UK.”

NEW PRESIDENT ANNOUNCED FOR SOUTH COAST COMMITTEE



Abby Johnson, Chartered FCSI, investment manager at Charles Stanley (pictured), is the new president of the South Coast Committee, replacing JPMorgan Chase regulatory reporting officer Simon Roche ACSI, who held the position for two years.

Abby is the second woman to be elected president in the branch's 23-year history. She specialises in portfolios for private clients, trusts, charities and self-invested personal pensions, and has 25 years of experience in financial services. She joined the CISI in 2000 and has been with Charles Stanley since 2014.

Commenting on her appointment, she said: "We are actively seeking collaboration with other professional bodies within our region, so there is plenty to be getting on with; these are exciting times!"

CISI AGM 2019

This year's annual general meeting will be held on Thursday 10 October at the CISI head office, 3rd Floor, 20 Fenchurch Street, London EC3M 3BY from 10.30am to 11am.

A Member (MCSI) or Fellow (FCSI) of the institute may be nominated for elected vacancies on the Board. Board members retiring by rotation may stand for re-election and the Board itself may sponsor candidates for any vacancies arising.

Nominees may be invited to meet with members of the Board Nomination Committee before going forward as a candidate for election.

A nomination form, which includes an explanation of the requirements for the election of candidates to the CISI Board of Directors, is available on the CISI website. Alternatively, the nomination form is available from Linda Raven at linda.raven@cisi.org.

The closing date for nominations for Board membership is Friday 26 July 2019.

INAUGURAL JOINT SOUTHERN AND SOUTH COAST BRANCH EVENT



By Keith Churchouse CFP™ Chartered FCSI, president of the CISI Southern Committee

The first joint CPD event between the two branches was held at the University of Portsmouth on 14 May 2019.

Neil Dobson, investment speaker at Invesco, gave an insightful and interactive presentation to the 49 attendees on the topic of behavioural finance. It was helpful for investment managers and financial planners in understanding client attitudes and reactions to investment risk, gains and losses.

This was followed by a choice of two breakout sessions, with Trevor Neil MCSI, trainer at Beta Group, providing a fascinating overview of bitcoin and cryptocurrency, and Trevor Head, senior protection specialist at AIG Life, focusing on the range of protections that are now available to clients and their families.

The group came together for the final presentation from Gervais Williams, managing director of Miton Group, who provided an absorbing and thought-provoking view on global and UK markets going forward.

The event was a great success and much positive feedback was received.

Our thanks go to the four excellent speakers and to Abby Johnson for all her hard work to make the event such a success. We look forward to running another joint event in future.

CISI CSFI MANSION HOUSE CITY DEBATE 2019



Sir Gerry Grimstone MCSI, recent chairman of Aberdeen Standard and Barclays; Kay Swinburne MEP; and Angela Knight CBE FCSI(Hon), plus (behind them) Lord (Paul) Myners, former Treasury minister and chair of Gartmore; and top economist John Kay CBE, debated at the Mansion House on 11 April 2019 on whether

we should be optimistic – or not – about the future of the City. We run this great debating treat every year with the Centre for the Study of Financial Innovation, one of the world's leading think tanks. And who won? Watch this great event on CISI TV for two hours' CPD, and some seriously well-informed comment, to find out.

Events preview

We offer many opportunities to help you meet your requirements for professional development. Below are just some of the highlights of the institute's CPD events programme, but for comprehensive details and to book, please visit cisi.org and click on the 'Networking & events' section. Please note that dates listed below are subject to change.

FINANCIAL PLANNING CONFERENCE 2019 Hilton Birmingham Metropole, 29 September to 1 October

Two full days packed with CPD, the most inspiring speakers from around the globe and hundreds of leading financial planners. All in one central location in Birmingham.

Find out more and book at cisi.org/fpconf19

LONDON CPD

22 JULY Financial Planning Forum: Single E to ESG

4 SEPT Compliance Forum: Good governance

5 SEPT Fintech Forum

9 SEPT The transatlantic divide

16 SEPT Mindfulness for hard-nosed financiers

26 SEPT Project Heather: Where impact meets IPO

REGIONAL CPD

24 JULY Value of advice (Manchester)

27 AUG Art in leadership (Edinburgh and Glasgow)

5 SEPT Intergenerational planning and summer drinks (Birmingham)

10 SEPT Bank of England update (Bristol and Bournemouth)

10 SEPT Wholesale market conduct (Dublin)

19 SEPT Socially responsible investing (Guernsey)

24 SEP Thematic investing; Cloud computing; Blockchain (Manchester)

SOCIAL EVENTS

5 SEPT Scotland branch annual dinner and awards night

16 SEPT Young Professionals Network: The power of personal storytelling

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

QUICK QUIZ

The Review's quick quiz features questions from CISI Professional Refresher, an online learning tool. This popular product consists of more than 150 modules covering topics including anti-money laundering, the UK Bribery Act, information security and data protection. The answers are on page 47.

Mindfulness requires us to be aware, in the present moment, without:

- A Anger
- B Fear
- C Judgement
- D Thought

What does fossil divestment involve?

- A Cutting ties with companies that extract fossil fuel reserves
- B Investing in firms that extract fossil fuel reserves
- C Selling shares in fossil fuel firms, while being able to buy their bonds
- D Selling shares in firms running coal-fired power stations

In the past year, FCA enforcement policy has seen lifetime bans increase by:

- A 7%
- B 50%
- C 70%
- D 75%

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

Disciplinary rules: important notice

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

Examples of matters which may impact suitability to remain a member include (but are not limited to): whether in the course of work, a member has committed any act or default likely to bring discredit

to them, the institute or the securities, investment, wealth and financial planning professions; if a member has performed their work incompetently; and, if a member has failed to satisfy a judgement debt, has made an assignment for the benefit of creditors, a bankruptcy or interim order has been made against them, or if the member has entered into a voluntary arrangement as defined in the Insolvency Act 1986.

More information at cisi.org/mrules





Financial planning news

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

FINANCIAL PLANNING AND PARAPLANNING ARTICLES

I hope you are enjoying reading all *The Review* financial planning articles as well as those we write for other publications, such as *Professional Paraplanner* and *NMA*. We reproduce these articles on the online *Review* platform. So, if you have missed any or would like to refresh your memory, please log in to your MyCISI account and you will find the online members' magazine listed on the left (alternatively, simply type in *cisi.org/review* to access the homepage). Click on that and you will see the Financial Planning tab at the top of *The Review* homepage. There are several financial planners on the Financial Planning Editorial Panel who help us choose the financial planning topics for the print editions and online articles, but if you have any thoughts, ideas or suggestions for new or interesting content, please contact me. jacqueline.lockie@cisi.org

CONSULTATION PAPER RESPONSES AND FCA-RELATED ISSUES

My thanks to those of you who responded to the Pensions Dashboard consultation paper.

You may have also seen that CISI CEO Simon Culhane, Chartered FCSI, wrote to FCA CEO Andrew Bailey about the professional indemnity insurance issues our financial planning member firms are struggling with. We will update you on the progress of these and other developments in the fortnightly ebulletin that you will receive called 'Financial planning and paraplanning news'. If you are not receiving these emails, please log in to your MyCISI account and update your dashboard preferences.

NEW CERTIFIED FINANCIAL PLANNER™ CERTIFICATION PATHWAY

We have launched a new enhanced CFP™ certification pathway with a new website at cisi.org/fp collating everything you need to know about obtaining the CFP certification. It includes information about the new level 6 exam and level 7 case study assessment syllabi, exam workbook and ebook, and an explanation of how it all bolts together. There is now one complete pathway for everyone, right from those starting afresh in the profession with no relevant qualifications or experience, through to those of you who have attained various qualifications along the way. There are comprehensive FAQ sections and an

enquiry form to establish what you need to do to achieve this global financial planning certification.

There are now over 181,000 CFP professionals across 26 countries around the world, and we know from these financial planners that the learning required to complete the CFP certification can transform your business, giving you a robust and repeatable process to offer a comprehensive financial planning service to your clients.

Please visit cisi.org/fp if you are interested.



FP CONFERENCES

Two successful conferences have already taken place this year: the Accredited Financial Planning Firms™ Conference on 6 March and the Paraplanner Conference from 17 June to 18 June. Feedback has been tremendously positive, and we have received many suggestions for next year. My thanks to all those financial planners and paraplanners who have helped and guided the content and structure of these events. The final conference of 2019 is the flagship financial planning event of the year, The Financial Planning Conference, taking place from 29 September to 1 October at the Hilton Birmingham Metropole. We held the conference there for the first time in 2018, and have implemented many changes to ensure all our attendees have

a hassle free and enjoyable conference in 2019. We have some fantastic, world-leading thought leadership and financial planners from around the globe. I can't wait to welcome everyone. Visit cisi.org/fpconf19 if you would like to book yourself on to the event.



EXCLUSIVE REVIEW OFFER

Enter code **FPCONFVIEW** when booking, for £50 off all packages until 11.59pm on 15 August 2019.

INVESTMENT COMPANIES GO ALTERNATIVE



In the world of investment companies, alternative assets are now all the rage. Of the past 50 investment company IPOs, 36 were in alternative assets, raising £5.7bn. Esoteric assets such as shipping and music royalties have joined more established alternatives such as debt, infrastructure, private equity and property.

What does it all mean? In a word, diversification. Correlations between alternatives-focused investment companies and mainstream equity markets are low, enabling wealth managers to build more robust portfolios. Income is also an attraction, with yields in the infrastructure, UK property and debt sectors averaging 4.7%, 5.1% and 6.6% respectively.

Investment companies allow illiquid assets to be accessed in a liquid format, an advantage that has been brought into sharp focus since the EU referendum. The fuss about the gatings of open-ended property funds obscured the

(arguably) more serious problem of their substantial cash drag and underperformance versus their closed-ended cousins. Over the past ten years, the average fund in the IA UK Direct Property sector returned an annualised 6.1%, while Real Estate Investment Trusts and other investment companies in the AIC Property Direct – UK sector averaged 10.1% on a NAV basis and 15.3% by share price.

To shed light on how investment companies offer access to alternative assets, the AIC will be holding seminars in Birmingham on 18 September, and London on 10 October.

Booking is open now at www.tinyurl.com/aicalts, or you can contact Debra Gibbons on 020 7282 5572 or debra.gibbons@theaic.co.uk for more information.

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BIG DATA ARRIVES AT JUPITER

Magnus Spence, head of investments, alternatives, at Jupiter, asks: is alternative data the holy grail for fund managers?

It is well known that active investment managers rely on finding new information to beat their benchmarks and competition. Over the past 30 years, the sheer volume of information has grown exponentially. In the never-ending quest to find an ‘edge’, some fund managers are now turning their attention to a new source of information. Welcome to the world of ‘alternative data’.

There are approximately 1,600 alternative data sets which can be purchased today, providing information on a huge variety of subjects, such as shopping habits, cargo movements, satellite images, attitudes and sentiments, factory production and carbon emissions. In theory,

this new information source should give fund managers an advantage and enable them to glean valuable insights before others.

But in practice, it’s not a simple as that. First, the data is not cheap, with some data sets selling for millions. Second, the data is often ‘raw’ and needs to be cleaned up before use; for example, by filling in missing values or removing outliers. Then, a data scientist is needed to process and extract the important trends.

Jupiter is exploring the potential use of alternative data sets, looking at topics from patent filings to sentiment measures about Asian companies based on neurolinguistic analyses of web-based Chinese text. Unsurprisingly, the sheer volume of data, coupled with the large number of sources, can be a challenge. Also, a significant number of

providers are based in America, which can result in US-centric coverage and potential concerns around ethical best practice differing across jurisdictions.

Jupiter has started to meet these challenges by building a data science team. Is alternative data the holy grail of investing? We don’t really know at the moment, but we are hopeful that it may help our fund managers stay ahead of the competition with this new and exciting potential ‘edge’.

Read the full article plus disclaimer at bit.ly/jupiter-big-data



QUENTIN McCORMICK CFP™ CHARTERED FCSI, MANAGING DIRECTOR AT PAVIS FINANCIAL MANAGEMENT, EXPLAINS THE VALUE OF LONG-TERM FINANCIAL PLANNING AND THE IMPORTANCE OF USING THE RIGHT TOOLS

Financial planning, not financial selling



WHEN DID YOU BECOME AN ACCREDITED FIRM? WHAT HAS HAPPENED SINCE?

We became an accredited firm in 2014 and have continued ever since. We still feel strongly that there are some excellent financial planning firms in the UK who would do themselves a huge favour by going down this route. What better way is there to stand out from other firms?

WHAT HAS ACCREDITED FIRM STATUS BROUGHT TO YOUR FIRM AND WHY SHOULD OTHERS SEEK TO BECOME ACCREDITED?

We became an accredited firm as a 'differentiator'. There were no other accredited firms in the Liverpool area in 2014, and nothing has changed. We're still the only CISI Accredited Financial Planning Firm™ in Merseyside, and enjoy being able to say this to clients. It is important for us to show our clients, staff and professional connections that we adhere to the highest possible standards in financial planning. Becoming an

// WHAT WE DO CAN BE TRULY LIFE-CHANGING FOR CLIENTS AND THERE ARE FEW PROFESSIONS THAT CAN SAY THAT //

accredited firm says that you take this business seriously. It's not an easy process but it's well worth the journey.

WHAT ACCOLADES AND AWARDS HAS THE FIRM PICKED UP IN RECENT TIMES?

We have been included in Citywire's Top 100 for the past five years. We have not previously entered the various advice awards but we are now thinking of doing so. We feel this should be for a team/company award so we are thinking of applying for Accredited Financial Planning Firm™ of the Year.

WHAT SORT OF BUSINESS IS IT AND WHAT SERVICES DOES IT OFFER? WHAT'S YOUR USP?

First and foremost, we are a holistic financial planning business. As I often like to say, "we are in the financial planning business, not the financial selling business". We recognise that cost is a key consideration in long-term planning and our client proposition reflects this. We believe it represents outstanding value for money.

HOW DID YOU GET INTO FINANCIAL PLANNING?

I started as a trainee broker consultant at Scottish Mutual in 1991. I had a great time there and amongst others I met Lawrence Gilgallon who is now business development manager at the CISI. I stayed there till 1996 when I was approached by the financial advice arm of an accountancy practice in Chester. I then moved to a larger independent firm in 2002. In 2005, I joined the Institute of Financial Planning (IFP) and was introduced to true financial planning. I achieved my CFP certification in 2007.

I had first met the previous managing director of Pavis, Bob Newton, in the early 1990s while I was a broker consultant with Scottish Mutual – we met through a mutual friend, an independent financial adviser called Ray Edwards. In 2012, I reconnected with Bob and we discussed the longer term succession issues with Pavis. They already had a great team in place but were looking for someone who could take over the running of the business when Bob retired. I became a shareholder and director of Pavis in 2013, and managing director in 2018. Suffice to say the past six years have been so much fun that Bob still hasn't retired!

WHAT'S THE BEST THING ABOUT BEING AT A FINANCIAL PLANNING FIRM?

Making a difference to people's lives and seeing the positive impact this has on them and their families. What we do can be truly life-changing for clients and there are few professions that can say that.

WHAT IMPACT HAS MiFID II HAD ON YOUR BUSINESS?

We have had to make some fairly minor changes to our review procedures but a lot of what MiFID II was 'about' has been our standard for a number of years.

WHAT DO YOU LIKE ABOUT THE CISI?

It is the only organisation that is truly trying to represent both the financial planning and investment professions in a coherent manner. We are currently seeing more investment professionals looking to advance their financial planning skills so they can best cater for their clients' needs. I feel there is a lot of momentum gathering and over the next three to five years we will see the CISI become the default choice.

WERE YOU INVOLVED IN FINANCIAL PLANNING WEEK 2018? IF SO, WHAT DID YOU DO? WILL YOU BE INVOLVED IN THIS YEAR'S FINANCIAL PLANNING WEEK?

We promoted Financial Planning Week on social media and around our local area. This generated a number of enquiries which has led to some high-value new clients. We aim to repeat this in 2019 and to promote the event more actively. We might look to use both press and radio as a way of communicating what we're doing.

WHAT DOES A TYPICAL WORK DAY LOOK LIKE?

I leave home about 7am and have breakfast at my desk. This helps me to avoid the worst of the Mersey Tunnel traffic jams. Preparation for client meetings takes precedence over all other tasks, and once this is done I can turn my attention to ongoing client reviews/suitability reports and dealing with the deluge of email, HR and business management issues. I aim to leave the office by about 4.30pm. I have been known to do evening and weekend appointments but can't remember the last time this happened. I will occasionally use Skype or FaceTime for client meetings

but find that many clients prefer the reassurance of a face-to-face meeting over tea and biscuits. I also prefer face-to-face meetings as I believe it helps the fact finding and 'know your customer' process.

WHAT ARE YOUR KEY TIPS FOR OTHER PLANNERS?

Having streamlined systems and procedures in place makes it easier to deal with more clients. You can't deal with hundreds of clients if you use lots of different cashflow software, platforms, investment propositions and so on. The advice needs to be bespoke but the tools for delivering this need to be consistent. We use Voyant for cashflow, Finametrica for assessing investment risk and I have used Transact for 16 years. We hear a lot about client segmentation and service. We prefer to have one core client offering which is ideally suited to clients with at least £250,000 of investable assets. Depending on the size and complexity, we then agree yearly, half-yearly or quarterly reviews. Where possible, we try to steer clients away from quarterly reviews as it invariably leads to too much focus on short-term investment performance. ●



QUENTIN McCORMICK
CFP™
CHARTERED
FCSI
Quentin is a
Chartered
Wealth
Manager and

managing director of Liverpool-based Pavis Financial Management, which was founded in 1992.

Quentin has been with Pavis since 2013. He took over as managing director in May 2018. He has been advising for over 20 years and was the regional chair for the Institute of Financial Planning's Chester and North Wales Branch immediately prior to its merger with the CISI. He is currently chair of the CISI Accredited Firms Steering Group.

POWERLIFTER AND WEALTH MANAGER SANDRA DAILIDYTE, CHARTERED MCSI, HOLDS LITHUANIAN SQUAT AND DEADLIFT RECORDS IN THE 72KG CATEGORY. LORA BENSON MCIPR, CISI HEAD OF MEDIA, REPORTS

Powering ahead

Sandra takes the weight of the world off her shoulders by powerlifting four to five times a week. She also competes regularly, holding Lithuanian squat and deadlift records in the 72kg category, and has been invited to represent Lithuania at the European Powerlifting Championships in December this year.

Her own personal best to date has been a deadlift of 175kg, which she completed in October 2017 when she shared the platform with the then strongest woman in the world, Donna Moore: “For comparison, she lifted 245kg! I firmly believe that one day I will be able to lift 200kg. I don’t believe in limits.”

Powerlifting is a strength sport, whereby three attempts are made at maximum weight on three lifts: squat, bench press and deadlift. “The goal of my training is to get as strong as possible, relentlessly focusing on perfect technique,” says Sandra.



Sandra celebrates having set a personal best by deadlifting 175kg

Sandra is focused and devoted to both wealth management and powerlifting, but work is her priority: “It sounds cheesy but I enjoy it so much, I would do it for free. Luckily I don’t have to!” She has recently joined Brown Shipley from Seven Investment Management as a senior client manager, with plans to broaden her skills to include financial planning.

Her ambition to work in finance was shaped both by geography and politics: “I was born in Lithuania in the Soviet Union during the time of perestroika. Not long after that, Lithuania became independent. As a very young country, Lithuania does not have deep roots in the financial services sector. Our first commercial bank ‘Second’ collapsed after three years due to criminal activities and lost millions of savings. However, this did not stop me pursuing my dream job in finance. I moved to the UK ten years ago, where I obtained a master’s degree in economics from the University of Edinburgh. I became a British citizen last year and can now officially call Scotland my home.”

Sandra’s interest in powerlifting came relatively recently: “I had never been a sporty person. At school I used to skip PE and at university the only lifting I did was a glass of wine! I started CrossFit in 2015 and shortly after that my coach ‘discovered’ me, and I began powerlifting three years ago. In many ways, my coach plays a similar role to my manager at work. He monitors my progress, we discuss areas to improve and he helps to prepare me for competitions. I am a very competitive person and standing on the platform certainly gives me more motivation.”

Most athletes use a tried and tested method to get psyched up and in the correct frame of mind, pre-competition. Sandra is no exception: “Before the competition I start using visualisation techniques – close my eyes and imagine successfully completing the lift. I use meditation and breathing exercises to keep calm. And just before entering the platform I listen to loud angry music and think of inequality. The

latter makes me angry and I channel that feeling to lift the weight.”

The UK has an active female community of powerlifters, but Sandra has experienced some negative remarks for her hobby: “There is a stigma about women in lifting and quite often I receive the backhanded compliment “but you do not look like a powerlifter”. We may compete against each other on the platform, but after the competition we are supportive of each other. There is an annual female-only competition called Nodumbelles Women’s Open Powerlifting. At my last competition in Edinburgh we had a full female platform: female judges, female spotters and loaders.”

// I LISTEN TO LOUD ANGRY MUSIC AND THINK OF INEQUALITY. THE LATTER MAKES ME ANGRY AND I CHANNEL THAT FEELING TO LIFT THE WEIGHT //

Sandra’s competitive powerlifting requires discipline, hard work, persistence and patience – all skills transferable to work. “Most importantly I feel strong and it is empowering knowing that nobody can push you around!

“I see many similarities between wealth management and powerlifting. Both require consistent hard work and when you have the odd bad day or training session, you must let it go. Similarly, with investing, time and compounding do the heavy lifting; and when the markets tumble, you don’t quit. We are in a long game here.” ●



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

“

You can give someone the knowledge and training, but it is much harder to change someone's values, work ethic and integrity ”

Wayne Hayhurst, Chartered MCSI

How to be an effective manager pp.37–39



ILLUSTRATION: JOSEP SERRA/IKON

global insights

p.16

Fairness in business

pp.17–27

*Special report:
Mental health*

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Flatlining funds

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Dematerialisation

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Financial planning



Anthony Hilton
FCSI(Hon)

FIRST
PERSON

It's time to play fair

PEOPLE, AND THEREFORE SOCIETY, HAVE AN INNATE SENSE OF FAIRNESS. FOR BUSINESSES TO REGAIN THEIR TRUST, THEY NEED TO START SHARING THIS VALUE

“ **The annual report of the Banking Standards Board contains a scatter diagram in response to a question about work relationships.**

As is the way with such diagrams, those words that are little used are denoted as small; those used more extensively are highlighted as bigger. Thus the reader can gain an impression of what most concerns the sector's employees.

On this occasion, 'behaviour' and 'treat' are the two most common, followed by 'concern', 'fair', 'bully' and 'unfair'. Words like 'aggressive', 'resent', 'fear' and 'blame' are also in this mix.

This is just one of the 80 pages and a lot of the report shows that banking is trying to do better. But these negative words and other metrics suggest it needs to try harder. Executives still have a lot of work to do in their organisations.

Good corporate citizens

Corporate social responsibility (CSR) could be a part of this, though some people think it does not really help. There is a feeling that a business does what it does in one part of its organisation, and then does CSR in another; one part is bad, one part is good. The complaint is that public relations teams talk up the good part for CSR purposes in a futile bid to disguise the bad part.

Those who really get it, who deliver truly sustainable enterprises, and who really take the employees, customers and suppliers with them, are still a minority. If CSR is really going to get traction, then it needs to be at the heart of the business. It is no good doing one noble thing in a sea of mediocrity; the whole organisation has to do what is right.

This plays to A Blueprint for Better Business, a charity run by Charles

Wookey, who wants business to be 'fair', as suggested in the banking scatter diagram. He says this is what businesses should do and not, as with CSR, what they should talk about. He has his work cut out though; many executives say life is unfair – and indeed for a lot of people it is. Business can also be unfair, at least part of the time, disadvantaging one set of people over another.

But after seven years of trying, Wookey is gaining traction for his ideas. At the Royal Society of Arts (RSA) in central London early this spring, he organised a debate provocatively entitled 'How not to run an unfair business'. Joining him on the panel were Justin King, the former chief executive of J Sainsbury and now with private equity group Terra Firma; the philosopher and House of Lords cross-bencher Baroness Onora O'Neill; and Jane Corbett, the Assistant Mayor of Liverpool. The RSA's CEO, Matthew Taylor, was the chair.

Wookey started by saying that business should be driven by fairness, first to produce wellbeing for its employees and the community, and second to create an ecosystem that is sustainable for enterprise. To do this, business needs to change in two ways. First, it has to get away from the idea that it is solely about profit; second, it has to realise that employees are not actors focused on money, status and power, but instead have a whole range of interests and emotions.

This requires a significant shift in thinking. Fairness – or unfairness – is at the heart of power in businesses and that often

means employees and suppliers are given a rough deal. Management wants to do something, wants to get out of a hole and employees must lump it.

This is in spite of the fact that business is a human organisation with consumers, employees and suppliers, all of whom are needed to enable the company to prosper.

Wookey is on to something because the starting point is indeed that fairness is deeply ingrained in society. If business is to be trustworthy, then it needs to reflect this. For

business to act fairly, it has to focus on three things: how is a decision made, with what frame of mind and with what result?

All of these are important,

but the key is the 'frame of mind', because that should mean the organisation is trying to be fair, even if it does not always accomplish it.

Then, even if it is impossible to be as fair as it would like to be, it should be possible not to be manifestly unfair to anyone – hence the seminar's title of 'How not to run an unfair business'. Fairness then becomes not a constraint, but an aim. Clarity of purpose, fair processes, treating people with dignity and respect, consulting people and engaging them on what has to be decided, and a welcome scrutiny, are all part of it.

Fairness is not something most executives think about, but perhaps they should. It might make people in the UK believe in business, rather than simply tolerate it. ●

“ **Fairness might make people in the UK believe in business, rather than simply tolerate it** ”

ILLUSTRATION: PADDY MILLS/SYNERGY

”

A healthy approach

WHEN IT COMES TO POOR MENTAL HEALTH, FINANCIAL SERVICES PROFESSIONALS ARE ONE OF THE WORST AFFECTED GROUPS. HOW CAN THE SECTOR START OUT ON THE ROAD TO RECOVERY? **ALEXANDER GARRETT** REPORTS

ILLUSTRATIONS: SARAH JONES

>> In 2006, at the age of 40, Brian Heyworth had a breakdown. One moment, he gave every outward sign of being the successful banker, functioning normally. The next, he remembers, “I literally collapsed in the office, then I was in tears with the HR department, and the next day I was in hospital.”

In fact, Brian had been suffering mental health problems since he was 12 or 13 years old, fearing that he was dying of cancer and then of AIDS, but never asking for help. During his thirties, he had two bouts of depression, “probably catalysed by work stress”, but bounced back after receiving antidepressants from his GP. He gave little clue to his colleagues that anything was wrong.

What’s remarkable is that, when the breakdown came, after spending two months in the Priory Hospital and another couple of months recovering with family, HSBC offered him a top job as head of global markets sales EMEA, in full knowledge of his medical record. “Stuart Gulliver, who was then CEO of the bank’s Global Banking and Markets division, asked me two questions,” says Brian. “‘Are you OK?’ and ‘Can you do the job?’”

Today, Brian is HSBC Global Asset Management’s global head of client strategy and an evangelist for good mental health in the workplace. He’s just taken on the role of chair at the City Mental Health Alliance (CMHA), a body whose vision is to help people at all levels in the City of London talk about mental health without fear of stigma. It was founded by and is a coalition of City businesses. In his own case, Brian prefers to talk about ‘growth’ rather than ‘recovery’ and says: “I feel like a better leader than I was before the breakdown. John Flint, our current CEO, says that in his experience, people who’ve had mental health problems are more resilient and more empathetic.”

Growing evidence

Nobody knows the exact scale of mental health problems in the financial services sector but from time to time, there are stark reminders of its existence. In August 2017, IT consultant Christopher Woolnough jumped to his death from a top floor balcony of London Stock Exchange a fortnight after complaining to his GP about

stress and anxiety. His suicide was a tragic public manifestation of a problem that remains largely hidden, often kept by sufferers even from immediate colleagues.

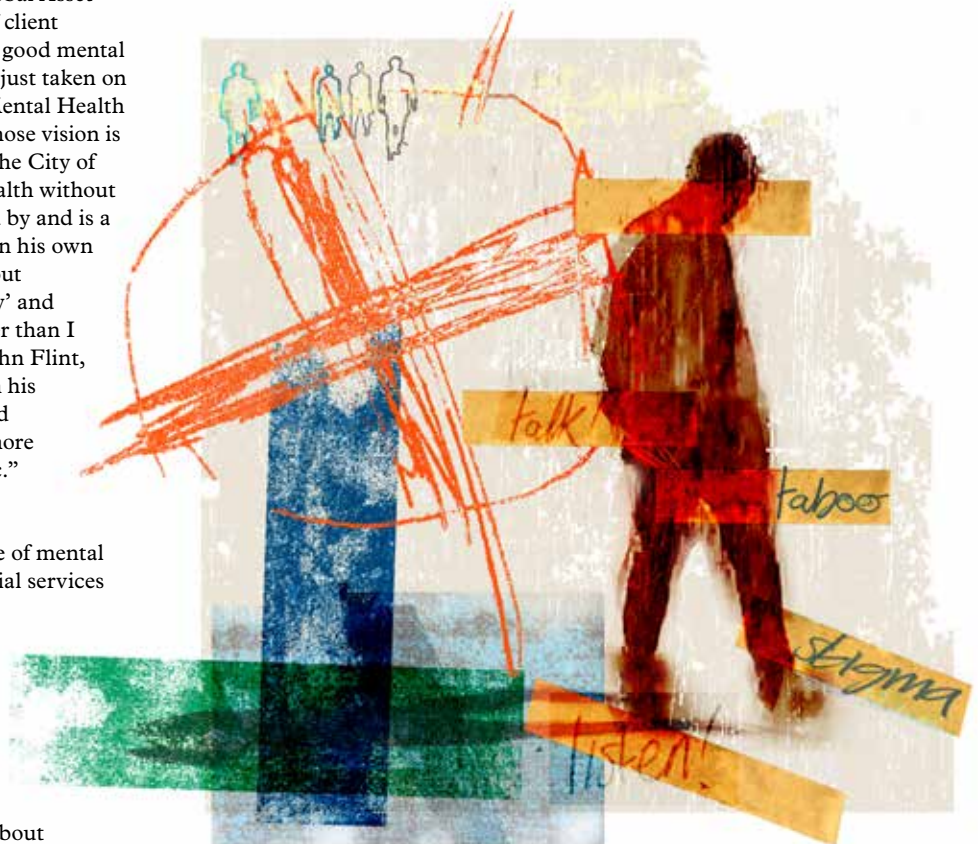
The World Health Organization says that one in four people in the world will be affected by a mental or neurological disorder at some point in their lives. The government-commissioned *Thriving at work* report on workplace mental health, by Dennis Stevenson and Paul Farmer, reports that around 15% of all people at work in 2017 had symptoms of an existing mental health condition. When the CMHA carried out a study among its member companies in 2016/17 – *Inside our City workplaces* – it found that 47% of survey respondents had experienced mental health difficulties while working for their current employer and only half had disclosed this to someone at work.

And when the CISI surveyed its members in 2018 about their experiences of dealing with mental health problems in the workplace, just 46% of respondents said they would feel confident speaking to their manager about mental ill health.

Is the problem so much greater in the financial services sector compared to the



Brian Heyworth, global head of client strategy at HSBC Global Asset Management



workplace as a whole, to the extent that those figures suggest? While not a like for like comparison, there is some evidence to support this assertion. A 2018 survey by HR consultancy AdviserPlus, which analyses sickness absence records of 150,000 employees, finds that, over a six-year period, those in financial services are on average 32% more likely to take time off due to mental health issues than those in other sectors.

Karen Kwong worked in the City for 16 years as an equity dealer before training as an organisational psychologist, and now coaches investment professionals on dealing with stress and building resilience through her company RenOC. She says: “The financial sector is ultra competitive. You often have to compete even within your own firm. The culture is one where you are rewarded mainly on the basis of your individual performance rather than that of the team, there is very little job security and the main behaviour that is encouraged is one of making money. So, it is a high stakes occupation and not far behind the police, the military and the emergency services when it comes to stress.”

Many of the bigger banks offer support for mental health on a global basis via their employee assistance programmes (EAPs). Royal Bank of Canada is one example. Jersey-based Gail McCourt, head of

fiduciary management, RBC Wealth Management, says that staff have access to a range of resources including the EAP, mental health first aiders, wellness fairs and lunchtime events. And the CISI’s EAP includes counselling services and support through general life situations, such as managing money, relationships, moving house, family issues and work stress, to name a few. Some adopt more innovative solutions. In the US, insurance firm Aetna pays employees up to US\$500 as an incentive if they can demonstrate 20 nights’ consecutive good sleep.

Jonathan Phelan, head of retail lending supervision at the FCA, set up a non-profit organisation through which he trains people to deal with mental health issues after experiencing his own difficulties in this area (see box on page 23). He believes the financial services sector does have some specific characteristics that can trigger mental health issues. One is that money is invariably at stake and the stakes can be very high. “If you are dealing with a multimillion-pound derivatives contract, there are massive consequences to making a mistake,” he says, “and that creates a pressure all of its own. Another is the emphasis placed on resilience. Feedback I’ve received from those in retail financial services is that their personal ethics sometimes run up against the pressure to sell financial products.”

The CISI’s survey of its members, mentioned earlier, received the largest response – 3,686 responses – in the shortest amount of time compared to any other survey ever run by the institute.

Many anonymous comments, described by the CISI as “disturbing”, reveal a sector that suffers from lack of trust in HR departments and managers, poor work-life balance and bullying (see box on page 20).

The 2018 survey was the first time that the CISI had sought members’ views on mental health. CISI CEO Simon Culhane, Chartered FCSI says the institute is overwhelmed and moved by the strength of feeling on this issue among members.

He says: “The feedback has shown that workload and working hours are root causes in respondents’ experiences. These factors are controlled largely by the culture within a firm, which is in itself determined by the leadership. If leaders have an enlightened approach to their own wellbeing as it relates to work stress, then this is an important example to set staff, to show the importance of self-care as it relates to mental health.”

Michael Cole-Fontayn MCSI, chair of the CISI and trustee of a mental health charity, the Charlie Waller Memorial Trust, has spoken frequently on the topic of mental health, and has championed increased awareness of the issue in the City over the past decades. >>

CASE STUDY

MILES KEAN, EXECUTIVE DIRECTOR, ENTREPRENEURS DIVISION, COUTTS BANK



Miles had his first mental health episode in 2008 at the height of the financial crisis. He says: “Mine was very much work-related. It was the financial situation at the time, there was a massive build-up of stress and everything seemed to be on the brink of collapsing before the government stepped in. I developed an anxiety disorder that was undetected, and it slowly built up until I blew up.”

Imagining anarchy on the streets and reading articles luridly suggesting that bankers would be dragged from their homes, Miles

went three weeks without sleeping before finally breaking down. He spent a further three weeks in the Priory Hospital before returning to work.

In two subsequent episodes, his anxiety disorder flared up and he had to take time off work – he says that in each case he had simply carried on as though nothing had happened – until he sought proper diagnosis on the third occasion.

The breakthrough in addressing his mental health difficulties was to receive a proper diagnosis and then to undertake cognitive behavioural therapy, which is “like a rewire of your brain”. Together with working on his fitness and changing his

lifestyle, it helped him get back to a point where he wanted to go back to work.

When he did, he found people tapping him on the shoulder wanting to quietly talk about their own issues and this gave him the impetus, together with colleague Mike Heyworth, to create a wellbeing strategy with the backing of the Coutts board. It encompasses an online hub, health checks, a network of 90 wellbeing ambassadors and training line managers so they know how to react when an employee comes to them in distress. Miles has since been promoted and says Coutts has been highly supportive.

>> He says: “Mental health should be as important as physical health in any firm. Firms should prioritise facilitating an environment where staff feel comfortable talking about mental health issues.” To encourage this, he refers to the CMHA’s detailed ‘Thriving at work’ framework – created for its members to allow them to create their own comprehensive support structure and benchmark themselves – suggesting that firms adopt the guidelines, which “allow firms to mature at their own pace”, and “might include allowing staff to learn and tell stories at formal and informal sessions”.

Why it happens

The causes of workplace mental health problems are many and various – and, in every case, specific to the individual. For a start, it’s important to make a distinction between those that are the consequence of working practices and those that are latent – or have developed outside the workplace and then been brought to work. In Brian’s case, he says that he may have experienced mental health problems whatever occupation he had chosen – but also concedes that his workload, and the pressures that created, acted as a catalyst for his breakdown.

According to Health and Safety Executive (HSE) – the UK’s independent regulator for work-related health, safety and illness – work-related stress can also trigger new mental health disorders. HSE highlights that stress is typically caused by work overload, employees not having the support or skills they need to do their job or, in some cases, workplace bullying. The culture in many financial services sector roles is one of long hours, working hard and pressure to perform, all against a background of growing regulation that squeezes resources.

The fallout

Mental ill health exerts a huge toll on employers and employees. The Stevenson/Farmer review, looking at the UK workplace as a whole, concludes that “300,000 people with a long-term mental health problem lose their jobs each year, and at a much higher rate than those with physical health conditions”. Supporting data from Deloitte calculates the cost of poor mental health in the workplace to be £33bn to £42bn, or approximately 2% of UK GDP.

According to the Stevenson/Farmer review, the cost of mental ill health is

WHAT YOU TOLD US

In the CISI’s recent survey on mental health, members from a range of disciplines shared their thoughts anonymously in response to the question: How confident would you be talking to your manager at work if you felt you were suffering from stress, anxiety or depression? A selection of responses from across the sector reveals a worrying lack of confidence in companies and senior managers.

Corporate finance: “I would be worried that this would affect advancement and/or be logged on an HR file.”

Compliance: “I have found employers unsympathetic about family issues, let alone mental health, and I would not discuss this at work in any circumstances, as any weaknesses are exploited in the banking sector by superiors.”

Capital markets: “Sadly, as soon as you mention mental illness you are deemed unfit to carry on a controlled function. Why would a company take such a risk? Another fear is that management will use this revelation at some future date against you. Declaring mental illness has no benefits, only lots of downsides.”

Asset management: “I have had time off before and I don’t feel [my manager] understands exactly why I couldn’t come into work – so now I work reduced hours so I can leave early and I won’t be judged for it.”

Wealth management: “As a female, the sector is hard enough to succeed in. By admitting to stress, it is another reason for them to say we are ‘not cut out for the job.’”

Operations: “Best way to get yourself dismissed or moved to a location forcing resignation. My firm dismissed someone suffering from this on Mental Health Day.”

Risk: “In my experience it is not treated as an illness, but somewhere between a weakness and skiving.”

Financial planning: “Afraid of losing my job if I admit to anxiety or any stress related conditions.”

Fintech: “In fintech there is a lack of diversity and therefore as a woman who is already not accepted within the male-dominated community, there is no way you would expose vulnerability to a gender imbalanced group.”

highest in the finance, insurance and real estate sectors, at £2,564 per employee – for all employees, not just those who have a mental health problem.

The cost can be broken down. First, there’s absenteeism. The AdviserPlus report says: “On average, we found a staggering 30% of all recorded sick days are related to mental health conditions. That’s a 7% increase since 2012 – and given that fewer than one in ten employees feel comfortable confiding in their employer about the issue, it’s likely this figure is itself significantly under-reported.” If individuals are off sick, that

// THE COST OF MENTAL ILL HEALTH IS HIGHEST IN THE FINANCE, INSURANCE AND REAL ESTATE SECTORS, AT £2,564 PER EMPLOYEE //

has an inevitable impact on productivity and puts greater pressure on those who are left to cover for them.

'Presenteeism' – or people coming to work when they are not well – also has a severe negative impact on any organisation, although it's one that's far harder to quantify. "What it means is that you're there, but you're likely making bad decisions," says RenOC's Karen. "A lot of people I coach make bad decisions if they are stressed. How does that work if lots of people are doing it?" The Stevenson/Farmer review estimates the cost of presenteeism – in the form of reduced productivity – at £17bn to £26bn out of the £33bn total cost of poor mental health at work.

And if you lose people as a result of poor mental health, there are staff turnover costs to consider, including recruitment and the expense of training up new hires to the same level.

For employees, the impact of mental health is felt in far more than financial terms. Data from the Mind Workplace Wellbeing Index shows a wide range of impacts, from difficulty with concentration and in juggling tasks to taking longer on tasks and relying more on colleagues. In extremis, poor mental health can mean not only an inability to hold on to a job, but also disruption of an entire career. In the most tragic of cases, it might mean losing your life.

There's one other cost employers bear: that of investing in measures to improve mental health at work. Here, at least, there are clear benefits to be found. Deloitte's research finds that: "The return on investment of workplace mental health interventions is overwhelmingly positive." A review of all studies suggests that for every £1 invested, the return on investment averages £4.20. Mental health training for employees is a typical intervention. Mental Health First Aid (MHFA) England offers such courses, which teach employees to spot the signs that a colleague is experiencing mental health issues, to offer help and to guide a person towards support. Learning takes place in small groups of around 16 people through a mix of presentations, group discussions and workshop activities. More than 2.6 million people around the world have trained in MHFA skills. In one powerful example, an academic study of the Australian Fire and Rescue Service finds that mental health training for



managers led to an ROI of £9.98 for each pound spent.

Helen Anderson, assistant director of marketing and communication at the CISI, says: "We have had firms tell us that they aim to have as many mental health first aiders as they have physically trained first aiders, which is an admirable target, particularly as our members tell us they are overwhelmingly unlikely to talk to their

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CASE STUDY

DAME JAYNE-ANNE GADHIA, FORMER CEO, VIRGIN MONEY



Jayne-Anne Gadhia, former CEO of Virgin Money, experienced postnatal depression after the birth of her daughter in 2002 – an episode she recounts in her book *The virgin banker*. Jayne-Anne writes, "At a moment that I had expected to be full of joy, the heavy, cloying black clouds of depression settled on me and would not let go." She couldn't even face listening to music, which had always been a great love. Jayne-Anne had planned to take just six weeks maternity leave, but instead took almost three months off to recover, and writes: "The experience changed me and the way I look at mental health issues today. I had thought that 'depression' was a sign of weakness, an imagined illness, an excuse. Now I know it is an illness as real as a physical ailment, and it needs as much care and repair."

>> line managers about this. Firms need representatives who can spot early signs of mental ill health and refer.”

A significant impact of mental health comes from failing to manage it effectively, whether that’s through allowing stigmas to perpetuate or failing to provide adequate support for those who are suffering. Lora Benson MCIPR, CISI head of media, says the institute’s survey findings show that the financial services sector needs to change how it manages its people – a theme that the institute explores further with an online learning module (the CISI calls these modules Professional Refreshers) on mindfulness, regular events focusing on mental health and highlighting the work that charities in this space do. The CISI hopes to bring all this content together on a portal on its website for members in 2019.

Potential solutions

When it comes to finding ways to help employees who may have mental health problems, there are many interventions that can be deployed, ranging from the conceptual – such as policies, commitments and partnerships – to the specific, such as

screening; sickness leave; therapies; sleep pods; mindfulness sessions; sleep incentives; resilience coaching; and training of mental health ‘first aiders’. Some of these interventions are preventative while some are aimed at treatment.

What’s striking, though, is the extent to which the most important part of the solution is perceived not to be any particular package of practical measures, so much as a change of culture and a re-striking of the conversation around mental health and reduction of the stigma of ‘speaking up’.

Until recently, mental health was a taboo subject. Typical responses to somebody presenting with mental health problems – in financial services as in most workplaces – have ranged from colleagues ignoring the issue, because they don’t know what to say, to a highly negative stigma that it is a sign of weakness and incapability. Support was almost invariably reactive and often failed to make changes that would allow the person to resume and flourish in their role. The consequence is that people kept their anxiety, depression and struggle secret, afraid that if they told anyone it would ruin their career.

The sea change that has taken place, and is still taking place, is of people speaking out. Lora from the CISI says: “We don’t pretend to have all the answers, but possibly one of the most powerful ways we can influence a change in the stigma of mental ill health in the workplace is to tell stories. By amplifying ‘real models’ rather than role models, we can start to show that there is an acceptance that you don’t have to be ‘OK’ all the time. The more we share the experiences of members or those in our sector who have directly been influenced by mental health issues at work, the more we slowly chip away at the perception that it is not OK to talk about it.”

Peter Estlin, Lord Mayor of the City of London, concurs, adding that “storytelling prevails as the most powerful tool for culture change”. The Lord Mayor’s Appeal helps companies encourage storytelling in the workplace through its This is Me storytelling campaign and its Wellbeing in the City online tool, developed in partnership with the Samaritans.

Above all, it is widely accepted that leadership on mental health has to come from the very top – and CEOs at some of

WHERE TO GO FOR HELP

If you or a colleague has mental health issues, or you want to find out more about what employers can do, here are some organisations that may be able to provide support.

Bank Workers Charity

Helps current and former bank workers and their families via a broad range of support, including physical, financial, mental and social. bwcharity.org.uk

Charlie Waller Memorial Trust

Aims to increase awareness of the signs and the dangers of depression amongst young people and to encourage those who may be depressed to seek help. Provides workplace mental health training. cwmt.org.uk

City Mental Health Alliance

A coalition of organisations that have come together to create an environment in the financial and professional services sector where mental health is discussed in the same way as physical health. citymha.org.uk

Evenhood

Trains organisations to have healthy conversations about poor mental health. evenhood.org

Mental Health at Work

A first stop to find documents, guides, tips, videos, courses, podcasts, templates and information from key organisations across the UK, all aimed at helping you get to grips with workplace mental health. mentalhealthatwork.org.uk

Mental Health First Aid England

Works to normalise society’s attitudes and behaviours around mental health by developing the skills we need to look after our own and others’ wellbeing. It’s on a mission to train one in ten of the population in England in Mental Health First Aid skills. mhfaengland.org

Mind

Provides advice and support to empower anyone experiencing a mental health problem, and campaigns to improve services, raise awareness and promote understanding of mental health issues. mind.org.uk

The Lord Mayor’s Appeal: Wellbeing in the City

An online learning

programme that brings Samaritans’ listening and wellbeing expertise into the workplace. It teaches employees the skills to look after their emotional health and look out for others, before they reach crisis point. thelordmayorsappeal.org

Time to Change

A growing social movement working to change the way we all think and act about mental health problems. time-to-change.org.uk

For a life-threatening mental health emergency, contact the emergency services of the country you’re in. In the UK, dial 999.

CASE STUDY

JONATHAN PHELAN, HEAD OF RETAIL LENDING SUPERVISION, FCA



Jonathan experienced post-traumatic stress disorder, leading to depression, following the stillbirth of his first child.

When he returned to work after the loss of his son, he found that 90% of his colleagues didn't want to talk about it and acted as if nothing had happened. He learnt, from his own experience, that people with mental health issues are often treated as if they are weak and incapable rather than having an illness. He concluded that what is really needed is a more human approach. "Organisations take too much of a

process approach when the best solution is improving the quality of conversations that people have," he says.

The experience led him to create a non-profit social enterprise, Evenhood, through which he writes, speaks and trains people about mental health.

A good conversation about mental health removes the emotion. It requires the manager to listen in a non-judgemental way, understand the triggers that have an adverse effect on the individual, and focus on what they really need – for example, in terms of autonomy, flexible working or feedback – to do their job effectively. Jonathan has even written a book about *The art of the mentally healthy conversation*.

the biggest companies in the financial services sector have spoken out publicly on the issue.

A global challenge

This is far from being a UK-specific issue. In Hong Kong, the CMHA set up a new chapter in 2017. Its survey of employees working in Hong Kong's legal, financial services and consulting sectors, published in January 2019, finds that while 31% of the 400 respondents have received some mental health training, just 8% think the sector currently offers adequate support for those affected by poor mental health.

Globally, there is growing awareness of the damage caused by poor mental health in financial services. A review of *Work-related stress in the banking sector*, carried out in a dozen countries across Europe, Asia, Africa and South America, was published by *Frontiers in Psychology* in 2017. It concludes that "occupational stress has clearly become a significant cause of ill health and is a serious risk factor for bank workers' psychological and social wellbeing. This literature review has demonstrated an increasing diffusion of adverse health outcomes from work-related stress in this sector." Yet, when the CISI replicated its all-member mental health survey in India, the poor response rate showed a reluctance to even answer the questions.

While many firms have in-house programmes to help deal with this, such as the EAPs mentioned earlier, nobody believes the issue is anything like resolved. But Brian, of HSBC and the CMHA, says we are close to an inflexion point and that progress has moved rapidly. "Three or four years ago it was about the stigma, then about role models, and now we're taking a much more detailed approach to practical solutions."

// BY AMPLIFYING 'REAL MODELS' RATHER THAN ROLE MODELS, WE CAN START TO SHOW THAT THERE IS AN ACCEPTANCE THAT YOU DON'T HAVE TO BE 'OK' ALL THE TIME //

Mental health is currently high on the financial services sector's agenda, thanks to a growing recognition that it's something that affects a huge proportion of the workforce. Nobody should be complacent at this stage. If anything, the full extent of the issue is only just beginning to become apparent – but at least people are talking about it. ●



FURTHER READING



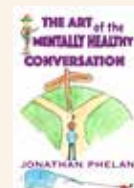
Thriving at work: the Stevenson/Farmer review of mental health and employers

Dennis Stevenson and Paul Farmer



Mental health: inside our City workplaces

City Mental Health Alliance



The art of the mentally healthy conversation

Jonathan Phelan



The virgin banker

Jayne-Anne Gadhia



The people's champion

NIGEL JONES HAS HAD A HAPPY AND SUCCESSFUL CITY CAREER, BUT HE UNDERSTANDS THAT THAT IS NOT THE EXPERIENCE OF COUNTLESS OTHER PROFESSIONALS IN THE SQUARE MILE. HE TELLS **EILA MADDEN** HOW HE IS WORKING TO CHANGE CERTAIN ASPECTS OF THE CITY'S CUT-THROAT CULTURE

When Nigel Jones was a teenager, he wanted to be a doctor. In the event, he became a lawyer, spending 32 years at

Linklaters, the Magic Circle law firm. Medicine's loss has been the City's gain. Not only because of Nigel's talents as a lawyer – that goes without saying. But also because he has been willing to put his head above the parapet to champion those suffering from mental ill health in the workplace and to encourage businesses to help employees keep themselves well.

His biggest intervention on this front was to co-found the City Mental Health Alliance (CMHA) – a group of banks, professional services firms, law firms and corporates in the City that recognise the importance of improving the way mental health is addressed in the workplace. Deloitte research reveals that poor mental health is costing the UK economy up to £99bn a year, of which £42bn is falling to employers. For Nigel, setting up the alliance to improve the quality of the working environment for City professionals – and thus their mental wellbeing – not only made good business sense, he says it was also “morally and ethically the right thing to do”.

City experience

Nigel's own time in the City has been hugely positive – an experience he wants others to have. It has allowed him to amass a range of new skills and work with “fantastically gifted, kind and generous people”. He even met his wife through work.

However, the City was never his intended destination. His father was a geologist and his mother was a part-time teacher. His grandparents came from the farming and teaching professions in the depths of the West Wales countryside, so there were never any footsteps to follow into the Square Mile.

His ambitions to be a doctor were frustrated early on in life by poor careers advice, so he ended up reading biochemistry at Oxford University. It was his undergraduate research project that sparked an interest in a preventative approach to tackling ill health in general. It also sparked a realisation that he didn't want to be a research scientist, but did want to put his

scientific skills to good use in some way when he left university.

At the time, intellectual property (IP) was an emerging area of law. Legal firms were looking for science graduates who could understand the technical intricacies of the work pharmaceutical firms were doing. On completing his legal education in 1986, Nigel joined the IP practice of Linklaters, where he stayed for his entire career.

Shortly after making partner in 1995, he set up Linklaters' first industry sector group, focused on healthcare. It was through this work that he realised we as individuals are ultimately responsible for keeping ourselves well and that the workplace could have an influence on that.

Linklaters was already doing a lot on this front, providing an in-house gym, a staff restaurant, health insurance and an employee assistance programme. What the firm didn't have was a senior partner to say

// THE CMHA'S VISION IS A HEALTHIER WORKING ENVIRONMENT IN THE CITY //

to the firm and the outside world that its focus on health and wellbeing was important.

Nigel became Linklaters' first

health and wellbeing partner champion. One of the first things he did was sign off a stress management policy, which had been sitting in a drawer unapproved because it had never had partner backing. He also went on a roadshow around the firm with the in-house GP, rolling out the policy and explaining why it was important to take it seriously.

Launching the CMHA

During this time, one question that plagued Nigel was why the firm engaged in work practices that partners knew to be counterproductive to the quality of client service, profitability and the health of employees. The answer? That the clients, including the banks and accounting firms, demanded it. So he decided to ask the banks why. An informal conversation over a coffee with two contacts (one from a City bank and one from a City accounting firm) led to the creation of the CMHA.

They recognised that people were their most valuable asset, so why were they, separately, putting so much pressure on them? Could they work together to tackle

>>

>> this problem? With seed funding from their respective organisations, the alliance launched with ten member firms. Poppy Jaman OBE, the co-founder of Mental Health First Aid England, came on board (and is now its CEO) and Paul Farmer CBE, CEO of mental health charity Mind, got involved as chair of the body's Expert Reference Group to give the alliance credibility in the area of mental health.

On launch night on 9 October 2012 there had been a storm in London and most of the public transport system was at a standstill. Even so, 110 out of 110 registrants turned up. "We heard some moving stories and it's grown from there to where we are now," says Nigel. "Our vision is a healthier working environment in the City."

It aims to achieve this in three ways: reducing stigma around mental health issues; improving people's knowledge and understanding of mental health and giving them the language to talk about it articulately; and identifying practical steps organisations can take to help their people keep themselves well. Whether it's encouraging physical exercise or giving people downtime to pursue a hobby, such as singing in a choir, the key has been to encourage firms to offer a range of interventions because different things will work for different people at different times.

Not everyone has been convinced, however. Making the health and wellbeing of staff a business consideration would require major change across the City, not least to its notorious long-hours culture. Those who have worked in the Square Mile understand that a nine-to-five working day isn't feasible if tight client deadlines are to be met, but that isn't what Nigel is advocating. He is looking for a more nuanced approach.

"It's about changing the way we interact with people so that they understand why they're working hard, that they feel they have a purpose and that if they have worked hard for a period, they are then going to get a bit of a downtime so that people are not working 24/7, 52 weeks a year without any sign of where the light at the end of the tunnel may be," he says.

Unhealthy behaviour

He also believes City firms shouldn't reward unhealthy behaviour – such as presenteeism, answering emails within two minutes of them arriving, and checking work messages at 3am – with promotion and pay rises. It is better, he says, to have people who are well rested doing quality work during the working day.

There are managerial behaviours that the City needs to move away from, too, such as issuing work with a 9am Monday deadline at 6pm the previous Friday. "That happens a lot, sometimes inadvertently, sometimes deliberately," says Nigel. "I think that's one of the practices that we should look to move away from out of respect for the quality of life of the people involved, but also so that we can recruit and retain those people into our organisations and ensure that they can, over their careers, continue to provide that high-quality responsiveness to whoever is asking the question."

Nigel makes a point of asking about his team's personal commitments so that he can do his best to accommodate them. It may not always be possible, but the two-way communication flow is one way to make people feel valued within the workplace.

Alongside the unrealistic deadlines, other factors of City life need to be tackled: constant pressure; shouting at employees;

not treating them as individuals; and not caring about their life outside work. "All of those things can increase stress on people unnecessarily and, if there's too much of that, for certain people that can move on to create illness," says Nigel.

// IT IS BETTER TO HAVE PEOPLE WHO ARE WELL RESTED DOING QUALITY WORK DURING THE WORKING DAY //

He wants to see City leaders demonstrate more positive behaviours. Question unreasonable deadlines set by clients and offer more realistic alternatives; doing this in front of junior staff gives them permission to question unrealistic internal deadlines, too. Encourage people to take time away from their desks to rest and re-energise at a time that suits them. Talk openly about weekend activities and ask colleagues about their weekends; it gives them permission to have a personal life. Most importantly, leaders should actively listen to their team members, ask how they are and show a genuine interest in their welfare. If you do that regularly enough, says Nigel, you will instinctively know when something is different – or even wrong.

Change is coming

As positive as leaders might be, how much can they really change? The City rewards, through promotion, people who work long hours, don't complain and don't challenge anything. People who succeed in that way transmit that mindset to the next generation. However, Nigel believes a change is coming.

"I think we're at a point where the younger generation isn't prepared to just do it the same way, therefore, I think adaptability, creativity and change is necessary at the more senior end," he says. "I also recognise that that's very difficult because that's the way people have behaved for a long time. It's been successful, it's paid the bills, it's generated bonuses, it's made them look good – all those things that make us feel positive."

Doing something different, such as having a more open and communicative culture, puts people in uncomfortable situations where they don't know how to react. What do you do, for example, when a junior member of your team bursts into tears and tells you something horrible has happened to them? Nigel believes managers need more training in mental health and

CV

2019 Stands down as chair of the CMHA

2018 Become a private investor in four technology start-ups

2018 Retires from Linklaters

2016 Appointed chair of the CMHA

2014 Appointed lay trustee to The Royal College of Psychiatrists

2012 Co-founds the City Mental Health Alliance (CMHA), becoming its first vice-chair

2012 Named as director of the Orchestra of the Age of Enlightenment

2010 Appointed as Linklaters' first health and wellbeing partner

1998 Establishes the firm's Healthcare Sector, its first sector-focused group

1995 Becomes a partner at Linklaters

1986 Joins Linklaters as a trainee solicitor

1984 Graduates from the University of Oxford with a BA in biochemistry

active listening to help them, their employees and their organisation to create healthier workplaces.

Stepping down

When Nigel retired from Linklaters in 2018 and ceased to be fully active in the City, he made a decision to also step down as chair of the CMHA – a role he has held since 2016 and which he gave up at the end of May 2019.

“I’m very proud of the achievements that the team has made and it’s an honour to have been in the position of chair throughout that period,” says Nigel. “I don’t take personal credit for any of it. It’s been a team effort from people who are in the executive team, on the board, and from members and former members like Michael Cole-Fontayn MCSI, who since standing down as chairman of BNY Mellon has continued to be a very active vocal supporter of everything we do, including through his work as chair of the CISI.”

Nigel sees the CISI playing a key role in the fight against mental ill health across the financial services sector by offering a platform for City workers to share their own stories about this issue and to help train the workforce to deal with it.

He also wants to see more public debate about the topic. We can’t assume, he says, that everyone in the City agrees with what we’re trying to do and we have to think about how we take those views into account.

Outgoing Prime Minister Theresa May took the debate to the public in a big way when, in January 2017, she appointed Mind’s Paul Farmer and Lord Dennis Stevenson, a former chair of Halifax Bank of Scotland, to lead an independent review of mental health and employers. Nigel sat on its Expert Advisory Panel.

The resulting report – *Thriving at work*, published in October 2017 – calls on employers to adopt six ‘mental health core standards’, covering areas such as raising awareness, line management responsibilities and monitoring staff mental health. There has been little action from the government since it published its response to the review in November 2017, accepting its recommendations in full.

“[Theresa May’s] inability to pursue that, along with many other things the government has wanted to pursue, as a result of Brexit is one of the many unfortunate consequences of what’s been going on in this country over the past two and a half years,”



says Nigel. “It shows that governments get distracted by all sorts of things.”

To this end, Nigel stresses that business should not wait for the government to take the lead on this issue. A practical CMHA guide on how to implement the recommendations of the Stevenson-Farmer review has generated more positive feedback from members than anything the alliance has done, he says.

Moving on

As Nigel moves to a portfolio career, he plans to remain involved in the campaign for a better working environment in the City and beyond. Through coaching and leadership development work, he aims to help people recognise the importance of their health, and he will continue to tell the CMHA story at events around the world. He has also invested in several tech start-ups that use technology in a positive way to tackle poor mental health.

Through all these activities, Nigel plans to help other people and organisations accelerate the pace through this journey, recognising what the goal is and, importantly, understanding that that may take some time to achieve. ●

NIGEL JONES

On advice for organisations

“We are social animals. We need human interaction, and organisations that discourage it or don’t actively promote it will do less well than those who do.”

On the importance of sharing

“Build and retain a real social network, which includes people outside your work environment as well as those within it, and be open about the challenges and opportunities you’re facing. ‘A problem shared is a problem halved’ doesn’t always work, but if you’re frustrated with the way your manager’s behaving and you have a chat with a friend about that, they may be able to share their own experiences and solutions with you.”

On advice for young professionals

“Don’t be afraid to be yourself. Acting, for most of us, is hard work and tiring. Pretending to be somebody else means you have to remember your lines. Just being yourself is much easier.”

// WE CAN’T ASSUME THAT EVERYONE IN THE CITY AGREES WITH WHAT WE’RE TRYING TO DO //



IMAGE: ISTOCK

Flatlining funds

FUND MANAGERS ARE NEGLECTING INVESTORS CAUGHT UP IN ZOMBIE AND ORPHAN FUNDS. **GILL WADSWORTH** REPORTS ON WHY, AND HOW ADVISERS CAN MOVE CLIENTS TO BETTER-MANAGED FUNDS

If there are two types of fund that sound deeply unappealing in the world of finance, it is ‘zombie’ and ‘orphan’.

While there are differences between the two, investors caught in a zombie or orphan fund may find they are no longer treated to the same service or performance initially promised by providers.

Orphan funds, as defined by investment research firm Morningstar, are those with less than €100m in assets and with a five-year track record that has seen net inflows/outflows of €10m or less in each of the five calendar years to the end of 2017.

Morningstar research criticises orphan funds for languishing with little assets, neglected by asset managers’ marketing teams and saddled with high fees that deliver poor investor outcomes.

Zombie funds, meanwhile, are typically products offered by life insurers – such as pensions or with profits funds – that have closed to new money rather than transferring the existing assets to a new, open arrangement.

Vast exposure

The extent to which investors are exposed to these kinds of funds is vast. Morningstar research shows £3.6bn of UK investors’

money is sitting in orphan funds, while the FCA estimates ten million policies are held by closed book pension providers, amounting to £400bn in assets. The chart opposite shows that orphan funds account for 25% of the total market for funds with five years or more track record.

The reasons a fund finds itself orphaned are numerous and varied. The Morningstar research cites a “tax impact or lack of paperwork from deceased relatives” as potential reasons. But ultimately, according to Laura Suter, personal finance analyst at wealth platform AJ Bell, fund managers are swamping the market with funds.

Laura says, “There are too many funds in the market and the majority of the fund flows go to a small percentage of those, so it is inevitable you will get subpar or orphan funds that limp on.”

With so many funds to manage, asset managers will divert resources to the most successful ones, with little incentive to bolster smaller alternatives, Laura adds.

Orphan funds also arise when investment strategies fall out of favour or the fee structure has become unattractive. The Morningstar research finds that, in some cases, negative-rated orphaned funds carry fees well above 2% and the average charge for an orphan

// MORNINGSTAR RESEARCH SHOWS £3.6BN OF UK INVESTORS’ MONEY IS SITTING IN ORPHAN FUNDS //

fund is 1.29%, which compares with 0.67% for an average equity fund.

Many zombie funds also have a problem with fees. PensionBee's Robin Hood Index 2018 shows that Phoenix Life, which is a closed book pension specialist, has one of the highest annual charges of 1% and is the worst offender for exit fees.

According to PensionBee, some of these fees escape the FCA's exit penalty cap, which came into force in 2016, because they relate to with-profits pensions termed 'market value reductions'. In other words, when a fund transfers out, Phoenix Life imposes a reduction on the pot to make it 'fairer' for those remaining in the with-profits fund. So rather than receiving 100% of their pension pot, someone leaving may see a reduction of 40%. These are not fees per se, but they amount to a notable reduction in a pension fund.

Philip Milton CFP™ Chartered MCSI, managing director at Philip J Milton & Co, says exit fees can pose a significant challenge for investors trying to escape the clutches of the zombie funds.

"Exit penalties can see people stymied from doing anything because they will see their money eaten away in charges. The FCA cap has helped, but it has always been a problem," Philip adds.

A question of cost

The existence of orphan and zombie funds begs a question about the level of service they receive. If investors are paying high fees for poor performance and limited attention, why are providers not taking greater steps to protect their clients?

The most obvious defence would be to close orphan funds and merge these with similar, more successful offerings. Merging funds can make a real difference to the performance of orphan funds since they might be reinvigorated under a new manager as well as benefiting from economies of scale.

However, for smaller investment houses, there may be no suitable alternative into which investors can be switched. It can also be expensive and complicated to close a fund, which means there is little in the fund manager's interest to take such action.

Laura from AJ Bell says: "There is no real incentive to close orphan funds if they are not costing the fund managers money. The accounting and administration costs of shutting them down could be quite high, not to mention the possibility of bad press."

The FCA is critical about the way in which fund managers merged funds in the

past. In its *Asset management market study* from 2017, the regulator says that the cost of mergers or closing a fund "is often borne by the fund rather than the fund manager".

The study also says that "firms might not have a policy in place for considering fund closures and mergers, which means that ensuring good customer outcomes might not be at the heart of the process".

However, the regulator does not offer fund managers any assistance in closing funds and does not have plans to make it easier for providers.

It is challenging to find an explicit fund management policy on the criteria for closing an orphan fund.

A spokesperson for BNP Paribas, which is among the highest holders of orphan funds in the Morningstar research, says, "There is no explicit policy [on orphan funds], although in common with most large asset managers, we do regularly review our fund range in order to ensure that we have the optimum client offering, and we have closed funds where the size has fallen below that which permits efficient management."

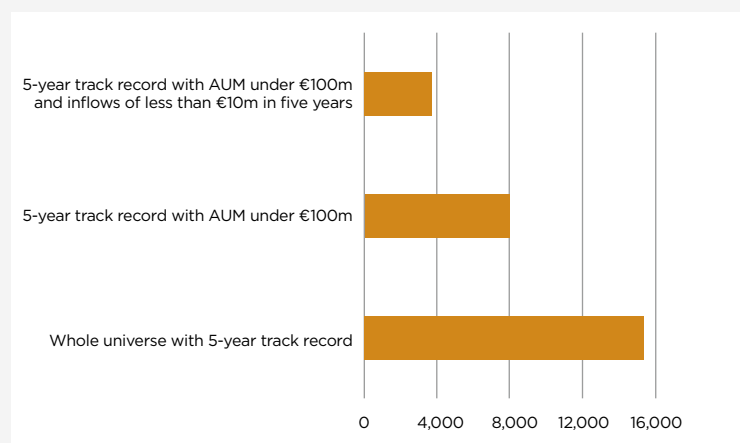
With no obvious incentives or strategies for providers to merge or close orphan funds, the onus is on advisers to help ensure their clients have a clear line of sight on the investment manager. They should ask questions of the investment manager's long-term commitment to the fund.

Laith Khalaf, senior analyst at Hargreaves Lansdown, recommends clients review their portfolios regularly to ensure none of their funds have become orphaned.

// IF INVESTORS ARE PAYING HIGH FEES FOR POOR PERFORMANCE AND LIMITED ATTENTION, WHY ARE PROVIDERS NOT TAKING GREATER STEPS TO PROTECT THEIR CLIENTS? //

>>

DIFFERENT FUND UNIVERSES AND THEIR TOTAL AUM



Source: Morningstar Direct. Data as at 31/12/2017

>> If it appears this is the case, the adviser should have a strategy in place for helping the client.

“Advisers and investors being engaged with their investments is the best way to identify and manage exposure to these products, which does take some time and effort,” he says.

Fighting zombies

The opportunities to merge zombie funds are slimmer. The chances of finding enough similarity between different products – especially if they have been brought out by a new firm – are few and far between, and the complexities involved may be prohibitively high.

Philip says an alternative is for investors to move out of zombie funds and onto a fund platform.

“Bringing all investments onto a platform which is accessible and transparent can be meaningful for clients, particularly if they have several investments spread about,” he explains.

If closed-book providers are unable to merge or close funds, they still have a responsibility to ensure suitable standards for investors. The advent of independent governance committees in 2015 has gone some way to keeping zombie funds active. The Phoenix Life Independent Governance Committee reported in 2019 that the insurer was “trailing various ways of increasing value for customers”, including

making it easier to access pension freedoms and ensuring suitable fund choices.

Investor responsibility

Reputational issues and market forces should drive providers to tackle their orphan and zombie funds, but investors have a responsibility to ensure they undertake suitable due diligence.

Laith says the relevant information is available in fact sheets but accepts investors may not know what to look for.

“Fact sheets aren’t the easiest read. If you don’t take some time to understand your investments though, the chances of staying invested in orphan funds longer than you might wish are higher,” he says.

For example, investors must be clear on charging structures, including whether they bought the product at a time when commission fees were included in the costs (see boxout).

Laith adds that a fund’s characteristics could have been entirely appropriate when the investors first purchased it, but as their circumstances have changed, the vehicle may no longer be suitable.

Even with careful due diligence, however, investors can still find themselves caught. Investment strategies fall in and out of favour and regulators change, as do charging structures. The likelihood of new orphan and zombie funds appearing frequently is high, but what matters more is how advisers can help their clients escape. ●

// PEOPLE DON’T NECESSARILY UNDERSTAND FACT SHEETS, OR THEY AREN’T ENGAGED. IF THAT’S THE CASE, THE CHANCES OF GETTING STUCK IN ORPHAN FUNDS ARE HIGH //

KEEPING IT CLEAN

If avoiding zombie and orphan funds is not enough to contend with, investors also need to beware the ‘dirty’ funds.

Following the 2012 Retail Distribution Review (RDR), which banned bundled commission, new charges appeared on units in collective investment schemes. These removed rebates paid to advisers and were referred to as clean or unbundled. Under the new RDR rules, product providers could no longer make payments to platforms and, as a result, many investors needed to move out of their old dirty or bundled classes.

Rob Morgan, pensions and investments analyst at Charles

Stanley, says it is incredibly easy for investors using execution-only platforms to clean up their investments. “The investor is not disinvested from the market; it’s possible to simply switch from a manager’s dirty fund to a clean one. It’s just a different charging structure,” he explains.

Unlike orphan or zombie funds, moving from a dirty to a clean class requires limited stress or planning for the individual.

However, just because an investor is in a dirty fund, it does not mean they are getting poor value and there may be no need to switch. Rob says, “Investors may be getting advice

included in the fee for the dirty fund.” Investors should speak to their financial planner before making any moves.

However, not all platforms have cleaned up their funds and some will still offer products with bundled fees. There is also a lack of information on what might be better for individuals and their personal circumstances.

It is not always clear to investors just what they are paying for and despite ongoing pushes for transparency from the financial regulator, investors must still take responsibility for ensuring they understand what they are paying for and why.

THE LONDON INTERBANK OFFERED RATE IS BEING PHASED OUT IN THE WAKE OF ITS MISUSE FOR PROFIT BY SOME BANKERS. ITS REPLACEMENT IS MEANT TO BE RISK-FREE. **PHIL THORNTON** REPORTS ON THE GREAT TRANSITION FACING FINANCIAL MARKETS

Goodbye LIBOR, hello SONIA

Before the global financial crisis, few people outside the financial sector had heard of the London interbank offered rate (LIBOR) – even though it has been a key part of the functioning of financial markets since the 1960s. LIBOR and other IBOR benchmarks are the interest rates banks pay to borrow money from each other and are also the basis for determining the rates charged on many other kinds of loans.

However, confidence in the reliability of LIBOR was eroded after the 2008 financial crisis by well-documented cases of attempted manipulation and false reporting. The LIBOR rate was set by a panel of banks that submitted short-term borrowing rates based on expert judgement. It emerged in 2012 that bankers at many major financial institutions colluded in a scheme to manipulate LIBOR for the purposes of profit.

In the wake of the scandal, the Bank of England established a working group in 2015, again consisting of a panel of major banks, which, in April 2017, recommended the Sterling Overnight Index Average (SONIA) benchmark as its preferred risk-free rate, and since then has been focused on how to transition to using SONIA across sterling markets.

With just over two years to go, that transition remains a fundamental issue confronting financial markets. Randal Quarles, vice chair for supervision of the US Federal Reserve Board of Governors, highlighted the urgency of the situation in a recent roundtable of the Alternative Reference Rates Committee: “My key message to you today is that you should take the warnings seriously. Clarity on the exact timing and nature of the LIBOR stop is still to come, but the regulator of LIBOR has said it is a matter of how LIBOR will end rather than if it will end, and it is hard to see how one could be clearer than that.”

The transition to risk-free rates has also been embraced by the EU, with EU Benchmark Regulation coming into force on 1 January 2018. The regulation introduces a common framework to ensure benchmarks are robust and reliable. Recently, the transitional period in which market participants are expected to make the move to risk-free rates has been extended until 1 January 2022.

Minimising misconduct

SONIA was launched in March 1997 by the Wholesale Markets Brokers’ Association – now part of the European Venues and Intermediaries Association



IMAGE: ISTOCK

(EVIA) – but since 2016 has been administered by the Bank of England.

It tracks the rates of actual overnight funding deals on the wholesale money markets and, unlike LIBOR, does not rely on submitters but on actual transactions. SONIA went through a period of reform, which ended in April 2018, in order to capture a broader range of transactions and increase the underlying volumes that the benchmark was based upon, improving the sustainability and representativeness of the benchmark.

According to the Bank of England, the decision to adopt SONIA was based on “robust transaction volumes” and how it measured overnight interest rates in a way that was “considered close to risk-free”, thereby minimising “opportunities for misconduct”.

Furthermore, as we get closer to the likely end of LIBOR in late 2021, there are concerns that the underlying interbank overnight borrowing market, which LIBOR is based upon, suffers from too low a volume to provide a reliable, representative benchmark. Notably, in a recent speech, Edwin Schooling Latter, director of markets and wholesale policy at the FCA, remarked: “There is a powerful logic to avoiding contractual reliance on a benchmark that is no longer representative of an underlying market, at least for those market participants that can avoid that reliance. That’s one clear reason to consider including a representativeness trigger in

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>> contractual fallbacks. With very small numbers of panel banks, and the disproportionate impact of individual transactions on the published rate that this would lead to, the properties of the rate – its level and its volatility – could also deviate from previous expectations.”

According to Latter, the low underlying volumes may lead to the “finding that the rate is or will no longer be representative upon departure of panel banks”, which “may lead rapidly to cessation of publication”.

Members of the LIBOR panel banks support continuing to submit their rates to compute the benchmark, but only until the end of 2021 when the FCA will no longer compel banks to submit rates. Beyond this date, the future of LIBOR is not guaranteed. The challenge for regulators, banks and market participants who use benchmark rates is to ensure that the transition from LIBOR to SONIA between now and the end of 2021 goes smoothly.

Smoothing the way

Based on publicly available data, total outstanding notional exposure to LIBOR has been estimated at over US\$370tn, according to the International Swaps and Derivatives Association (ISDA), a trade body for participants in the derivatives market. Derivatives, syndicated loans, securitisations, business and retail loans, floating-rate notes (FRNs) and deposits are all significantly exposed to LIBOR.

This market comprises more than £30tn of over-the-counter derivatives and £4tn of exchange-traded reference LIBOR. LIBOR is also important for the real economy, providing a reference for more than £200bn of small and medium-sized enterprise (SME) and corporate loans, around £125bn of FRNs, and £200bn of structured debt.

Tim Bowler, president of ICE Benchmark Administration Limited,

which currently administers LIBOR for the financial markets, says the derivatives market has been using SONIA for some years. He also sees different trends across markets that use the benchmark rate, and says there has been greater progress for UK LIBOR than in other jurisdictions.

From the lenders’ perspective, banks are working on how they would adjust pricing LIBOR, which is a risk-based rate, to SONIA, which is a risk-free rate. “If you are looking at where the biggest challenges from the transition from LIBOR to SONIA are, they will manifest themselves in the lending market,” Tim adds. Commentators have suggested this may be rectified with a credit spread adjustment to SONIA, which recognises the bank credit risk premium and adjusts the risk-free rate accordingly. For instance, ISDA has recently launched a consultation covering adjustments to apply to fallback rates in the event certain IBORs are permanently discontinued. The adjustments address the difference in tenors between IBORs and the risk-

free rates, which are typically overnight rates, and account for the difference in risk premia.

A big question is whether market participants will be ready. The *IBOR global benchmark transition report*, carried out by EY on behalf of ISDA in 2018, involved analysis based off in-person interviews and electronic surveys with 150 market participants in 24 countries. It finds that while almost nine out of ten respondents are concerned about their exposure to LIBOR and other interbank rates, only 12% have developed a preliminary project plan.

“Last year’s survey showed that there was a lot of work still to be done,” says Scott O’Malia, ISDA’s CEO. “It showed that people were working out how much legacy business they had, what their exposures were, what they needed to do, and getting familiar with the issues. That is the area where most people are.”

Financial institutions that use LIBOR will need to update their systems and operations to manage how their loans are priced. “The derivatives market has been working on this for some considerable time and the initial working groups were made up largely of banks, so there is greater familiarity with the process,” Scott says.

Tim says the derivatives market has been using SONIA for some years and is adapting to the new benchmark well, as it has used SONIA for the discounting methodology for valuation for some time. The vast majority of issuances of FRNs are tied to SONIA too. Issuance of SONIA-referenced FRNs in 2019 has already eclipsed 2018 – with a total amount of £26bn outstanding. Furthermore, there have been three securitisations to date that reference SONIA, with a total deal size of just under £9bn. Tim acknowledges that “the capital markets have really adapted well and have come up with a standard on how to incorporate SONIA into documentation. The only market that has been slow to date to adopt SONIA has been the corporate lending market”.

This is because most corporations are used to borrowing with a fixed-term setting for budgetary risk management processes. Corporates and their banks are trying to work out how they would make the migration from a term setting (LIBOR) to an overnight rate (SONIA). “Most corporations are used to borrowing with some sort of term setting for budgetary risk management processes, so that is a factor you have to address when it comes to adoption in the lending market,” Tim says. Currently, to make an adjustment from an overnight rate to a term rate, SONIA is compounded daily over fixed-term tenors. There are concerns however around resulting uncertainty, as the interest rate is unknown until the end of the investment period.

Legacy contracts

Meanwhile, there is a major issue facing the sector: how to deal with legacy contracts written before the decision to potentially discontinue LIBOR, and contracts still being created, sold, and entered into on a daily basis since the decision to transition to SONIA. Nearly US\$2tn in loans may need to have their documentation revised following the discontinuation of LIBOR (and other IBOR) benchmarks in 2021. Millions of documents will need to be reworked for loans that reference LIBOR but that will mature after the switch off date.

// THE BIGGEST CHALLENGES FROM THE TRANSITION FROM LIBOR TO SONIA WILL MANIFEST THEMSELVES IN THE LENDING MARKET //

ISDA is also working on the development of robust replacement language in new contracts to mitigate the risk of a permanent end to LIBOR. Scott says ISDA has the capacity to employ a legal amendment that lenders, borrowers and counterparties will abide by. “One document can amend all the other documents – that is a fantastic tool,” he says.

This will require the creation of an alternative rate to replace LIBOR in old and new contracts before 2021. Last year, Andrew Bailey, head of the FCA, raised the idea of a synthetic LIBOR. However, this remains controversial as it may impede the adoption of risk-free rates, causing market fragmentation.

Nevertheless, David Clark, chairman of EVIA, says a synthetic curve could be created. “Some people feel there is room for a synthetic rate supported by an algorithm evidenced by shorter-term derivatives and longer-term capital market rates,” he says, adding that this could include products based on SONIA. “That would be acceptable to a lot of people in the market.”

Decisive shift

Even if those hurdles can be jumped, there is now only around 30 months until SONIA becomes the primary interest rate benchmark in sterling markets. A spokesperson from UK Finance says: “Effective and transparent benchmarks are an essential part of market activity and underpin the wider integrity of our financial system. With the LIBOR benchmark linked to a number of important financial activities, it is essential that the sector and the regulator work together to ensure a smooth transition to an alternative rate.”

In May 2019, the Working Group on Sterling Risk-Free Reference Rates (RFRWG), which is made up of experts from major sterling swap dealers and hosted by the Bank of England, said sterling-denominated financial markets had begun to “shift decisively” away from LIBOR and towards SONIA over the past year.

In the derivative markets, the share of swaps traded using SONIA was broadly equivalent to that linked to LIBOR, as of April 2019. Liquidity and open interest in SONIA futures was also growing steadily, the Working Group said: in the previous three months, more than 25,000 lots a day had been traded across three exchanges.

SONIA is also being adopted in cash markets. SONIA-linked FRNs have rapidly become the market norm, and LIBOR-linked sterling FRN issuance beyond 2021 has all but ceased. In April, Nationwide Building Society issued the first SONIA-linked residential mortgage-backed security, following two other securitisations that were retained in December 2018 and March 2019. The Association for Financial Markets in Europe (AFME) has produced model securitisation wording for the new issue of bonds, providing a new and easier mechanism to accommodate the transition from IBOR to an alternative benchmark rate in the event of LIBOR becoming unavailable.

“SONIA is in a very good position and people are actively trading SONIA-linked derivatives and issuing SONIA bonds. This has made a difference, and people are now starting to look at how they can address their legacy sterling LIBOR portfolios,” Scott says.



IMAGE: ISTOCK

However, while there has been considerable progress in the sterling markets, the cessation of LIBOR, and other IBORs, is an international issue. As such, effort must be made to ensure different jurisdictions have a coordinated transition to risk-free rates. The Global Financial Markets Association, which brings together AFME, the Securities Industry and Financial Markets Association (SIFMA) in the US and ASIFMA in Hong Kong, released in April an IBOR transition document summarising the work completed to date in the five major jurisdictions, including the current state of fallback wording reform and term rate development.

Repricing loans

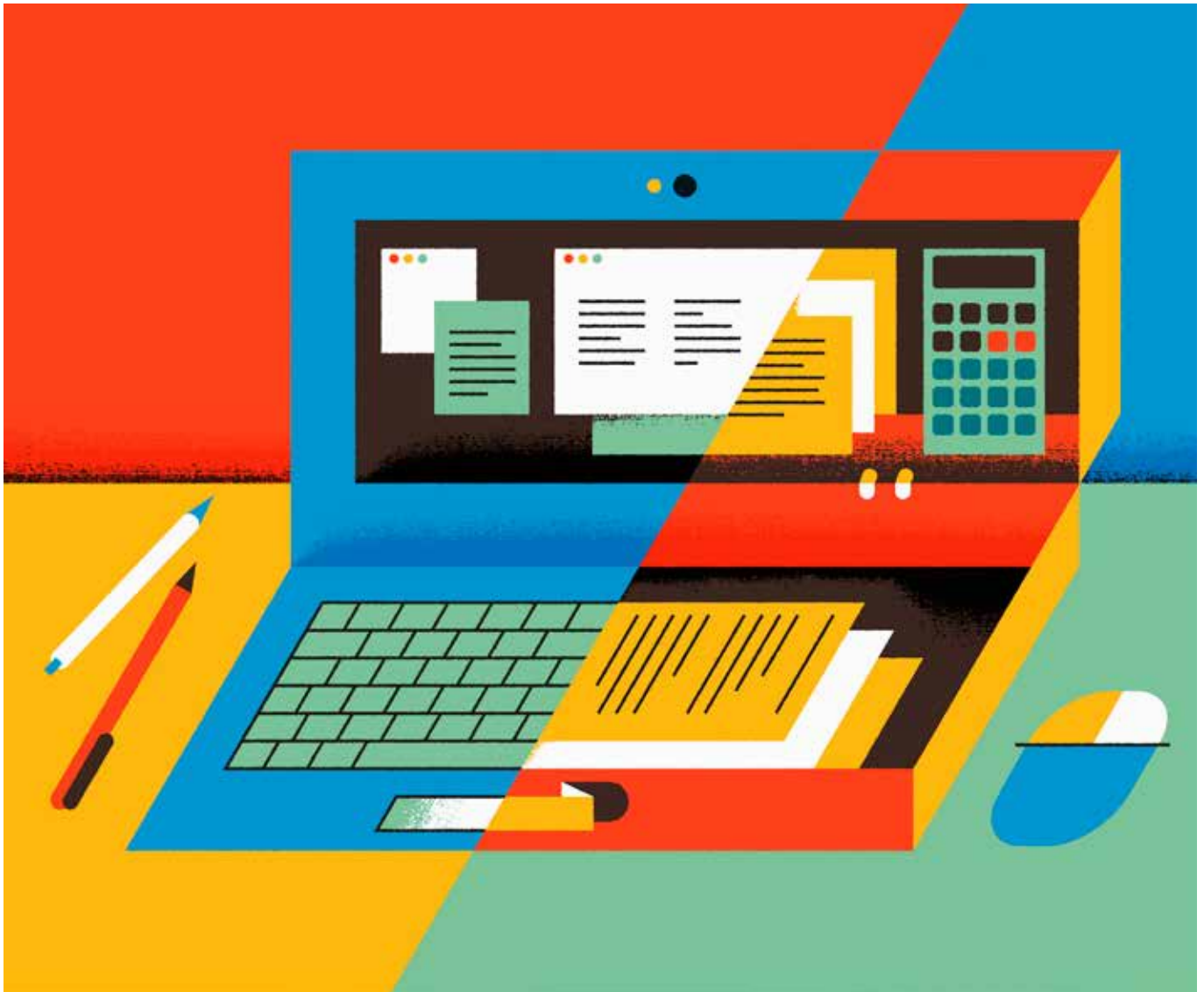
It is inevitable that a transition will have material effects on the economy and financial markets, creating winners and losers. David says there will be positive and negative effects.

On the plus side, creating a SONIA curve will require creating new products, he says. “That can only be positive for the market because it will introduce more products for people to manage their risk with.”

On the other hand, many users, especially those in cash, debt and credit markets, will need a credible interest rate curve to work off which may require the use of LIBOR for an extended transition period. In particular, measuring the spread between risk free rates and other market rates is crucial for cost analysis, David says.

In its May update, the RFRWG says SONIA adoption has proceeded rapidly over the past year, across a wider range of products than some market participants initially expected, including not only derivatives, but also FRNs and securitisations. “The Working Group encourages lenders, borrowers and infrastructure providers to take advantage of this momentum and growing liquidity wherever they can, pressing ahead with transition to the use of overnight rates, and making the necessary investment,” says its chair, Tushar Morzaria, who is also CFO of Barclays.

Borrowers and banks are going to have to figure out how to make adjustments to their systems and how their loans are priced, Tim says. He likens the shift from LIBOR to SONIA to changing the gauge of a rail network that forces train companies to adapt by updating their rolling stock, adding: “That is exactly what the market has to go through.” ●



The end of the paper trail

PAPER SHARE CERTIFICATES ARE TO BE PHASED OUT. WHAT WILL THIS MEAN FOR THE FUTURE OF TRADE SETTLEMENT AND WHY DO THE HOLDERS OF THOSE CERTIFICATES NEED TO ACT NOW?

RICHARD WILLISHER REPORTS

The so-called dematerialisation of share certificates, not only in the UK and Ireland but across the EU, has been under discussion for more than ten years. The issues were crystallised by the EU Central Securities Depositories Regulation (CSDR), Regulation EU 909/2014.

Article 3.1, albeit in legalese, sets out what is to happen: “Any issuer established in the Union that issues or has issued transferable securities that are admitted to trading or traded on trading venues, shall arrange for such securities to be represented in book-entry form as immobilisation or subsequent to a direct issuance in dematerialised form.” Immobilisation is when shares still exist in paper form but the paper is held by a depository. Dematerialisation means that the shares exist only in electronic form.

The following paragraph continues: “Where a transaction in transferable securities takes place on a trading venue, the relevant securities shall be recorded in book-entry form in a CSD [central securities depository] on or before the intended settlement date, unless they have already been so recorded.”

This means that new and existing shares that are traded on a trading platform, such as a public stock exchange, will only be recorded in electronic form and their issuance and trading will be recorded by book entries at a CSD.

The regulation stipulates that the article will apply from 1 January 2023 for transferable securities issued from then onwards and from 1 January 2025 to all securities regardless of when they were issued.

Why is this happening?

The European Securities and Markets Authority, the pan-European regulator, explains that the aim of CSDR is to harmonise and bring discipline to a number of aspects of the post-trade settlement cycle.

The benefits for all parties, including investors and those involved in the execution and settlement process, will be speed, efficiency and lower cost, according to Deutsche Börse press office in Frankfurt. Currently, certificated equity trades are required to be settled within a ten-day period, compared to a two-day turnaround for electronic, dematerialised trades.

Equiniti, the business services organisation, currently chairs the UK Dematerialisation Steering Group, made up of stakeholders including share registrars, UK companies that are currently required to issue certificates to their shareholders, custodians, investors, lawyers, regulators and the UK government department for Business, Energy and Industrial Strategy (BEIS). Steve Banfield, industry director at Equiniti, says that shareholders currently holding paper share certificates are subject to increased trading fees compared to electronic trades as the process is manual and carries higher risk. It also takes significantly longer.

More traditional investors who currently hold paper share certificates may be uncomfortable with the changes, but any concerns they may have are unfounded. In Steve’s words: “All shareholders [will be required] to access their investment online. Although a significant majority of investors are moving online out of choice, there is a

small number who might not have access to or be willing to switch to an online medium. These investors will be catered for and supported through any procedure required when it comes to accessing their information or trading. Those with characteristics of vulnerability would also be supported throughout the process.”

Those concerned about dematerialisation should also be comforted by the regulation itself, which will be implemented and enforced by regulators in each of the EU jurisdictions, and in the UK. CSDR specifically states: “Immobilisation and dematerialisation should not imply any loss of rights for the holders of securities and should be achieved in a way that ensures that holders of securities can verify their rights.”

What’s next?

The adoption of electronic trading and paperless settlement has already progressed a long way. According to Laith Khalaf, senior analyst at Hargreaves Lansdown, a UK retail broker, the process has been taking place over the past 20 years. “It will have relatively little impact on retail shareholders,” he says. “The vast majority of investors have already dematerialised their shares voluntarily through brokerage accounts, with the brokers holding the shares on their behalf in nominee form.”

Nonetheless, there will be some shareholders who still have share certificates in a drawer somewhere at home and/or who may not be active dealers. Steve says the steering group will reach out to those who hold paper shares in a manner to be decided. Paper shares will be void but their holdings will remain unchanged and recorded in electronic form.

According to Steve, there is a proposal to provide an online repository so that investors can access their holdings through a unique access code known as a holder key. This model, he says, minimises the disruption to the market place and the sector as a whole.

There are some other models, however. In Germany and France, book entries have been the standard means to expedite trades for a number of years. Anna Kulik, secretary general of the European Central Securities Depositories Association, explains that Germany functions with a hybrid of immobilised and dematerialised securities. Immobilisation was adopted after World War II and a legal entitlement to paper shares ceased in 1994. France

// THE AIM OF CSDR IS TO HARMONISE AND BRING DISCIPLINE TO A NUMBER OF ASPECTS OF THE POST-TRADE SETTLEMENT CYCLE //

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// IN MANY WAYS
THE REGULATIONS
ARE PLAYING
CATCH UP TO
THE CURRENT
MARKET REALITY //

>> dematerialised its securities at the beginning of the 1980s.
In Australia, the system is slightly different. There, various dematerialised models are already in operation, having been phased in between 1989 and 1995. There are no share certificates; instead, they have been replaced by a statement recording the trade. However, the statement is in paper form and there is still the potential for it to be mislaid.

In the UK, dematerialisation is still a work in progress. Asked what the cost impact for shareholders could be under a new system, Steve says: “It is not envisaged that the investor will incur any additional costs. Conversely, the process should serve to eliminate a number of costs, such as higher dealing fees and the charges for replacing lost certificates.”

Informing shareholders

A remaining question is how shareholders would be advised that the dematerialisation is taking place. As yet, there is no guidance on this from official or market sources. Perhaps, in the manner that potential investors were blitzed with newspaper and TV adverts about the privatisations that took place during the Thatcher years, a widescale communications programme would be likely. Given the range of internet-based communications tools now available, including social media, reaching the vast majority of shareholders ought to be much easier now than back then.

As with all nationwide changes in financial services practices, the measures

taken will be aimed at the majority of stakeholders, while the few that remain to be covered will have to be dealt with on a case-by-case basis. One could imagine, for example, that when unaware shareholders pass away, their holdings may come to light and it may fall to executors to pursue the assets, as indeed would be the case at present.

With three and a half years to run until the first hard deadline for new share issuance and five and a half years to full dematerialisation of share certificates, there are still a number of unanswered questions.

Even so, the sector, collectively, should start preparing for the change now to avoid the risk of having thousands of share certificates to dematerialise three months before the deadline – something that would have major staffing cost implications and may even be humanly impossible. “It’s an urgent issue that needs to be addressed now, rather than leaving it till the last minute,” the head of investment administration at one wealth management provider told *The Review*.

Brokers should inform clients about the changes, and what actions they need to take, through their regular client newsletters, magazines and via their websites. They should also encourage clients to spread the news among elderly parents, aunts, uncles and grandparents, who may still have paper share certificates tucked away in a shoe box under their beds. This leads to an added complication – many old share certificates may name companies that no longer exist, such as been the rollercoaster of M&A activity over the past few decades. In such instances, share ownership will need to be traced through the history of that company’s mergers and acquisitions.

Share certificate holders should get in touch with their brokers now to have their shares moved into the broker’s nominee account, the head of investment administration warns.

Market stakeholders are on the case and through the UK Dematerialisation Steering Group are actively progressing towards UK implementation of CSDR. While the project is a major, UK-wide one, which will likely require significant human and technology resources, in many ways the regulations are playing catch up to the current market reality. The bulk of share trading is already being electronically executed and managed post trade. The market has been driving this for some time, so it is reasonable to imagine that there will be few outstanding issues with dematerialisation by the beginning of 2025. ●



ILLUSTRATION: ARON VELLEKOOP/LEÓN/IKON & ADOBESTOCK

How to be an effective manager



ILLUSTRATION: ISTOCK

EVERYONE LIKES THE IDEA OF WORKING FOR A GOOD BOSS, BUT WHAT DOES THAT ACTUALLY MEAN AND HOW CAN YOU SUCCEED AT MANAGING TEAMS? **STEVE SMETHURST** REPORTS

How do you know if someone is a good manager? When *Manager Tools* – which provides tools to facilitate effective management – asks this question of delegates at its effective manager conferences, it receives answers that might cross your mind: their people like them; they communicate a lot; they’re smart; they care; they listen well.

From the perspective of an employee who has a manager, this sounds like the dream boss. But that’s not the only perspective that counts. “Your first responsibility [as a manager] is to deliver whatever results your organisation expects from you,” writes *Manager Tools* CEO Mark Horstman in his book, *The effective manager*. A manager’s second responsibility is to keep their people.

The book says that managers who consistently achieve results and retain their teams display four key behaviours towards the people that they manage:

- they get to know them
- they communicate with them about their performance
- they ask them to do more
- they delegate work to them.

What they don’t do is take responsibility for their happiness. In an interview with

The Review, Mark says: “Make no mistake, happy employees without results will end up unemployed. The idea that a manager can make an employee happy is a bad one. No one can legitimately be held responsible for somebody else’s happiness – happiness is a personal choice.”

Instead, *Manager Tools* uses retention as a proxy for happiness. If someone chooses to stay, you can reasonably infer that they are happier than they could be somewhere else. Retaining people comes down to building trusting relationships with those that you manage, Mark says, and the best way to achieve that is to communicate through weekly, structured one-on-one (or ‘O3’) meetings – more on this later.

No need for recruiters

The first step to effective retention is effective recruitment. For Mark, whose new book *The effective hiring manager* is due out this autumn, one key to better recruitment is to develop solid, professional relationships with potential recruits, which means spending time at sector events. “After knowing people for two to three years, you should have a pretty good sense of their strengths and weaknesses. You shouldn’t need to hire a recruiter,” he says.

// YOUR FIRST RESPONSIBILITY AS A MANAGER IS TO DELIVER WHATEVER RESULTS YOUR ORGANISATION EXPECTS FROM YOU //

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>> The other key step is to have a standardised process that every person goes through during the recruitment process. If the approach changes, you can't learn from it when you make a bad hire. "Do not trust your gut, do not give a clever interview and do not just have a chat," Mark says.

Bloomsbury Wealth has been applying lessons learnt from Manager Tools since 2014. Charles Wood CFP™ Chartered MCSI, a wealth planning manager at the firm, has found the Manager Tools process to be priceless on recruitment, with podcast questions that prompt applicants to give examples of the behaviours that the manager is looking for proving particularly useful.

Manager Tools' online 'Interview creation tool' generates interview questions based on the information you provide about the requirements of the role you're recruiting for. The questions follow a three-part format:

- a lead-in sentence referencing a situation
- the question
- the behavioural response.

One example of a question might be: 'We have to feed back with sensitivity to clients. Tell me about a time when you had to defuse a difficult situation with a client.'

Wayne Hayhurst, Chartered MCSI, is Ribble Valley branch principal for wealth manager Raymond James in Longridge, Lancashire. He also favours an approach based on behaviours. "The few people I've recruited that haven't gone to plan have been those I took on because of their qualifications. Their integrity and values weren't a priority.

"You can give someone the knowledge and training they need to pass exams and to

become a competent wealth manager, but it is much harder to change someone's values, work ethic and integrity. It makes more sense to recruit individuals with these embedded traits and behaviours and then give them the skills to develop into quality wealth managers."

In 2018, Wayne established an in-house academy that takes on postgraduates. The first cohort is still undergoing training but they are all still at the firm and on track to do what they were brought in to do. Wayne says: "I look at their core values as well as their qualifications, then give them experience. It has worked brilliantly."

One-on-ones

Another factor of effective management is weekly, structured O3 meetings with people that you manage. The recommended length for an O3 is 30 minutes. Charles was initially dubious about losing half a day a week for meetings. "I feared it was a management fad. But with Manager Tools you get right down to the nitty gritty," he says.

It recommends having a clear agenda for an O3: the first ten minutes should be given to the managed employee to speak; the next ten minutes to the manager; and the final ten minutes to talk about future issues.

Manager Tools research suggests 74% of people with managers and 89% of managers want to spend their allotted times talking about work. People who are managed may ask for guidance on approaching a problem or seek clarification on assigned tasks. Managers typically ask for updates on ongoing work and share ideas for potential new work.

// YOU CAN GIVE SOMEONE KNOWLEDGE AND TRAINING, BUT IT IS MUCH HARDER TO CHANGE SOMEONE'S VALUES, WORK ETHIC AND INTEGRITY //

FIVE STEPS TO SUCCESSFUL MEETINGS

"A monkey could run a meeting," says Mark Horstman. "It is not hard, yet most managers are terrible at it. Once you learn how to do it, people will actually look forward to your meetings." Here are his five tips.

Step one: Set an agenda

Send out an agenda for the topics to be discussed and timings for each topic. It's what gives you the authority to say, "It's now 10.15am, we have to move on."

Step two: Start on time

This sends a message that the meeting will be run with professional standards. Don't worry if people show

up late at the first couple; they will soon figure out they need to be on time.

Step three: Set the rules

Set ground rules for all future meetings: starting, staying and finishing on time; one person talking at a time; laptops closed; phones on silent.

Step four: Keep talkers in check

If someone is dominating, warn them, "We've got two minutes before the next item." It's a polite cue that you'll soon have to move on. A minute later, interrupt with, "Just one minute on this, OK?" And then, "I'm really sorry,

I'm going to have to cut you off." If there's push back, just say, "I'm sorry, we started on time and there is an agenda and we have other topics to discuss and the ground rules say we need to stay on time. I'm happy to return to it at the end of the meeting."

Step five: Deliver on promises

If you've had to cut off a long-winded speaker by promising to return to their point, do so at the end of the meeting. By this time, most people won't want to revisit their points; they were just holding court and by now everybody in the room knows that if there's nothing to add, they get to leave five minutes early.

Charles finds O3s provide a structure and process that lets him focus on the team member, getting to know them and forming a solid relationship. “The O3 is there for them to tell me what’s bothering them, or to ask any questions. Then towards the end it allows me to say things like: ‘You’re doing X and Y – which appears to other people that you’re not paying enough attention to detail, or you’re not trying hard enough.’”

He now has fewer interruptions because team members are more aware of business priorities. As he says, “Most financial planning firms are very structured and process-driven in terms of what they do for clients, so it feels good to know we also have a process for managing the team.”

This extends to delegation. Charles advises other managers to challenge their team, but to be careful to not overdo it “as it can just result in a bunch of stressed out people”.

Dealing with resistance

According to Manager Tools, the three most common reasons managed people resist O3s is that they are a form of micromanagement, they don’t have time, and communication takes place on an informal basis already.

In *The effective manager*, Mark says that not only is an employee who wishes for no oversight a risk, but people who are too busy to change their behaviour by accommodating a weekly O3 have dangerous implications for the wider organisation – their resistance prevents the organisation itself from changing.

In such instances, Mark suggests managers highlight the actual definition of micromanagement and point out that the O3 is not seeking to do that. He also advises starting the O3s three to four weeks down the line, when the employee’s diary is not likely to be full, and pointing out the small percentage of time the meeting will take up. If these efforts fail, managers should resort to using their ‘role power’ – the authority assigned to them by their role – to kickstart the meetings in the hope that resistant team members will start to experience the benefits.

Managing an employee who offers one-word answers is another potential problem. Give them time to open up. Begin with an open question such as, ‘How are things?’ If there is not much in response, move on to the next agenda item. If this continues for three sessions, start the next three sessions by inviting them – through three different questions – to share information. If that still doesn’t work, start to ask specific questions about the status of work and any specific concerns or needs they have.

ASKING MORE OF YOUR PEOPLE

“We’re obligated as managers to get the most out of our directs [people who report to us] as we can,” Manager Tools CEO Mark Horstman writes in his book, *The effective manager*.

This is something that can be achieved through coaching, which Manager Tools defines as a “systemic effort to improve the performance of a direct in a specific skill area”. This area might be chairing meetings or having constructive working relationships with colleagues.

Manager Tools’ coaching model comprises four steps: collaborate to set a goal; brainstorm resources that can

be used to achieve the goal; create a plan; act on the plan.

Crucially, the coaching process should involve a series of short-term tasks for which the deliverable is reporting on the task being completed. Each task should embody a deadline, a behaviour that needs to change, and a success metric. One example quoted in *The effective manager* is: “By 1 January, you will submit the capital plan without any errors.”

Reviewing progress on coaching should be part of the weekly O3 discussion and take up no longer than five to ten minutes of the meeting.

Beyond effective people management skills, financial planners and wealth managers must ensure that they also meet regulatory requirements in supervision of staff. For example, the FCA’s Training and Competence sourcebook sets out requirements for supervisors of employees who advise retail clients. The FCA also provides several examples of good practice, including: putting in place procedures to ensure supervisors are properly trained and competent; having clear criteria and procedures for assessing the competence of advisers; and reassessing competence regularly and using the results to influence the level of supervision.

Outsized returns

The great thing about effective management, concludes Mark, is you don’t have to put in Herculean efforts. “The average manager sucks at their job,” he says. This may sound glib but a major Gallup survey of US employees in 2018 indicates that only 34% are ‘engaged’ at work and 53% are ‘not engaged’. The average engagement level over the past 18 years that Gallup has been tracking this number is 30%. If a manager’s job is to keep employees engaged, they are clearly not excelling at it.

“The moment you invest a little bit of time and effort in learning how to manage effectively, you get an outside return,” says Mark. “You’ll have less tension, less conflict and your employees will stick around longer – more work will get done too.” ●

For a special message for CISI members from Manager Tools, visit bit.ly/manager-toolsCISI



FIND OUT MORE
Log in with your CISI details to watch Mark’s keynote address to the 2018 CISI Financial Planning Conference at cisi.org/effectivemanager

Around the world with CFP™ professionals

CERTIFIED FINANCIAL PLANNER™ PROFESSIONALS AROUND THE WORLD MAY FACE DIFFERENT CHALLENGES DEPENDING ON WHERE THEY ARE. **AMYR ROCHA-LIMA CFP™ MCSI** DRAWS TOGETHER INSIGHTS AND VIEWS FROM GLOBAL CFP PROFESSIONALS

The raison d'être for the financial planner everywhere will always be the same – making their clients' financial goals a reality. The work is similar in character and complexity, although subtle differences exist for peers overseas. These are the nuances created by working environments, cultural differences, legislation and the economic climate in each country. We spoke to CFP professionals in Brazil, Canada, South Africa and America to gain a picture of financial planning across the world.



Canada: The millennial factor

Shannon Lee Simmons CFP® (pictured) is a Canadian chartered investment manager, life coach, speaker and author who won the Wealth Professional Award for Innovation in 2018, awarded by online publication *Wealth Professional Canada*. She focuses on attracting millennials to her business by building her personal brand through popular finance shows, writing a personal finance column, and being active on social media and on her own YouTube channel.

Shannon – who, at age 34, is herself a millennial – started New School of Finance, a financial planning firm for Canadians that focuses on an advice-only approach and affordability. “Many millennials are just starting to save,” she says. “They have good

jobs but don't meet asset-under-management requirements.”

Shannon continues: “The main pain points I see with Canadian millennials is housing affordability. In major urban centres, housing prices and rent have skyrocketed in the past five years. Many people are spending over 45% of take-home pay on housing. It makes other things like day care, savings and emergency savings difficult when so much money is going into bills each month.” Shannon helps her millennial clients address this by publishing freely available educational material on her YouTube channel, including a four-part series titled *Can you afford to buy a house?*

The real estate search site Zoocasa compiles an annual *Housing trends report* that, in 2018, shows that home ownership remains a coveted goal for many Canadians. However, achieving this is a challenge. Based on the average Canadian home price of CAN\$491,065, even a minimum 5% deposit is CAN\$24,553 – but 38% of renters only have CAN\$4,999 or less saved.

Another issue for which Shannon helps clients prepare is the possibility of losing their job in their late 50s. While they could get another job, their income level would not be as high, she says. When discussing this issue with clients, Shannon builds a financial plan that incorporates a scenario with a lower-income assumption later in life to highlight the budget changes that might be required. “Planning around this from [clients in their] 40s and 50s is super important to ensure people are able to still make it work if this happens to them. I also advise clients to be more aggressive with their mortgage payments. The less outflows they have later in life, the more flexible they can be.”

ILLUSTRATIONS: LUIS TINOCO



Brazil: Financial planning for medical professionals

Thiago Sampaio CFP® lives and works in Salvador, Bahia – the fourth largest city in Brazil and still largely uncharted territory for the financial planning profession. His business caters predominantly to the medical profession because, despite the high salaries earned in the private care sector, these professionals complain of lack of time and knowledge to manage their own finances. Brazilians generally aren't comfortable talking about finances, investments and insurance, Thiago says – a sentiment confirmed in a recent study by the Brazilian Financial and Capital Markets Association on the relationship of Brazilians with money: *Debate a relação do brasileiro com dinheiro*.

Thiago adds that, because financial planning (as a CFP professional sees it) is quite a new concept in Brazil, one of the biggest hurdles he faces is selling the concept of financial planning in the first place. He overcomes this by asking prospects questions that help to build a picture of their overall financial situation and their attitude to money. Questions include: Tell me a little bit about your day-to-day financial situation; how do you make financial decisions? Who influences you in the important decisions you need to make in your financial life? Is there anything causing you frustration?

Thiago meets a new client six times in their first year of working together, taking them through the Financial Planning Standards Board's six-step process (see box). He adds, "The most important thing is to help the client design the pathway for change to occur. If the client feels confident, they will walk side-by-side with you for a long time."

Thiago finds that prospects' biggest worries are around debt, better budgeting, and concerns around retirement. Once a prospect understands that no one product

answers all of the questions that Thiago poses, and that a CFP professional can help to build a plan to tackle their financial concerns, they start to buy into the financial planning process.

US: The financial planner with a niche

Jared Reynolds CFP® has noticed a shift towards working with a niche client base, much like Thiago's focus on medics. Jared, who lives in Missouri and has a love of the great outdoors, has made championship-winning bass fishermen the centre of his financial planning practice.

This group faces specific challenges, such as weighing up the value of sponsorship deals or TV contracts that they might be offered as a result of their sporting prowess. Jared says that the approach to tackling these challenges is very similar to the simple risk and reward scenario that financial planners are used to dealing with for other types of client.

He uses an approach that he calls "passion prospecting" to attract new clients. This involves organising fishing and hunting trips with potential clients – the more adventurous and expensive the trip, the better the prospects because they attract people with larger discretionary incomes. On his latest trip, he took prospects peacock bass fishing in the Amazon. He hopes to build a reputation for organising 'cool trips' that will attract more people from his niche who want to find out more about the services his firm offers.

He believes that the CFP professional is a financial planner, first and foremost. "Many times, when prospective clients come to see me, they bring in what they think is a financial plan from another adviser," Jared says. "Almost without fail, what they have is basically a sales proposal with a pitch to sell some product that will somehow solve all their financial problems.

"A CFP professional should talk about what the client is trying to achieve and look at everything affecting them financially. What strategies will help the client achieve their goals the best way? It may involve a lot of tax planning, estate planning, and other solutions that don't involve any kind of product."

Jared's firm uses sophisticated financial planning software: Riskalyze to assess a client's risk profile and Emoney to build and deliver a financial plan to show clients their whole financial picture. This includes the financial impact of their decisions before



>>

THE FINANCIAL PLANNING STANDARDS BOARD'S SIX-STEP FINANCIAL PLANNING PROCESS

- 1 Establish and define the relationship with the client.
- 2 Collect the client's information.
- 3 Analyse and assess the client's financial status.
- 4 Develop the financial planning recommendations and present them to the client.
- 5 Implement the client's financial planning recommendations.
- 6 Review the client's situation.

>> they even make them. This ultimately helps them to make better-informed decisions.

Jared says that his favourite part of the job is “that moment when presenting a plan and seeing the client’s reaction when everything comes together, then working with them over the long term and building not just a relationship but a friendship”.



South Africa: Focusing on pre-retirement and retirees

Janet Hugo CFP® is the Financial Planning Institute of South Africa’s 2019 Financial Planner of the Year. She entered the profession around 15 years ago, when she and her husband had to review their insurance policies and coverage. Although their broker had set them up with new policies, she had many unanswered questions that eventually led to her pursuing a career in financial planning.

When Janet opened her practice, she made financial plans for clients that quantified how much life cover they needed. She was independent of the insurance companies and was loyal to her clients first, whatever the commission differences, knowing that chasing the best commissions would not let her sleep well at night.

Today, Janet’s practice focuses mainly on retirement planning and she says that the behavioural aspect of financial planning is something her clients are beginning to value. She believes that in order to achieve long-term goals, it’s important to “identify and wrestle with some of our personality-driven investing mistakes” and encourages clients to adopt a rational approach to investment decisions. She aims to make clients feel more confident about their financial planning by ensuring their goals are SMART: specific; measurable; attainable; realistic; time-based.

In 2018, South African stocks had their worst year since 2008, falling 24% in US dollar terms as a strengthening dollar and worsening trade relations between the US and China buffeted emerging markets. Amidst a climate of stock market wobbles, she says her coaching approach has encouraged her clients to stay the course with their investments: “Goals-based wealth management helps investors to focus on their goals and outcomes, as opposed to short-term returns.”

She adds, “Much of good financial planning is about asking the right questions and providing for the ‘what happens if’ worries that we all have.” Janet will ask clients

BECOMING A CFP PROFESSIONAL IN THE UK

In the UK, the CISI is the licence holder of the CERTIFIED FINANCIAL PLANNER™ certification. Following an extensive two-year review, the CISI has launched an enhanced CFP™ certification that raises the level 6 Diploma in Financial Planning to the level 7 Diploma in Advanced Financial Planning, reflecting the inclusion of the application of a broader range of knowledge. To find out more about how you can gain the CFP certification, visit cisi.org/cfp.

how they plan to take care of their ageing parents, whether their will is up to date or how they are going to educate their children.

Janet believes that a CFP professional marries information between several professional disciplines – legal, accounting, taxation and investment. “In many situations, we are often the only person sitting at the table who is able to interpret the implications of these various professions into the personal circumstances of our clients.

“Clients are starting to value the way a CFP professional can deliver complex financial information in language they understand, as well as the behavioural aspect of financial planning.”

The big picture

Whether catering for millennial investors, giving people the confidence to change their career or helping people plan for their retirement, a CFP professional is an expert in comprehensive planning, but the client is the expert in their life. The best way to bring financial planning to life for clients is to collaborate on solutions. This, across the world, has proved to create true partnerships between financial planners and their clients.

CFP professionals are skilled in drawing up a financial plan and allocating assets into appropriate investments to fund that plan, ensuring that a sustainable withdrawal strategy is in place throughout retirement, and identifying and mitigating risks through protection planning.

This overall knowledge enables them to ensure that clients attain overall financial wellbeing. It is not just about an investment or an insurance policy – it’s about how these elements work together. ●

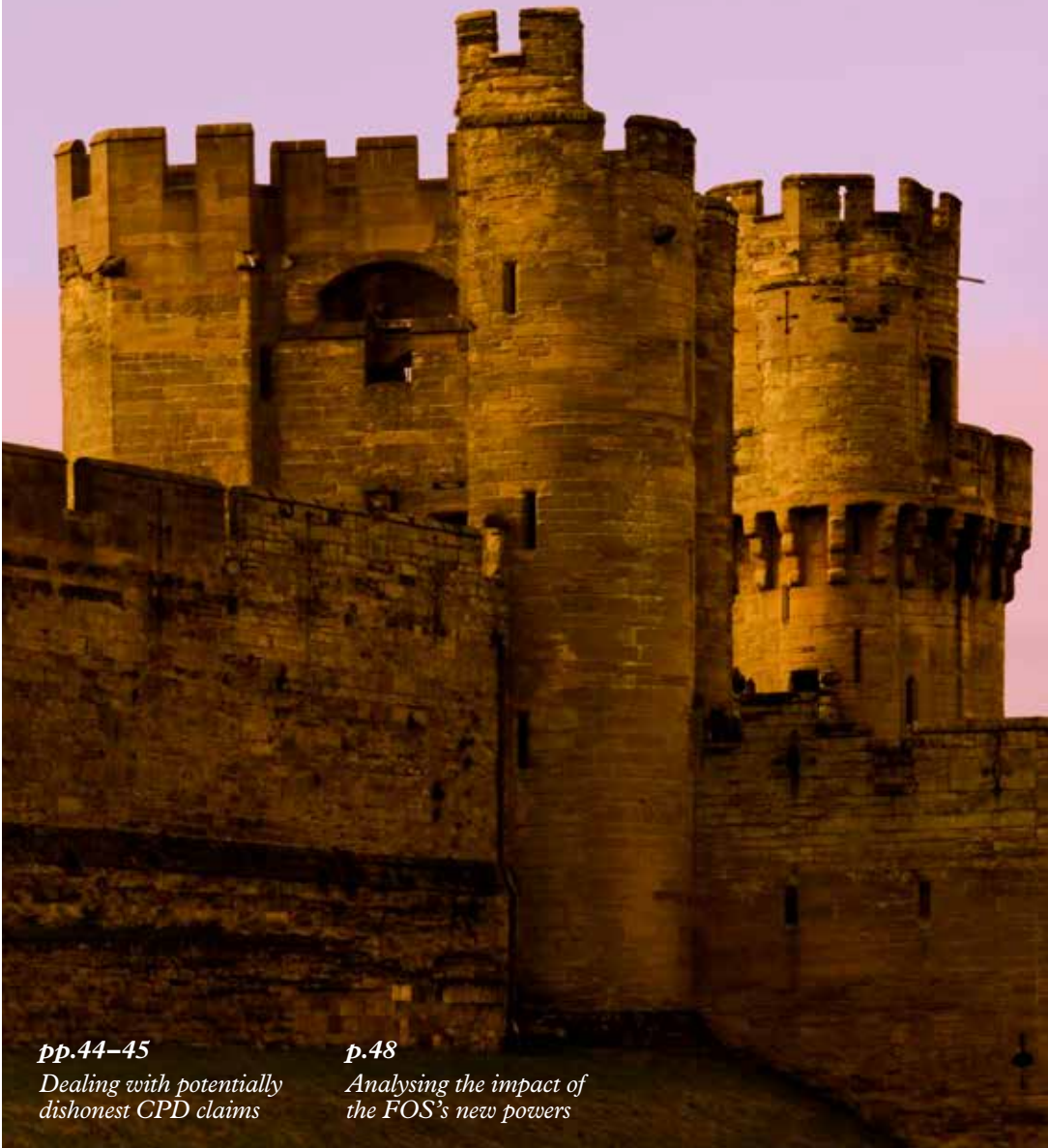


Amyr Rocha-Lima CFP™ MCSI is a partner and financial planner with CISI Accredited Financial Planning Firm™ Holland Hahn & Wills LLP. He is also a member of the CISI’s Financial Planning Forum Committee.

“

In assessing how deterrence should work, many regulators have latched on to a principle of three lines of defence. This concept of defence as applied to financial institutions has the customer-facing staff as the front line, compliance as the second line and audit in the castle keep”

Money laundering deterrence in Europe pp.46–47



pp.44–45

Dealing with potentially dishonest CPD claims

p.48

Analysing the impact of the FOS's new powers

IMAGE: ISTOCK

CPD

(continuing professional dishonesty)



A CISI CHARTERED MEMBER SUSPECTS THAT HIS MANAGER, ALSO A CHARTERED MCSI, IS CLAIMING CPD FOR EVENTS AT WHICH SHE HAS NOT REMAINED FOR THE DURATION. HOWEVER, THERE IS NO QUESTION ABOUT HER COMPETENCE OR CAPABILITY. WHAT SHOULD HE DO?

// WHEN HE IS FEELING PARTICULARLY SUSPICIOUS, CHRIS WONDERS WHETHER MONICA IS BEING DELIBERATELY DISHONEST //

Chris is an investment manager at Hardworking Investments, and has worked there for four years. When he started in financial services, he worked hard to attain his CISI qualifications, and has worked his way up to Chartered MCSI. Chris takes completing his continuing professional development (CPD) requirements seriously, and regularly attends training sessions organised by Hardworking Investments.

Monica is head of investments (an FCA certification function) at the firm. She joined Hardworking Investments in the previous year, and her arrival was much anticipated, as she is known to be one of the smartest and most knowledgeable professionals around. Since starting her job, she has lived up to this reputation – speaking with authority on a variety of topics, ranging from technical expertise to regulatory updates, as well as soft skills, such as leadership and listening skills. Chris, along with his colleagues, is impressed and eager to learn a lot from the new head of their department.

For that reason, Chris decides to attend many of the same CPD sessions as Monica, anticipating that even if she is not on the panel or delivering the training, she will ask insightful and interesting questions which he can learn from. However, after attending a few of the

same training sessions as Monica, Chris starts to recognise a pattern. Monica is usually already in the room when Chris arrives, deep in conversation with the trainer or speakers. Chris overhears her on several occasions asking the speakers about the key points they plan on covering in the session, which at first he thinks is entirely appropriate – she is a senior manager, after all, and he assumes she wants the opportunity to ask them some specialist questions before the rest of the attendees arrive. However, Monica then prefers to sit near the back of the room near the door, and Chris notes that she usually leaves the sessions after around 15 minutes – slipping away with an apologetic smile to the event organiser.

In meetings, Chris has noticed that – when asked about upcoming trends or updates – Monica just tends to repeat the information she gleans from speakers before events without giving too much additional detail, and passing off any interesting insights as her own. Nevertheless, on other occasions Monica comes up with original solutions to problems, and is clearly very knowledgeable about technical subject matters.

Hardworking Investments gauges attendance at CPD events through the use of a sign-in sheet, which employees can sign either at the start or end of the training sessions. If attendees are CISI members, Joe – Hardworking Investment's

learning and development assistant – then logs into the CISI ‘Super user’ page to load members’ attendance into their CISI MyCPD logs.

Chris has witnessed Monica adding her name to the sign-in sheet at the start of sessions, before leaving early. He is aware that, like him, Monica is a Chartered MCSI, but she does not attend many CISI CPD sessions – preferring to attend the ones offered internally. When he has seen her at CISI events, she has stayed for the duration of the talk.

Chris wonders if Monica is aware that she is automatically being awarded an hour of CPD for each of the Hardworking Investments training sessions she attends, even if she only stays for around 15 minutes. When he is feeling particularly suspicious, he wonders whether Monica is being deliberately dishonest, but usually dismisses these feelings on the basis that Monica is a well-liked and respected person, and that she is clearly knowledgeable and has the skills to do her job at a high level.

What should Chris do?

1. Speak to Joe, and establish if Monica lets him know when she has had to leave training sessions early. If she does not, Chris should inform the learning and development manager that Monica has been leaving internal CPD training sessions early.
2. He should do nothing – this is not his responsibility and Monica is responsible for her own learning and development. Besides, everyone has busy periods where they are unable to dedicate huge amounts of time to attend training sessions.
3. Report his suspicions to the CISI, as they may add Monica to their next CPD audit.
4. Approach Monica and indirectly enquire about her CPD (for example, by saying “I had to leave a CPD session early last week, do I need to let anyone know?”), hoping that this will lead to a change in behaviour or perhaps even an explanation. ●



WHAT WOULD YOU ADVISE?

Visit cisi.org/greymatterscpd to share your views. The survey results and CISI’s opinion will appear in the Q3 2019 print edition of *The Review*.

In his shoes: The verdict

This Grey Matter, published in the Q1 2019 print edition of *The Review*, presents a dilemma for a head of HR, who is faced with how to manage allegations of bullying behaviour against the CEO of a family-run asset management firm.

Should you wish to suggest a dilemma or topic to be featured in a future Grey Matter, please contact us at ethics@cisi.org.

Suggested solutions and results are as follows:

1. Conduct further investigation, including reviewing the references received from Mike’s previous employer and seeking witness statements from members of staff that might be willing to go on record about Mike’s behaviour. (46%)
2. Report his concerns to the chairman (John Footes III, Mike’s father), which is consistent with the guidance set out in the firm’s whistleblowing policy. (48%)
3. Do as Lisa asked and keep the information confidential. He cannot take further action until more information comes to light about Mike, and exposing Lisa would be a breach of the trust she has placed in him. (2%)
4. Call Mike in to answer allegations of poor conduct that goes against the RICH values. (4%)

Responses received: 397

Unusually, this dilemma split opinion between two of the suggested solutions – conducting further investigation (option 1) and reporting to the chairman in line with the whistleblowing policy (option 2). Both options have pros and cons.

Further investigation may elicit information that Richard could present to the chairman – thereby protecting Lisa’s identity. However, Richard may still be asked about what prompted him to investigate now – years after Mike joined the firm – which may require him to reveal the tip-off. Furthermore, one respondent noted: “given Mike’s character and dominance at his previous firm, it is likely that potential whistleblowers will be afraid to speak up”.

A number of commenters stated that if the firm has procedures in place for reporting, these should be followed (option 2). However, John’s ability to remain impartial was questioned by one respondent.

Our recommended option reflects a number of suggested solutions. Richard should review all the information available, including references supplied when Mike joined the firm and exit interviews given by staff who have left since Mike became CEO. However, it would be inappropriate to seek out new information at this stage. Instead, he should present the available information to John. Richard could suggest that John recuse himself from investigating his own son’s conduct, not only because if he were involved it may further damage their relationship, but because appointing someone else (ideally, someone outside of the Footes family) to oversee the process would ensure impartiality and fairness.

Money laundering deterrence in Europe: time to get serious

THE EUROPEAN AML SYSTEM OVER THE PAST THREE DECADES HAS BEEN LARGELY INEFFECTIVE IN DEALING WITH MONEY LAUNDERING AND RELATED ECONOMIC CRIMES. IS THIS THE DEATH OF THREE LINES OF DEFENCE, AND IF SO, WHAT IS NEEDED NOW? BY **RICHARD PARLOUR**, PRINCIPAL AT FINANCIAL MARKETS LAW INTERNATIONAL

The Sommet de l'Arche in Paris established the Financial Action Task Force (FATF) 30 years ago to combat money laundering. Where have we come to in Europe and what remains to be done?

The term 'money laundering', unheard of in 1989, is now in common parlance, and has been globally criminalised. Predicate offences – crimes that are components of more serious crimes – have widened from drug trafficking to the proceeds of all crimes. Europol has established itself internationally in anti-money laundering (AML) terms. The Egmont Group has grown to a large international organisation of 159 financial intelligence units, representing the operational arm of AML and counter financing of terrorism (CFT) deterrence to complement the strategic arm of the FATF. Fifteen EU member states (plus the European Commission) are direct FATF members and the remaining 13 are members of Moneyval, a 28-state European FATF equivalent which includes members such as the Caucasus states, Russia and Ukraine.

European governments evaluate each other's AML performance occasionally. However, the amount of proceeds of crime recovered as a result of successful money laundering prosecutions, compared to the amount thought to be available to be laundered, is around 0.1% at best. It is small wonder that commission of the underlying predicate offences remains rife, and increasing, particularly in relation to emerging criminality, such as cyber crime. Why is the European AML system so ineffective in reducing the impact of the underlying crimes upon European citizens?

Key issues

The major AML issues in Europe can be divided into three distinct areas: governance, risk management and capability. Some feel it is a simple question of reforming the European AML supervisory architecture, but the answer is more complex and nuanced than that. True, AML deterrence in Europe does need better governance, but improved structure of European authorities alone will not keep organised crime lords and other members of the

dark economy awake unless it is allied to action, commitment and improvements in capability.

1. Governance

There are many fault lines across Europe in relation to AML governance:

- ▶ There is no clear stated focus on what the objective of AML should be across Europe. Yet without clarity of vision, mission and modus operandi, it is difficult to see how progress can be achieved. It should be greater than merely securing the financial and operational integrity of the EU, though that would be a good start. The focus of most governments seems to have switched to fining the gatekeepers rather than convicting the perpetrators of the predicate offences. This is ineffective in terms of reducing the scourge of drug trafficking across Europe, for example.
- ▶ With only 15 EU member states being members of the FATF, the remaining 13 member states members of Moneyval, and 19 of the 28 EU member states members of the eurozone, there is dislocation across the EU in terms of deterrence, not just of money laundering, but of financial crime in general.
- ▶ There is no EU coordination body for AML policy except for the European Commission, certain monitoring and supervisory functions carried out by the European Central Bank and European Banking Authority, and certain loose information sharing arrangements between national member state authorities.
- ▶ Laws relating to crime are reserved to individual member states. True, there is some coordination of investigation through Europol, and instruments such as the European Arrest Warrant have been created, but usage of such instruments varies wildly across the EU.

Governance is not just about architecture, however, but also about 'battle rhythm':

- ▶ The gestation periods of European legal and policy measures are far too long. In relation to the Fourth Money Laundering Directive, for example, the 'flash to bang' time (carrying out policy development within FATF to implementation of the associated directive)

was well over a decade. This is far too long in relation to deterrence of money laundering, a problem which will be exacerbated by the need to respond to the explosive growth of cyber crime.

- ▶ The mutual inspection cycle is also around a decade long. With virtually all EU businesses subject to so much annual control and monitoring, why should this concept not apply to AML deterrence at governmental level? There is currently no annual assessment of EU member state performance against the FATF 40 recommendations.

2. Risk management

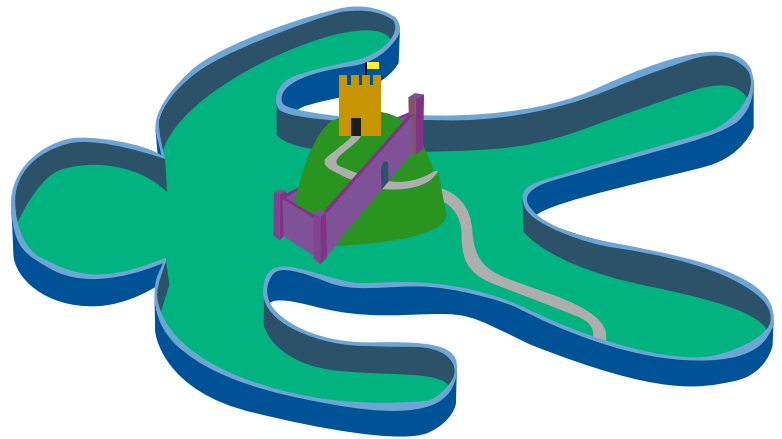
No key performance indicators (KPIs) have been set by the FATF or Moneyval, and member states are not even collecting figures on the underlying offences in a coordinated manner, yet this is vital for effective policy development and the combat of money laundering and its predicate offences. How can policies possibly be effective if you don't know the numbers? True, the FATF has developed some indicators (known as 'immediate outcomes'), but these are not the same as KPIs related to the predicate offences. An assessment of what really needs to be measured is urgently required, in order to develop the correct tools, fund the most effective action, and reduce the ever-growing scourge of the underlying crimes. Even the most advanced EU member states are assessed as having several areas where major improvements are required, so greater government commitment is necessary.

To reduce compliance burdens and increase effectiveness, the concept of risk-based deterrence has been introduced. Although highly attractive conceptually, the risk-based system has been stymied since it has become the regulator who decides what the risk is, rather than allowing firms to carry out their own risk function, with regulators checking that the risk process works and the firm developing its risk assessment skills. This initiative needs to become less dirigiste to succeed.

In assessing how deterrence should work, many regulators have latched on to a principle of three lines of defence. This follows the old military principle of castle building, with the outer wall representing the first line of defence, the inner wall the second line of defence, and the keep the final line. Fine for castle building in mediaeval Europe, but the only organisation building castles these days is Walt Disney. This concept of defence as applied to financial institutions has the customer-facing staff as the front line, compliance as the second line and audit in the castle keep. This concept is outmoded, ineffective and encourages the wrong mentality in crime fighting. Better a system of integrated active defence, where all AML assets are designed to work together, as currently used by the world's militaries to great effect in defences such as integrated air defence systems and integrated carrier battle groups.

3. Capability

Training of law enforcement in how financial markets work is generally below what it could be. Virtually all law enforcement officers are given some financial investigation training, but this is not the same as



instruction in the operation of financial markets such that law enforcement has a chance of recognising egregious behaviour, apprehending the perpetrators and obtaining necessary evidence. Specialist financial police are needed, properly trained and supported, in all countries. Commitment currently ranges from financial investigation units consisting of just one law enforcement officer, to specialist financial police like the Guardia di Finanza with a force of around 70,000 persons.

Fines levied on banks are in the billions, yet at the same time governments appear unwilling to fund even small law enforcement projects. One member state agency, for example, promised funding for its creaking IT system to cope with suspicious activity reports, requiring just over €5m, has finally been allocated the funding, but not until 2023.

AML compliance has become an end in itself, highly bureaucratic, with the real objectives having become lost in a mass of organisational data kleptomania. Digitisation of business has given rise to a search for an automated AML nirvana, reducing human input to a bare minimum. Yet money laundering deterrence is a human issue and programming errors can increase costs dramatically, as battles to reduce false positives have shown.

Compliance is also often seen as all cost with little or no benefit. CEOs appear to prefer running the risk of massive fines than investing sufficiently in ensuring that their business models and compliance functions are properly aligned, effective and efficient. Far from scandals having changed such attitudes, they have been perpetuated, as the recent response by Scandinavian banks demonstrates. ●

Quick quiz answers:

1.C, 2.A, 3.C



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JOIN THE DEBATE

So where does the solution lie? Watch CISI TV in July 2019 for a live debate with the author on the various steps and options that are under consideration. Give your views at #FATFat30. The debate will be available on demand subsequently. The Centre for European Policy Studies – on whose cyber crime task force last year the author served as chair – intends to create a new group on how to progress the combat of money laundering at EU level. Interested parties are invited to contact the author.



Ask the experts: Financial Ombudsman Service

The Financial Ombudsman Service, which arbitrates on disputes between financial services firms and their clients, now has the power to order firms to pay as much as £350,000 in compensation to a wronged client. FS Legal's **Gareth Fatchett** explains the impact it will have on firms and consumers

What is the Financial Ombudsman Service (FOS)?

It's an arbitration scheme for when people have disputes with financial services firms that are still trading. The results of the arbitration are binding on the participants and the FOS charges the firm that has a complaint against it for administering that complaint. The complainant is not required to pay any legal costs. The FCA raised the maximum amount of compensation the FOS can award a complainant from £100,000 to £150,000 in 2012 and recently to £350,000. The scope of the scheme has also been widened to allow small and medium-sized enterprises (SMEs) to bring a claim. It's a particularly difficult scheme for financial services firms to defend against because, even if they win, they're still incurring costs to deal with the complaint so they always end up losing.

How does the scheme work?

Initially, the complainant brings their claim to the firm and the firm has eight weeks to respond to it. If the complainant disagrees with the firm's response, they are entitled to refer the matter on to the FOS, but the referral has to be made within six months. The FOS will collect and look at all the evidence from both parties and adjudicate. If either party disagrees with the decision, they can ask for somebody else to look at it, but that happens inside the FOS. Once it gets to the final decision stage, it's binding on both parties.

How do financial services firms foot the bill for FOS awards?

Every firm is required to have insurance. The increase in the award limit to £350,000 is a significant problem for insurers because we are likely to see more claims brought to the FOS, particularly because claimants know that they have nothing to lose, because no one's going to come after them for costs if their claim isn't accepted. It's very common for claims management companies (CMCs) to help

an individual to bring a claim to the FOS. If the claim is successful, the CMC will charge a percentage of the claimant's award as a fee. If it's unsuccessful, they will forego a fee. It's a typical 'no win, no fee' approach. The risk for insurers has increased by more than 100% and that's going to have to be paid for by somebody. If there is an increase in professional indemnity (PI) premiums, then there will be a knock-on increase in costs for consumers wanting financial advice and that's not a good thing. In my opinion, it's a short-sighted move because it means that firms are now going to face significantly higher bills just to trade.

“If there is an increase in professional indemnity premiums, then there will be a knock-on increase in costs for consumers wanting financial advice and that's not a good thing”

If costs are passed on to consumers, it will open up an advice gap for those who can't afford to pay. Is there a better model the UK could adopt to narrow this advice gap?

A better model might be what a court would do – so, require a complainant to pay the defendant's legal costs if the complainant loses – but the problem with that is once you have court costs and lawyers involved, the consumer may be put off bringing a genuine claim by the fact that they might feel worse if they lose and have to pay more costs. The regulators will be thinking that we don't want to have a situation where genuine complainants are put off for no apparent reason.

Are there any estimates of how much PI insurance premiums are going to increase by?

No, because the price is effectively set by the insurance market and the insurance market won't do that until policies come up for renewal. Insurers may take a different view depending on how they're feeling and that is a really dangerous thing to do if you're regulating a market. It's giving firms that are operating in that market little control over their own destiny. This change is ill thought through because it's good for consumers, SMEs and general protection in the market, but it's bad for the firms that have to shoulder the cost, particularly when they can't control those costs.

Which other countries operate similar compensation schemes and how do they work?

A lot of countries have ombudsman style schemes and they all operate in very similar ways to our own, but ours is different because it has a significantly higher claims limit now. That probably reflects the fact that the UK is a big centre for financial services.

Is there any likelihood of the sector appealing against the FCA's decision to raise the award limit?

I don't see that being the case. The increased limit has been in place for complaints brought from 1 April 2019 onwards. ●

GARETH is a partner in the Birmingham office of FS Legal. He is well known, nationally and internationally, for acting for large groups of investors who have received negligent financial advice. He was shortlisted for International Lawyer of the Year by the Birmingham Law Society and is frequently consulted by and quoted in the press, including the *Financial Times*, *Money Marketing* and IFA Online.

“

Renewable energy is gaining impetus these days as part of a focused approach in every country’s economic growth policy”

Solar energy into the 2020s, pp.56–62



IMAGE: ISTOCK

REGULATORY UPDATE

General regulatory changes

50 **SMCR**

The FCA is encouraging firms to prepare now for the SMCR

50 **The FCA**

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FROM THE EDITOR

THIS SECTION PROVIDES REGULATORY AND STRATEGIC INFORMATION FOR SENIOR MANAGERS. IT DESCRIBES THE POSITION AS AT 11 MAY 2019. THE REPORT CAN ALSO BE ACCESSED AS A PROFESSIONAL REFRESHER AT CISI.ORG/PR OR BY LOGGING IN TO MYCISI.

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SOME REGULATORY HOT TOPICS

- Will Brexit ever happen?
- The FCA's role in the London Capital & Finance mini bond failure
- Persuading the Treasury, media and public that they must fight for financial services to be included in the future relationship with the EU
- Delays in transferring assets between platforms
- An individual senior manager's responsibility under the Senior Managers and Certification Regime
- The Australian Royal Commission's scathing report on bank practices
- Who will be the next governor of the Bank of England?
- The Pensions Dashboard
- The increase in Financial Ombudsman Service awards
- What can be done to rebuild trust in the financial sector?
- How long can the equity market bull run continue?

GENERAL REGULATORY CHANGES

1. SMCR

The FCA is encouraging firms to prepare now for the Senior Managers and Certification Regime (SMCR). It suggests that firms should start by making bespoke training plans and ensuring that staff understand the practical application of the specific rules that are relevant to their roles. (The previous step is for the firm to identify who the senior managers will be and what they will be responsible for.) Jonathan Davidson, the FCA's executive director of supervision for retail and authorisations, has said: "The SMCR is an important way to ensure individuals at all levels within firms take personal responsibility for their actions. It is good for business when employees buy into a firm's purpose, feel personal accountability and are inspired to speak up and listen."

The FCA wants the SMCR:

- to change the culture of firms from one of achieving corporate objectives to one of personal responsibility
- to have an individual whom they can chase if there is a problem, rather than be met with a committee structure where no individual is responsible
- to know who is responsible for operational resilience (which is now as important as financial resilience) if services go down, and for cyber security and money laundering systems and controls.

2. The FCA

Andrew Bailey, CEO of the FCA (and a leading candidate to be the next governor of the Bank of England), has explained his view of regulation after Brexit. His main point is that rule outcomes are more important than prescribing rules on how this should be done. He cites the difference between common law in the UK and the continental dirigiste approach, and the greater importance of the wholesale sector in the UK. In the important test of equivalence of UK rules to EU ones, he says, "It is not about whether we each approve of the other's rules, but whether they achieve the common substantive outcomes." However, he has also argued that there should be a "mutual recognition", not an "equivalence", approach between the UK and EU – allowing the UK more flexibility to develop its own rules, particularly for the wholesale market – and, significantly, that services as well as goods should be covered in a customs union, given the importance of financial services to the UK (which seems at odds with his comments on equivalence). The draft Political Declaration attached to the Withdrawal Agreement between the UK and the EU talks only of "close and structured cooperation" post Brexit – which falls well short of mutual recognition.

Separately, Bailey has commented on the idea of making the UK a light touch regime post Brexit to increase its competitiveness. He has said that if the UK is going to have the competitiveness debate, “let’s please have it in the public interest framework that does not entrench the interests of incumbents”. He has also considered whether regulatory principles should be given more weight, commenting that “history has shown a tendency to talk principles but write rules” (enforcement notices normally cite breach of principles, not of specific rules). He has also considered the future of UK regulation and how it can be made future-proof, adding, “We will be leading a debate about this with stakeholders so that we can keep pace with the developments taking place in the markets that we regulate and in wider society.” This points to principles rather than specific rules.

FCA enforcement policy has seen lifetime bans increase by 70% in the past year (24 from 14). These are imposed, for example, if “an individual lacks honesty and integrity, or competence and capability”. The FCA’s director of enforcement, Mark Steward, says that the FCA has a “large number” of investigations in train and some of these are in “important phases”, addressing “very serious issues such as financial crime, false or misleading statements and significant anti-money laundering system and control issues”. He says that often the FCA finds that senior management are either invisible or lacking in influence, or that management data is insufficient to alert them to its persistence. ‘Dawn raids’ also nearly doubled to 25 in 2018, while there were 504 investigations open at the end of the 2017–2018 financial year, compared to 420 from a year previously. However, the FCA has said it will keep these under review and drop those where there is no evidence of serious wrongdoing.

The FCA is planning a 2% increase in expenditure this year to £558.5m, meeting its commitment to keep this flat after inflation despite continuing Brexit preparation costs and expanding its remit to claims management companies. Further Brexit costs could delay the FCA’s plans to introduce more pre-emptive supervisory tools to prevent harm to consumers in good time, such as



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the joint regulator/sector initiative to prevent ‘phoenixing’ of individuals into new regulated businesses. Ideally, the pre-emption would include artificial intelligence (AI) tools. Some would like to see more information about how the FCA’s total expenditure is allocated between different functions. The levy for banks is increasing by 4.3% on average; advisers will pay 1.1% less than 2018.

3. Brexit

Firms breathed a sigh of relief when the UK and EU agreed the extension until October. Even before that, at the last minute before the original March deadline, some EU countries (for example, the Nordics), but not all (for example, France), were preparing to grant temporary waivers to UK firms to enable them to continue to do business with customers in the EU. Many firms had already prepared for a ‘hard’ Brexit in March by moving EU customers and some resources to EU-based entities – with the 15 leading London international banks moving only about 1,500 jobs (the original estimate was 4,600), with more to follow if there is no agreement; one of these banks has said, “We are waiting and seeing until the end before moving people” – or by having methods to dodge the loss of trading ‘passports’. Common approaches to this latter tactic include an EU entity sending orders back to London for execution, reverse solicitation (where the EU customer solicits the order) and the EU entity putting its name to a transaction negotiated with the UK company. The movement of assets and other things are unlikely to stop or be reversed given the

uncertainty about whether there will be any agreement before October. The exchange-traded funds (ETF) sector has a particular concern following a European Securities and Markets Authority decision that equities that are dual listed in the UK and EU (such as Unilever) will need to be traded on EU exchanges, where there is often less liquidity. Some ETF providers fear that the FCA will retaliate by requiring UK investors to trade on UK exchanges only. This would split the market.

4. FOS

There has been much controversy following the increase in maximum payments from £150,000 to £350,000 on 1 April. The FCA/Financial Ombudsman Service (FOS) were unwilling to postpone this despite warnings from advisers and professional

// TOGETHER WITH
OPERATIONAL
RESILIENCE,
CONDUCT RISK IS
THE UK REGULATORS’
TOP PRIORITY //

bodies such as the CISI that some insurers were not ready to increase cover, that this would lead to big increases in professional indemnity (PI)

premiums for firms (the worst case is 500%), and cause some advisers to leave (the worst case is up to 1,000). The FCA was warned of the impact the increase would have on advisers, but controversially supported the FCA executive’s view that customers (particularly for defined benefit (DB) pension transfers and SMEs) would benefit from a smaller number of more focused advisers, and that the advisers left would provide more “affordable advice”. As a default, where insurance

coverage has excesses and exclusions, firms can increase their capital to make up the shortfall beyond the current minimum of the higher of £20,000 or 5% of investment income, plus 2.5% of insurance mediation and home mediation income. So, the action has moved to PI policy providers, with the FCA encouraging them not to make big increases in premiums, and to increase cover mid year, which some are struggling to do. Advisers argue that this discussion is likely to be ineffective and that insurers are likely to insist upon unrealistically high standards for cover and refuse risky business, such as DB transfer advice.

5. Corporate governance

Together with operational resilience, conduct risk is the UK regulators' current top priority. It has three main forms – behaviour, financial crime (particularly money laundering and evading sanctions) and data regulation – described in point 8, 'Financial crime'. Some larger firms are moving beyond monitoring staff and detecting bad behaviour, such as rogue trading, to prevention. This clearly involves culture change through leadership and training, but also the use of sophisticated AI and machine learning tools to both cut down on the number of false positives requiring investigation – for example, as shown through simple word recognition (such as 'fraud') – and to cover change of an employee's tone of voice or individual circumstances (for example, divorce), which may make that person more high risk.

6. Whistleblowing

The perils of being a whistleblower are illustrated in a recent case involving UBS. A junior employee met a senior board

director to complain about the bank's treatment of her. She later claimed that she had been raped by him. A law firm (Freshfields) was asked by the bank to conduct an independent investigation. They told her that their fees would be paid by the bank, but it is unclear whether they also told her that the hundreds of social media messages that she claims the law firm "coerced" from the personal phones of her friends, without her being legally represented, would be disclosed to UBS for its review. She also complained that she was not allowed to see the Freshfields report because of legal privilege between lawyer and client. The FCA and the police are investigating. Lots of lessons for whistleblowers and firms here.

7. FSCS

The controversy over payments from the fund to investors in London Capital & Finance's (LCF) bonds continues. There are 14,000 investors. Initially, the FCA, the Financial Services Compensation Scheme (FSCS) and the administrators, Smith & Williamson, advised investors that mini bonds were not covered by the FSCS. However, the media and political pressure to do so has been intense. The FSCS now says it "looks at whether a particular regulated activity (for example, advising) was actually carried out in practice – if it was, then [it] may be able to compensate if the firm owes a customer a civil liability in connection with that regulated activity (for example, it carried out that activity negligently, or in breach of contract/regulatory rules)". The administrators are sending questionnaires to investors, asking them whether they in fact received advice even though the LCF staff were trained not to provide it.

They will also examine voice recordings from the call centre. Advisers are concerned that the FSCS may be called upon to pay large sums, the responsibility for which will fall upon them. They question whether the call centre could have had enough information about the financial circumstances of the investor to make a "personal recommendation".

Caroline Rainbird, previously of the Bank of Scotland, will become chief executive of the FSCS in June.

8. Financial crime

This remains a key focus for the FCA and firms. The advance of AI and machine learning in monitoring transactions and electronic communications continues. It has fined a discretionary fund manager (Linear Investments) £409,000 for failings in its manual oversight of trading in its Direct Market Access service (which enables clients to place orders on the market directly in the name of the firm) before 2015. It became aware that it should monitor these in January 2013, but failed to introduce a system (an automated one) until May 2015. There are many lessons to be learnt from this.

9. Pensions

There have been many developments, but most centre on pension withdrawals and transfers. It's a big story that affects more individuals directly compared with the few who invest. Here are some developments:

- The government is proceeding with the Pensions Dashboard despite sector challenge. However, pension schemes will be able to develop their own dashboards alongside the planned non-commercial one. Most importantly, pension schemes will have four years to supply data to this; state schemes will do this "at the earliest opportunity".
- Complaints to the FOS on pension transfers often focus on the time taken for the transfer, with the scheme reviewing the amount to be paid after three months of delay (the FOS is upholding 48% of claims against adviser delays). The FCA has warned specific pension providers to speed up transfers or face new prescriptive rules on times for transfers. It is reopening the debate upon whether to ban contingent charging by advisers for pension transfers – it sees an "inherent conflict of interest" here if the adviser is only paid if the transfer proceeds.



'Does whistleblowing have to end badly?' Rebecca Aston, CISI head of professional standards, discusses this question cisi.org/whistleblow

- The government is concerned about what happens to the cash from DB transfers and withdrawals, and believes that consumers should be told how it could be invested under their control. Hence the regulator's focus on 'investment pathways'. The FCA proposes that pension providers should offer their non-advised customers a choice of investment pathways to meet their retirement objectives. The Personal Investment Management and Financial Advice Association criticises this as discouraging the customer's engagement with his or her pension and encouraging the return to annuities provided by the provider. Providers have been told to create governance committees to provide independent oversight of investment pathways given to consumers.

SECTOR CHANGES

10. Private wealth management and financial advice

Recent developments include:

- Platform switching: There are often delays of many months in a client switching assets from one platform to another, particularly if the transfer is of the investments themselves. Recent research by Lang Cat of 95 advice firms finds that although there were often significant costs to be saved by moving (calculated at up to £91,000 over 30 years for a client with £500,000), many advisers do not move existing clients because of the complexity of the process of re-registering the securities in the name of the new custodian (the estimated adviser time is 20 hours). One solution to this would be for the FCA to provide clarity that moving platforms does not trigger a duty to reassess client suitability from the beginning, and for advice firms and platforms to improve their procedures.
- The FCA's proposal that advisers should have a duty of care to clients is now in doubt; due to the need for primary legislation, the SMCR and sector pushback, it is considering the alternative of changing how it authorises, supervises and enforces its Principles instead. Such change could give a potential direct private right of action against firms for breaching them.
- The FCA is reviewing the outcome of the Retail Distribution Directive and the Financial Advice Market Review. It published 24 questions for firms and asked for comments upon any barriers



'Beating the transfer market: when customers need to transfer their assets'. Read our online article about platform switching cisi.org/transfers

to competition and to advice affordability by 3 June 2019. It is holding a series of roundtable discussions around the country with advisers in June and July. The FCA has said: "We want a high level of engagement on this. This is an incredibly important area, advice and guidance is incredibly important for the industry, but also for consumers."

11. Asset management

Some interesting trends:

- Evidence is emerging of the reduction in external research spending and how this has varied between asset managers after the revised Markets in Financial Instruments Directive (MiFID II). At the time, median spend of 10 basis points (bp) per asset was expected; however, some larger groups have cut this to as little as 1bp (for example, Amundi, with €1.4tn of assets). In contrast, managers with less than €250bn of assets may be paying more. It is difficult to know the pre-MiFID II cost since this was 'bundled' with transaction costs.
- Fund managers internationally are putting pressure upon the companies they invest in to be environmentally friendly. For example, major fund managers are calling upon oil companies to align their business with the Paris Accord on Climate Change targets. However, they appear less keen to align their own funds with these targets. In a survey of major funds, only 21% had such a policy and 46% said none of their funds were committed to it. There are also fears about 'greenwashing', under which investee companies say they are environmentally friendly while delaying the expensive and painful changes to actually be so. Some institutional investors are pressing companies on

this. Hans Hoogervorst, head of the International Accounting Standards Board, has said: "We should not expect sustainability reporting to be very effective in inducing companies to prioritise planet over profit – greenwashing is rampant". In parallel, impact investing is also growing – it is estimated at US\$502bn currently. The International Finance Corporation has produced a list of nine principles defining this, plus regular independent verification of adherence.

- Financial regulators worldwide are becoming increasingly concerned about the potential systemic and missale dangers of passive fund growth. The US regulator started the trend with a thorough review in 2016 and Ireland has followed. The Central Bank of Ireland has said: "It became apparent there were issues that warranted investigation, a lot of which came from product innovation and the resulting potential for increased complexity". The International Organisation of Securities Commissions (IOSCO) is now studying investor protection and market integrity problems. These include the possibility of authorised participants who make two-way prices in ETFs to withdraw in a crisis; ETF's tolerance for liquidity; impact on broader markets, particularly when the underlying assets are illiquid, increasing volatility; and so on. There may be new global rules in the future.
- The FSCS has said that compensation paid to clients of Lifetime SIPP is likely to fall into the provider funding class rather than the life distribution, pensions and investment intermediation class.

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

GOOD ANCESTORS – BUT NOT QUITE YET

In her final weeks in power, UK Prime Minister Theresa May put climate change at the heart of her agenda by committing the country to a net zero carbon target. This is a major shift in economic policy, and one which requires serious parliamentary debate and scrutiny rather than a press release and some secondary legislation. Her successor will inherit that decision, plus the Brexit problem and a swathe of other challenges. This brave attempt to bring the issue to the fore and to be good ancestors brings echoes of St Augustine’s wayward prayer: “Lord, make me pure, but not yet.”

Climate change falls into the death and taxes category – we’d all rather put them off, as with St Augustine and chasteness, but they are happening. The science on climate change is undeniably depressing.

The business of green, responsible, sustainable, call-it-what-you-will finance arched forward on 2 July 2019 when Sir Roger Gifford, banker and former Lord Mayor, launched the Green Finance Institute with hefty backing from the City of London and UK government. The City grandees regard green finance as “prudent, profitable and one of the best tools available in the race to cut carbon”. Sir Roger is rightly keen to stress the profitability: old-fashioned but trusted enlightened self-interest.

In the wholesale field, this manifests itself in fast-growing business for savvy institutions like, for instance, London Stock Exchange (LSE). Green bonds listed on the exchange have raised in excess of US\$25.3bn in seven currencies. Investment in the UK’s clean energy sector has surpassed £100bn since 2004, representing 12.6% of all new investment in clean energy for the EMEA region.

2018 saw almost US\$170bn in labelled green bond issuance. There are 16 renewable funds listed on LSE with an aggregate value of over US\$7bn. In all, there are almost 100 green bonds listed on LSE in seven different currencies.

On the retail side, all of the world’s biggest asset management firms, from Aberdeen Standard and BlackRock to Vanguard, have seen a dramatic upsurge in demand in this area in recent years. Martin Gilbert, the robust chairman of Aberdeen Standard Investments, told a Guildhall audience in May 2019 that processes to measure environmental, social and governance (ESG) issues are vital for any firm wishing to win any

sizeable investment mandates. From October 2019, most British pension schemes with more than 100 members will have to report on their compliance with such measures.

Larry Fink, CEO of BlackRock, writes annually to his opposite numbers in firms in which he invests. This year, he turned to the key matter of purpose: “Companies that fulfil their purpose and responsibilities to stakeholders reap rewards over the long term. Companies that ignore them stumble and fail. This

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dynamic is becoming increasingly apparent as the public holds companies to more exacting standards.”

He continued: “[The world is] undergoing the

largest transfer of wealth in history: US\$24tn from baby boomers to millennials. As wealth shifts and investing preferences change, ESG issues will be increasingly material to corporate valuations. This is one of the reasons why BlackRock devotes considerable resources to improving the data and analytics for measuring these factors, integrates them across our entire investment platform, and engages with the companies in which we invest on behalf of our clients to better understand your approach to them.”

THE REGULATORS ARE ALSO ON THE CASE

A recent UK Prudential Regulation Authority survey finds that 60% of banks recognise that climate change is a factor that could increase their operational risks, especially where key elements in their operations, or of their wider supply chain, are located in vulnerable areas. These

risks though may be dwarfed by transition risks, such as changes in market sentiments. The gradual but inevitable move towards lower-carbon business will entail significant legal, market, policy and technological evolution.

But there is bright light at hand. Solar power, in the right regions, can be an answer to two urgent prayers – for cheaper, renewable energy, and for higher, more consistent yields. Our main paper in this *Review of Financial Markets* focuses on how science, business and finance are coming together to achieve those desirable objectives. And a better taxonomy of ESG, green, responsible, sustainable finance is emerging which will make communication of and between these three key pillars – science, business and finance – much clearer. We will be covering this in depth in the next issue of *The Review*.

THE BATTLE AGAINST ECONOMIC CRIME



In his article on pages 46–47 of this edition, on the fractured state of European anti-money laundering (AML) laws and practices, Richard Parlour, a prominent lawyer in the fight against economic crime, paints a picture of complexity and gaps, across the three key areas of governance, risk management and capability. So where do the solutions lie, and how should the new EU task force on AML of which he is part – he chaired the previous task force on cyber crime (see *RoFM Q2 2018*) – tackle them? At the next Cambridge International Symposium on Economic Crime in September 2019 – the 37th such annual event – and at follow-ups with CISI members, Parlour will be discussing steps including:

GOVERNANCE

- Develop clarity of vision and mission. Processes need to have an impact on the underlying threats, or there is no point introducing them.
- Assess whether a new AML body is needed within Europe at policy coordination level. This could be separate, or be the policy arm of Europol, for example.
- Ensure coordination works between EU member states, EEA member states, and non-EU/EEA states, at all levels, and with similar bodies in related areas.
- Improve cross-border cooperation, at all levels, including data collection,

intelligence generation, policy making, investigation, information exchange and prosecution.

RISK MANAGEMENT

- Adopt KPIs that relate to the underlying criminal threats that AML laws are intended to impact. These need to be thought through, rather than being measures which are adopted purely as they are a measure and/or are easy to measure (such as the number of suspicious activity reports filed with law enforcement). The right metrics are needed to combat the threat. Data collection techniques in this area are also in need of improvement.
- Allow firms to develop and use risk-based systems to improve effectiveness.
- Carry out effective 'Benefit Cost Analysis' (rather than cost benefit analysis) of proposed new measures. This is a particular hobby-horse of Parlour's; he strongly feels that regulators need to put the benefit horse before the cost cart, in part by understanding more clearly how our sector works.
- Adopt active, coordinated defences, rather than the static three lines of defence model with all the attendant difficulties to which he refers in his article.

CAPABILITY

- Encourage training and spending on specialised financial police.
- Increase funding and support of law enforcement, particularly of undercover operations and IT systems, enabling law enforcement to follow the money trail from commission of crimes.
- Improve training standards to a new EU

level, including the courts process, policymakers, investigators and intelligence analysts.

In essence, he believes, the options are to carry on as now ('EU AML 1.0'), with little success. "Alternatively," he says, "Europe can counter money laundering with renewed vigour, centralising that which needs to be centralised, integrating all AML defence systems, and ensuring that 'EU AML 2.0' works in all the member states, particularly given the differences in threat, vulnerability and risk of those states."

The price of getting this wrong was outlined in a talk to CISI members in June 2019 by Oliver Bullough, author of *Moneyland*. This is his name for what he calls "the secret country of the lawless, stateless, super rich. Over the past 50 years it has become the third largest economy in the world, and is annexing more every day". His talk (now on CISI TV) to the CISI came two weeks after Britain's National Crime Agency geared up its use of 'unexplained wealth orders', a strenuous new legal device to combat some of the higher levels of economic crime. This theme is high on the agenda of most global regulators.

In Britain, for instance, the FCA's action plan for 2019–20 highlights steps including:

- Improving tackling money laundering through intelligence and data and strengthening partnerships on tackling economic crime
- Deepening our understanding of types of fraud in key sectors
- Raising standards of professional bodies' AML supervision through the Office for Professional Body Anti-money Laundering Supervision.

COMING NEXT



In the next issue of *The Review*, we feature fascinating new research by Dr Keith Arundale, a member of the CISI/ ICAEW Diploma in Corporate Finance Examination Panel and senior visiting Fellow at Henley Business School, University of Reading. His research investigated differences in practice between the ways in which European and US venture capital funds go about

originating, executing, monitoring and exiting from their investments, and the structural and wider environments in which they operate.

Also next issue, a review of the work of Judge Business School at University of Cambridge on crypto regulation.



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SOLAR ENERGY INTO THE 2020s

THE DRIVE TO PROMOTE GREEN ENERGY, TOGETHER WITH FALLING SOLAR TECHNOLOGY COSTS AND MATURING PRACTICES, IS ATTRACTING STRATEGIC LONG-TERM INVESTORS, HUNGRY FOR YIELD, INTO THE SECTOR. ISLAMIC FINANCE HAS A SPECIAL ROLE ALONGSIDE CONVENTIONAL FINANCING, NEW RESEARCH FINDS

In the past decade, the world has witnessed a pressing need for a major transformation from conventional energy sources to renewables, starting with planned efforts in limiting the global temperature rise to below 2°C for the present century. According to the International Energy Agency (IEA) World Energy Outlook 2018, rising disposable incomes and an additional 1.7 billion people, mostly added to urban areas in developing economies, will push up global energy demand by more than a quarter between now and 2040.

While the prevalent approach followed by many countries is to decrease their energy-related carbon emissions, a key driver for climate change is arriving at a universal agreement on improving energy efficiency along with faster adoption levels for renewable energy as their primary source.

According to figures from the International Renewable Energy Agency (IRENA), global renewable capacity more than doubled in the past decade from 1,060 MW in 2008 to 2,179 MW in 2017 (one megawatt is one million watts; roughly enough to power 750 homes at once).¹ This provides an additional thrust to the overall appeal of renewable energy as one of the preferred areas for investing in the future. Increasing renewable energy deployment by various countries contributes to numerous policy objectives, including boosting national energy security and economic growth, creating jobs, developing new industries, reducing emissions and local pollution, and providing affordable and reliable energy.²

Global new investment in clean energy increased by almost 50% from US\$200bn in 2008 to US\$332bn in 2018, with maximum investment per MW in the solar sector compared to the rest of renewable energy sources. This is largely

due to a drastic decrease in required capital cost, thereby reducing the total investment in solar to US\$130bn in 2018, according to Bloomberg NEF.

Looking at the Gulf Cooperation Council (GCC) region, the renewable energy market has been on an upward trend in recent years with all countries incorporating renewable energy targets in their National Determined Contributions (NDCs) under the United Nations Framework Convention on Climate Change (UNFCCC).

Renewable energy financing in the GCC region generally has long tenures with high debt-equity ratios (more than 70%). However, the rise of the green bond market is seen as one of the innovative financing methods, with the National Bank of Abu Dhabi issuing the first green bond in the Middle East, valued at US\$587m, in 2017.³

Islamic finance is considered one of the new options for solar financing, alongside conventional loans, bonds and equity schemes. One of the popular finance techniques, green sukuk, which are Shariah-compliant green bonds, have recently been used in five renewable energy projects in Malaysia (as at December 2018). Indonesia launched the world's first sovereign green sukuk bonds (for US\$1.25bn) in February 2018, whose proceeds will partially finance renewable energy projects.

Overall, the adoption of green sukuk as one of the alternatives to several traditional financing techniques will grow due to factors such as increasing number of solar projects, lower capital cost, faster, favourable green energy policies, along with preference towards Shariah-compliant instruments.

GLOBAL SOLAR ENERGY LANDSCAPE

Renewable energy is gaining impetus these days as part of a focused approach in every country's economic growth policy. It is considered one of the many ways to achieve a country's development ambitions and to meet the increased

demand for power with emphasis on developing the infrastructure needed to meet the demands of the future. Increasing global prosperity drives growth in energy demand. According to IRENA's 2018 report on the global landscape of renewable energy finance, global annual investment in renewable energy rose steadily from 2013 to 2015, peaking at US\$330bn in 2015 before falling to US\$263bn in 2016. While annual investment declined in 2016, capacity additions in the same year were up from 2015. This was partially due to declining costs, and the time lag between financial

closure (ie the time of investment) and the completion of construction, after which an installation becomes operational.

Cost declines

for key technologies have influenced finance flows in the renewable energy space. Lower solar and wind power costs were key contributors which reduced the total value of renewable energy investment in 2015 and 2016, as each dollar of investment financed more capacity than in previous years.⁴

However, global clean energy investment reached US\$332.1bn in 2018, down 8% in 2017, according to Bloomberg NEF.

GLOBAL NEW SOLAR ENERGY INVESTMENT

Investments in renewables have continued to increase each year and continue to make remarkable progress. According to the Frankfurt School-UNEP Centre annual *Global trends in renewable energy investment 2018* report, global investment in renewable energy went up by 2% in 2017 to US\$279.8bn, taking cumulative investment since 2010 to US\$2.2tn. This rise in capital expenditure took place in the context of a further fall in the cost of wind and solar that made it possible to buy megawatts of equipment more cheaply than ever before.

// GREEN SUKUK AS AN ALTERNATIVE TO TRADITIONAL FINANCING TECHNIQUES WILL GROW //

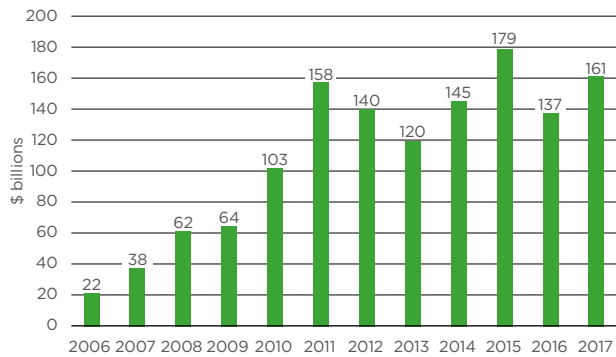
¹ IRENA (2018), *Renewable energy statistics 2018*, Abu Dhabi.

² REN21, *Renewables 2018 global status report*.

³ IRENA (2019), *'Renewable energy market analysis: GCC 2019'*. IRENA, Abu Dhabi.

⁴ IRENA and CPI (2018), *'Global landscape of renewable energy finance'*, 2018, Abu Dhabi.

FIGURE 1: GLOBAL NEW INVESTMENT IN SOLAR PHOTOVOLTAIC (PV) (US\$bn)



Source: Deloitte Islamic Finance Knowledge Centre

Solar power gained prominence in 2017 as total installed capacity from new solar power projects stood at 98 gigawatts (GW), which was more than the total of new coal, gas and nuclear plants put together.⁵

Global investment in solar projects increased dramatically to reach US\$161bn in 2017, as shown in figures 1 and 2.

REGULATORY AND INVESTMENT POLICY SUPPORT

The majority of the financial support has come through government-backed programmes boosted by the willingness of development financial institutions (DFIs) to advise and fund these projects. For example, the World Bank Group’s lending arm, the International Finance Corporation (IFC), has provided nearly US\$6bn in capital for 250 renewable energy projects in emerging markets (5 GW solar and 4 GW wind).⁶

Technology is accelerating the deployment of renewables. Automation and advanced manufacturing are improving the production and operation of renewables by reducing the costs and time of deploying renewable energy

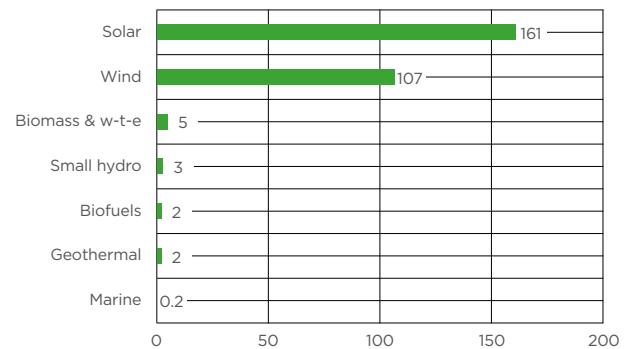
systems. Artificial intelligence (AI) can improve weather forecasting, optimising the use of renewable resources, whereas blockchain can enable energy attribute certificate (EAC) markets to help resolve trust and bureaucratic hurdles.

Advanced materials have the potential to transform the materials in solar panels and wind turbines (Deloitte analysis).

EMERGING MARKETS

In 2017, emerging markets accounted for 63% of global new investment in renewable energy, widening the investment gap with developed countries to a record high. China recorded the highest growth for solar and wind segments along with capacities marking above 100 GW for both in 2017. China accounted for over half of new solar additions and two-thirds of global photovoltaic (PV) production in 2017. Developed countries have benefited from market and product designs that initially took off in emerging countries. For example, renewable energy auctions are a trend that emerging markets embraced first and that have brought steep

FIGURE 2: GLOBAL INVESTMENT OF RENEWABLE ENERGY BY SECTOR 2017 (US\$bn)



Source: Deloitte Islamic Finance Knowledge Centre

price declines in renewable prices across the globe.

A combination of enabling trends and demand trends are helping solar and wind compete on par with conventional sources and win (Deloitte analysis, see table 1).

INVESTMENT TRENDS BY REGIONS

A report published by IRENA – *Unlocking renewable energy investment: the role of risk mitigation and structured finance* (2016) – identifies the main risks and barriers to renewable energy investment and provides policymakers and public finance institutions with a strong portfolio of measures, instruments and tools (see figure 3) that can be used in combination to mobilise private investment at scale.

INVESTMENT IN RENEWABLE ENERGY PROJECTS – GCC

The renewable energy projects in GCC are concentrated in the UAE. According to IRENA’s *Renewable energy market analysis: GCC 2019* report, investment trends in renewable energy projects in the GCC spiked in 2011 with US\$765m invested in the UAE’s 100 MW Shams 1 CSP plant, which became operational in 2013. Investment activity dropped in 2012. Because of increasing government interest and falling technology costs, investment in new projects rose in 2015, and included US\$326m in the UAE’s 200 MW Mohammed bin Rashid Al Maktoum Solar Park Phase II; US\$400m in the

⁵ Frankfurt School-UNEP Centre, *Global trends in renewable energy investment 2018*.
⁶ MESIA, *Solar energy outlook 2019*.

TABLE 1: SOLAR ENERGY GROWTH

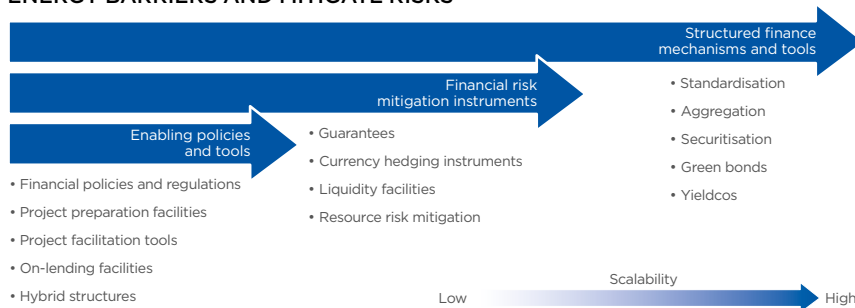
Enabling trends	Demand trends
Lower solar cost	Focused approach by government to support growth of non-conventional energy sources
Expanding investor interest	Population growth, increasing economy and climate changes are fueling demand for power
Technology innovation	Persistent energy deficit

Source: Deloitte

Shagaya project in Kuwait; and US\$600m in Oman's 1 GW Miraah Solar EOR project.

After a lean year in 2016, renewable energy investments again picked up in 2017, mainly in three large-scale solar projects in the UAE. In Dubai's Mohammed Bin Rashid Al Maktoum Solar Park, the 950 MW solar PV Phase III and the 700 MW CSP Phase IV received investments of US\$940m and US\$3,870m respectively, as reported by IRENA. In Abu Dhabi, about US\$870m was invested in the 1,177 MW Noor Abu Dhabi solar PV plant in Sweihan.

FIGURE 3: POLICIES, TOOLS AND INSTRUMENTS THAT REDUCE RENEWABLE ENERGY BARRIERS AND MITIGATE RISKS



Source: IRENA, 2018

MENA

The Middle East will require additional power capacity of 267 GW by 2030, an increase of 66%, according to research by Siemens. The following tables highlight the market growth trends and list some of the key solar projects and capacity.



MENA	Industry investment trends
<ul style="list-style-type: none"> Morocco, Jordan and Egypt are including large scale CSPs in their energy mix Morocco planned to construct 800 MW project valued at US\$2.4bn 	<ul style="list-style-type: none"> Investment in renewable energy projects within the MENA region has seen an upward trend due to the rise in clean energy-based electricity demand coupled with factors such as growing population, economic growth, decreased cost of solar energy, and increased industrial activity. Solar energy has continued to gain momentum both globally and in the MENA region. As of H1 2018, over 470 GW of solar photovoltaic was installed worldwide, of which 100 GW was added in 2017. The 200 MW Kom Ombo solar PV project in Egypt and Jordan's Round 3 PV auction received bids below 3 US\$ cent/kWh. In addition, the Egyptian government has requested bids no higher than 2.5 US\$ cent/kWh for the ongoing 600 MW solar PV West of Nile tender. The biggest solar projects to be financed included the 800 MW Noor Midelt PV and solar thermal portfolio in Morocco, at an estimated US\$2.4bn, and Dubai Electricity and Water Authority (Dewa) in UAE Phase IV is 950 MW and has a total project cost of US\$4.36bn. Morocco's 580 MW Noor II and III projects at the Ouarzazate solar complex, one of the largest in the world to consist of PV and Concentrated Solar Power (CSP). Concentrated solar power in MENA: Despite the MENA region's contribution standing at a mere 7% of the global CSP's generation of 5 GW, countries such as Morocco, Oman and the UAE are early adopters of large scale CSP, while other countries like Egypt, Jordan and Kuwait have or are looking to implement utility scale projects.



Source: MESIA



TABLE 2: MENA SOLAR PROJECTS

Project	Country	Capacity (MW)	Status
CREG PV IPP	Algeria	150	-
Solar PV EPC	Algeria	50	-
Algeria PV	Algeria	4,000	Announced
West Nile PV IPP	Egypt	600	-
West Nile PV IPP 2	Egypt	200	-
Round 3 Solar PV	Jordan	150	-
RAI Solar PV	Jordan	50	Awarded
Noor Midelt PV	Morocco	800	-
ANME Solar Park	Tunisia	1,700	Announced
Tunisia Authorisation Scheme	Tunisia	64	Awarded
Tunisia PV – Round 1 Auction	Tunisia	500	-
Tunisia PV – Round 2 Auction	Tunisia	70	-
Solar IPP project	GCC country	900	-
Solar IPP	GCC country	2 GW	-
12 Solar PV projects	GCC country	-	-

Source: MESIA, Solar Outlook Report 2019 and others

GCC*	Industry investment trends
<ul style="list-style-type: none">  The GCC region is expected to add 7 GW of new renewable energy  KSA's 300 MW project began construction in November 2018 	<ul style="list-style-type: none"> • The GCC region is expected to witness a dramatic rise in renewable energy deployment. Led by the UAE, Oman and Saudi Arabia, nearly 7 GW of new renewable power generation capacity is expected to become operational by the early 2020s. • According to IRENA, the Solar PV remains the dominant technology in the GCC's project pipeline, with a share of over 75%, followed by CSP at 10% (all of which was accounted for by a single project in the UAE) and 9% share for wind projects, primarily in Saudi Arabia and Oman. Solar-assisted enhanced oil recovery in Oman is also expected to contribute about 1 gigawatt-thermal (GWth) in 2019. • GCC countries are investing in the renewable energy value chain including project developers, manufacturing companies, and research and development initiatives. Although the bulk of investments to date are concentrated in the UAE, as deployment picks up, investment flows will likely be distributed more evenly among the countries in the region. • Saudi Arabia's 300 MW solar PV Sakaka project, the first utility scale project in the country, was awarded at 2.34 US\$ cent/kWh and began construction in November 2018.

Asia*	Industry investment trends
<ul style="list-style-type: none">  China leads with US\$126bn investment  Indonesia witnessed US\$1bn worth of investment for RE projects 	<ul style="list-style-type: none"> • The East Asia-Pacific region was the dominant destination for renewable energy investment which witnessed rapid growth from US\$64bn in 2013 to US\$114bn in 2015, before a dip to US\$88bn in 2016. • According to Frankfurt School-UNEP Centre Global trends in renewable energy investment 2018 report, China was the leading country for renewable energy investment in 2017, which accounted for US\$126.6bn, contributing to 45% of the global total. There was an extraordinary solar boom in that country in 2017, with some 53 GW installed (more than the whole world market as recently as 2014), and solar investment of US\$86.5bn, up 58%. • Indonesia was the prominent country in Asia within the geothermal energy space with total of US\$1 bn worth of investment. Almost 60% is contributed by Supreme Energy Muara Laboh geothermal project of 80 MW. • Pakistan continued to attract investment in non-hydro renewables, particularly large-scale and small-scale solar, but its total of US\$695m, while up 42% on 2016, was far below the average of US\$1.7bn achieved in 2014 and 2015.⁷

Europe*	Industry investment trends
<ul style="list-style-type: none">  Renewable sector employs about 1.2 million people  The European Investment Bank has supported solar photovoltaic projects 	<ul style="list-style-type: none"> • Europe shows that renewable energy can reach very high penetration at low cost. By 2050, renewables will comprise 87% of the electricity mix, with wind and solar playing a dominant role, according to Bloomberg Nuclear Energy Finance. • By 2050, Germany will be running on wind and solar, and 84% renewables, but it has the highest emissions in Europe. • By 2025, the UK will have added 158 GW of wind and solar. • According to IRENA, The renewable sector employs about 1.2 million people in Europe. This figure would increase substantially with a doubling of the renewable share by 2030. • The EU will require investment of around US\$76.5bn annually to achieve 34% renewables in its power mix by 2030, according to IRENA. • Turkey's renewable energy sector will attract nearly US\$28bn investments by 2020, according to a new report by the World Bank's IFC arm. • Some US\$16.4bn of these investments will be made in wind power, US\$7.4bn in solar energy, US\$3.4bn in geothermal energy, and US\$560m in hydro power, according to data compiled by state-run Anadolu Agency.

*Source: MESIA, Solar outlook report 2019

INDUSTRY AND BUSINESS LEADERS' OUTLOOK

This section summarises the feedback from Deloitte's online survey questionnaire, which aims to understand how Islamic finance as an option could be considered to fund projects. The target audience consisted of executives from organisations whose primary industry was oil and gas production, solar generation, banking, asset management or professional services.

Figure 4: What is the estimate of solar energy contribution to energy generation in your country?

- Majority of respondents (more than 70%) believe that share of solar energy in their country's total energy generation has been low despite having considerable amount of support from their governments.
- This is evident from the fact that non-hydro renewables comprise only 11% of the gross energy consumption

compared to 29.7% for petroleum products.⁸

Figure 5: Aside from solar energy, what other renewable energy projects exist in your country/region?

- Apart from solar, geothermal is the primary renewable energy source

⁷ Frankfurt School-UNEP Centre Global trends in renewable energy investment 2018.

⁸ Economist Intelligence Unit (EIU).

THE RENEWABLES ROLLOUT

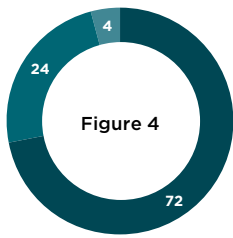


Figure 4

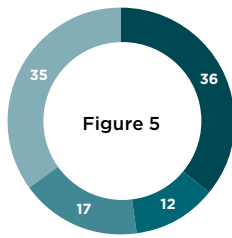


Figure 5

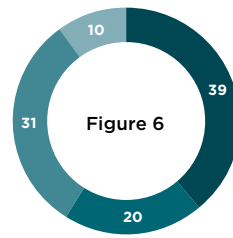


Figure 6

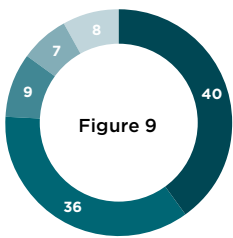


Figure 9

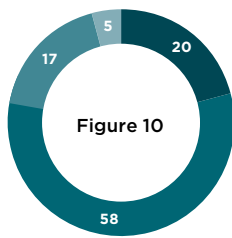


Figure 10

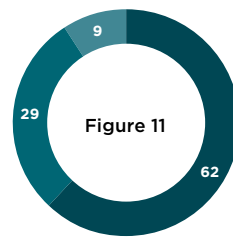


Figure 11

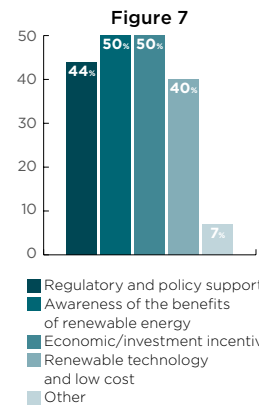


Figure 7

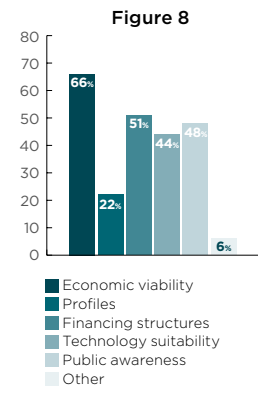


Figure 8

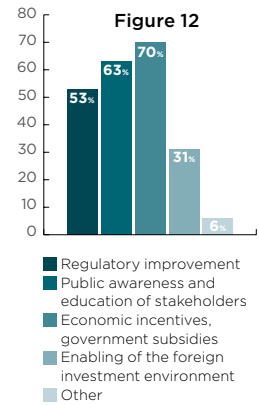


Figure 12

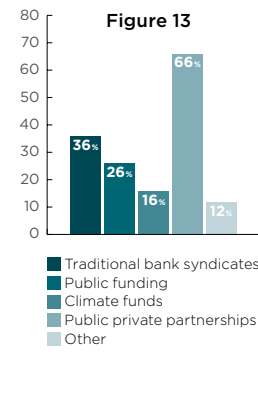


Figure 13

Source: Deloitte Islamic Finance Knowledge Centre

followed by wind turbines and biofuel which substantiates strategies to invest in and undertake renewable energy projects in future.

- As reported by IRENA, there is ample evidence that Solar PV and wind power dominate global spending on new renewables projects, moving from 83% of total finance in 2013, to 93% of total renewable energy investment in 2016.
- Therefore, solar projects can be seen as an important asset, underpinning economic growth of the countries.

Figure 6: Is there a defined solar energy strategy/initiative in your market/jurisdiction?

- A majority (70%) of industry experts identify the presence of solar energy strategy in their market.
- This indicates that the countries' governments are starting to make room for more solar projects in the coming future. This hopefully will

result in significant change in the solar energy market.

Figure 7: Which factors have most influenced the growth of solar energy projects in your country?

- Awareness of the benefits of renewable energy, and economic/investment incentives are the factors which have most influenced the growth of solar, with more than 50% of respondents indicating the same.

Figure 8: Which factors do you think will influence the growth of solar energy projects in your country?

- Technological suitability and financing structures (40% of respondents) are major influencers to the growth of solar energy.

Figure 9: What is the level of regulation and government support/guidance relating to solar energy in your country/region?

- A large number of respondents have

witnessed government support on regulation and guidance, with many other leaders considering it to be at the nascent stage with very little progress.

- Results indicate that countries' governments are active in shaping solar energy strategies within their countries.

Figure 10: Have you or a member of your team, or any affiliate organisation, engaged in Islamic financing of a solar project?

- Less than 20% of respondents were engaged in Islamic financing of a solar project. Factors such as technological improvements and demand for innovative ways of financing will see an upward trend in the future.

Figure 11: If you are considering Islamic finance for solar projects, which of these options suit you more?

- Investment in equity-based and debt-based investments (collectively

90%) are considered best options for investing in solar.

- A small amount of respondents suggested that diversified options between debt and equity could be a good method.

Figure 12: What types of support and policy would you be interested in seeing to consider solar energy in your business?

- A majority (60%) of respondents expect to see improvement in regulatory and foreign investment environment, which will help them consider solar in their business.

Figure 13: Which of the following is more suited to solar financing projects?

- Most of the respondents (66%) believe public private partnerships (PPPs) are suitable for financing projects, followed by traditional bank syndicates and public funding.
- Few respondents (12%) suggested that Islamic finance instruments like mudarabah and sukuk would be the ideal way to invest in solar projects.

CONCLUSIONS

As this paper illustrates, solar energy developers and investors alike now have enviable structures of Islamic finance to

boost growth of green energy in the countries we studied. The drive for more sukuk and other Islamic financing structures such as murabaha, ijarah and mudarabah in greenfield projects will continue to play a key role in the solar industry investment landscape.

The UAE and KSA collectively will be leading the GCC region with the maximum number of solar projects currently active or announced by their key industry players, followed by Bahrain and other nations.

The increasing acceptance and the adoption of Islamic finance across the countries studied indicate that energy operators and investors are taking advantage of the equity-based financing model. Different Shariah-compliant financing structures have been used for different phases of solar projects. Sukuk stands out as a popular asset class amongst international investors.

Due to such offerings, both developers and investors have implemented Islamic financing strategies in their project financing and plant investments, thereby boosting their acceptance levels across the world. Many international agencies have started to reap the benefits offered by Shariah-compliant financing options,

which lowers their debt to equity ratios for capital intensive projects.

Hence, in the coming few years, Islamic finance will be considered as one of the primary financing strategies and in particular, in the GCC, Jordan, Egypt, Malaysia, Indonesia and Pakistan. Other countries will follow suit as the market matures and becomes a driver of green economy in these regions.

// INCREASING ACCEPTANCE AND ADOPTION OF ISLAMIC FINANCE //

KEY MESSAGES

- Financing solar and renewable energy projects will develop faster than ever, particularly in countries challenged by new environmental and climate rules, responsible investment guidelines, green energy principles, sustainable finance, social impact attributes and investment governance. Success in achieving a balanced commercial and social financing strategy will require inclusive industry stakeholder partnerships that embrace sustainable finance and responsible investment.
- Governments and private sector enterprises are under increasing pressure to provide sustainable and competitive energy prices to meet growing economies' energy demands. This will require innovative project financing strategies to access a diversity of international investors and perhaps tap into Islamic financial institutional investors.
- Energy and solar companies need to be mindful of the disruptive technological and regulatory and policy reforms which are shaping the industry infrastructure space, and hence develop commercially viable and sustainable financing structures.

Dr Hatim El Tahir, director of the Islamic Finance Group of Deloitte & Touche, is the chief driving force behind this work. He is a regular and valued contributor to the CISI's work on Islamic finance and also, broadly put, responsible investment. He is the architect of our annual Islamic finance summit, which is available on CISI TV.

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INDUSTRY OUTLOOK SUMMARY

OPPORTUNITIES

Government policies

Many countries have formulated explicit solar focused regulatory policies along with ambitious RE targets.

Declining capital cost

Large numbers of investors have shown interest to invest in solar sector owing to decline in cost of capital required with support from industry and government.

Use of unproductive land areas

Many countries have started to utilise available unproductive lands in their countries to set up solar plants.

Financial support

Many government agencies offer financial support in terms of tax exemptions, incentivising SMEs engaged in RE project development, providing incentives for citizens to adopt RE based electrification programmes in their localities and buildings.

CHALLENGES

Lack of available government resources

State owned utilities in some countries want to keep a firm grasp over the power sector and are hesitant to liberalise their energy sectors.

Unrealistic expectations

Countries need to set expectations for tender prices based on their own risk profiles, not on tender results achieved in other countries.

Subsidy reform

In the long run, energy subsidies are unsustainable, hence, long-term reform is a necessary measure that will help countries become energy independent.

However, reform, if not implemented with an adequate safety net to protect the poorest segments, may cause public unrest.

THE SUN SHINES ON ISLAMIC FINANCING STRATEGY

The increasing use of independent power producer (IPP) and power purchase agreements (PPAs) in many countries, including those analysed, is welcome news for Islamic financing strategies, as this helps identify and quantify both business and financial risks to design structures that balance, with risk sharing and asset-backed and ownership transfer elements designed in the structure. This is important to ensure that all stakeholders' interests are safeguarded.

Sale-based, lease-based and equity-based Shariah-compliant financing structures such as murabaha, ijarah, mudarabah respectively can be designed to reflect the solar project risks and timeline requirements, in the different phases of the project lifetime.

Evidently, solar asset sukuk financing brings benefits and skills along the entire value chain. Its transactional structure, as seen in the below proposed structure, is divided in different phases to reflect the level of the project implementation and capital expenditure.

The proposed solar sukuk structure described below illustrates the suitability of sukuk in addressing developers' and investors' interests alike.

IMPROVING GRID NETWORK THROUGH SOLAR SUKUK STRUCTURE¹ Project overview

1. Gulf Municipality (GM) - project originator is seeking finance to build a 100 MW solar plant (Gulf Solar Farm).
2. GM aims to procure an independent power project (IPP) to build the project asset in one of its suitable sites.
3. GM will purchase the renewable energy certificates (RECs), through its affiliate, Gulf Electricity & Water Authority (GEWA).
4. GEWA will enter with Gulf Solar (service manager) into a Power Purchase Agreement (PPA).

TRANSACTION HIGHLIGHTS Construction phase:

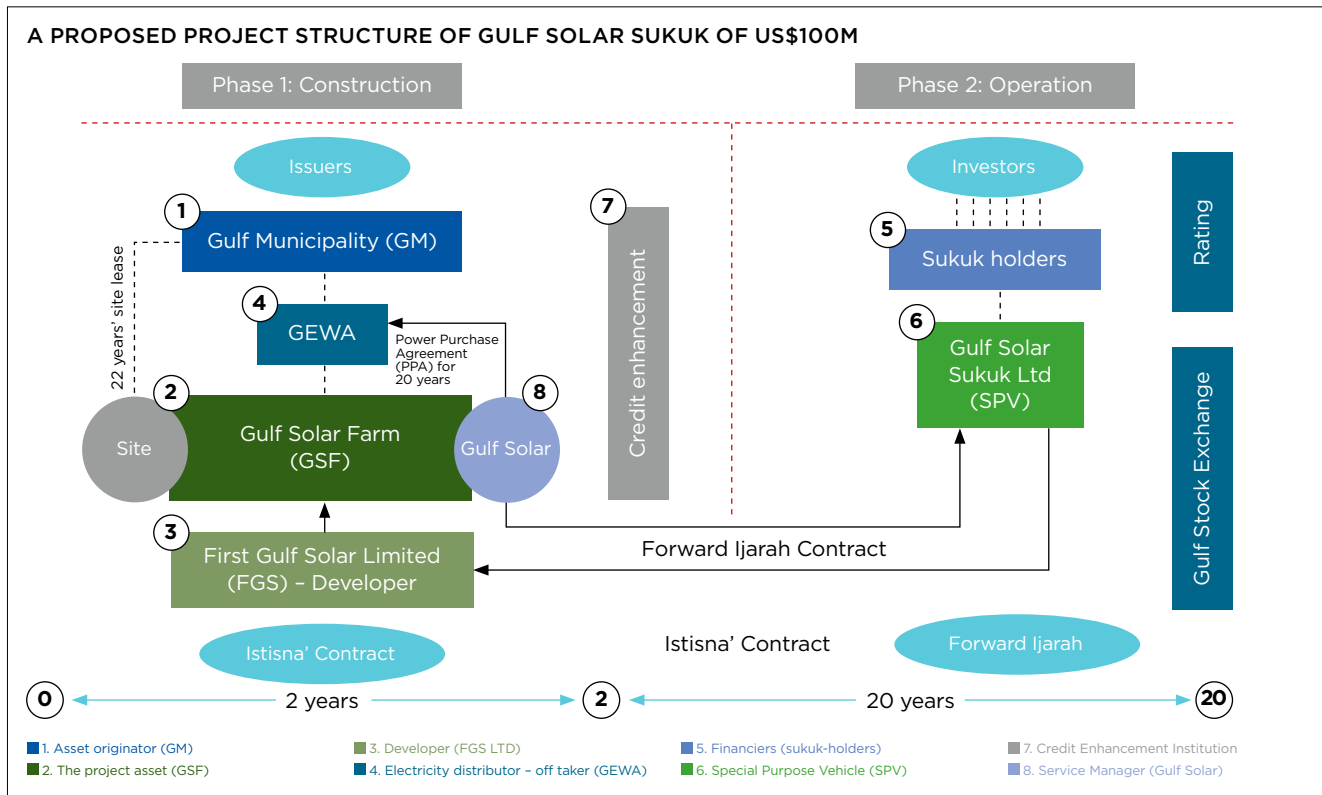
- A special purpose vehicle (SPV) will be set up to act as trustee

of sukuk holders (also known as investors).

- Gulf Solar Sukuk (SPV) signs an Istisna' contract with the project originator (GM), to construct the project asset (Gulf Solar Farm).
- A tech know-how developer (First Gulf Solar) will deliver the project asset.
- Upon completion (two years), title and asset ownership pass to the Gulf Solar Sukuk (SPV).

Operation phase:

- GM (the project originator) will also sign a forward ijarah with Gulf Solar Sukuk to lease the solar farm.
- The completion of the solar plant, Gulf Solar Sukuk (SPV) leases the solar farm to project originator (GM).
- Both parties are subject to a purchase undertaking where the project originator (GM) will repurchase the solar farm from the Gulf Solar Sukuk (SPV).



¹ Developed by Deloitte IFKC and published in the IIFM's Annual sukuk report, 7th edition, 2018.

MANAGING CLIENTS' PERCEPTIONS OF RISK AND REGRET

KEITH ROBERTSON, CHARTERED FCSI, BRINGS HIS SHINING LIGHT TO BEAR ON SOME OF THE WEAKNESSES IN THE PROFESSION'S APPROACH TO EXPLAINING, ASSESSING AND UNDERSTANDING CLIENTS' RISK APPETITES

In his paper in the Q3 2018 edition of *Review of Financial Markets*, Keith Robertson stirred a few hornets' nests with a poke at some of the received wisdoms of 'behavioural finance', and some of the realities behind them. Here he continues the theme with his own scathing take on the issues of framing, regret – and bar charts.

There is another irrational group in our professional world: those advisers who outsource investment to third-party discretionary investment managers (DIMs). These practitioners want to concentrate on financial planning and, without false modesty, often claim insufficient competence in investment, which of course is why they farm out this function. But if they are not competent to do the investment themselves, how can they possibly be competent to judge the investment competence of their outsourced manager? Where a service comprises a series of linked functions, one link of which the key facilitator does not understand, the chain of linked competencies breaks apart. When things go wrong, whom is the client to hold responsible?

This is a form of reverse availability bias. Selection of a DIM is bound to be subject to some form of bias and error. There are scores, if not hundreds, of DIMs out there, so how to select the right one? It is impossible to conduct proper due diligence on each, so there must be some

sort of shortcut applied. Perhaps a third-party rating (but who assesses the competence of the third party to carry out such a function flawlessly?), perhaps a recommendation from a colleague or, most likely, a plausible pitch. Even for a diligent adviser there will come a point when the 'next one', whoever that is, will do. Anchoring bias, availability error and halo effect may all come into play. Yet what else can an adviser, who is likely not to be an investment specialist, do? But who is fooling whom in such a setup?

FRAMING FRAMED

Among all the psychological biases, errors and heuristics rampant in retail financial services, in terms of the public interest and the doctrine of treating customers fairly, framing is probably the most important and dangerous of all. It is unique because it is the only one which has nothing to do with investors, except as victims. Framing is not something that investors do in finance, it is always something that is done to them. This technique is deployed to take advantage of the psychological traits and vulnerabilities exposed by prospect theory, among others. When marketing to retail clients, advisers and managers will employ framing to present selected information to a prospect in the best light and later, when a prospect becomes a client, framing will be

ever-present when meeting with or reporting to the client. This will happen because everyone wants to present themselves and their offering in as good a light as possible. There is nothing intrinsically immoral or ignoble about this. The bigger worry is that advisers fail to spot inadvertent framing in their own presentations or malignant framing from elsewhere in their day-to-day work with clients. It is present in every polished bit of material provided by DIMs, fund

managers and the sell-side generally.

When framing is used in conjunction with other techniques to take advantage of an unprepared lay investor by triggering some of the biases and errors discussed in this paper, it is entirely plausible to say that sell-side designers are subtly forcing clients into decisions they would not willingly make if they had been better informed or warned. Framing, primed also to trigger availability bias, anchoring, representativeness and loss-aversion, together can make a toxic blend – not so much to mislead investors, but to lead them where, with more knowledge, they would not likely go. One could select myriad examples of unfair framing but, for sake of space, one need consider only risk-profiling questionnaires.

Most questionnaires have or had a set of 'composure' questions to assess how the investor might react to market falls. This question seems less common than a couple of years ago, so perhaps criticism has had some effect. In its simplest form the question would be along the lines of: "Markets can be volatile; would you feel uncomfortable if the stock market fell by

// FRAMING IS PROBABLY THE MOST IMPORTANT AND DANGEROUS OF ALL //

0% / 5% / 10% / 20% / >20%?" It is important to realise that any risk-profiling process will structure questions and

answer algorithms to capture as many responders as possible in their medium-risk bracket. That is pretty safe from a regulatory perspective, as the last thing anyone wants is a few outliers at one extreme or the other. Having tested many questionnaires, it turns out a responder has to be pretty dogged to get outside the middle of the bell curve.

One can see that a naïve but not necessarily risk-seeking responder might look at the range of options and think, "well, everyone knows that markets go up and down, so it would be ridiculous to go for 0%; I certainly would not want to lose 20%, so if I go for 10% or perhaps 5%, that wouldn't make me seem too timid".



Keith Robertson, Chartered FCSI, is a highly qualified practitioner who has spent over 20 years as a practising fee-charging financial planner and investment manager. He continues to sit on the CISI level 7 exam panels and forum committees.

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The question has been framed in such a way that the highest figure of >20% looks as if it is heading off into the distance, and an inexperienced investor would have no idea what it feels like to lose 10% or 15% of an investment, so the framing, together with the availability and anchoring of the 0%-20% range guides the investor to somewhere safely in the middle. In fact around 70% of respondents finish up in the middle three risk bands; this may not be coincidence.

But 0%-20% seems a rather low range for a market fall, given what markets have done historically. In the UK, top-to-bottom falls have been up to about 75%-80%. It is hard to be sure, because most statistics will, at best, show only the daily closing price; one has to hunt hard for the daily range. Anyhow, in the early 1970s the UK market fell around 75%. In the US, in the decline from its September 1929 peak to its July 1932 bottom, the Dow Jones index fell 89%. Markets in emerging markets have chalked up even bigger falls, approaching 95% on occasion. So, instead of settling on 0%-20% for its composure question, the risk-profiling manufacturer could have injected a more realistic scenario with: "Markets can be volatile; would you feel uncomfortable if the stock market fell by 0% / 25% / 45% / 65% / >85%?" One doubts that 70% of respondents would fix on the mean or median of 45% - that's a lot to lose. Given the range to anchor on, and the shock of realising it might actually happen, one would expect at least 70% of respondents would mark 0%.

A respondent, anchoring on a range of possible losses, may ask whether that means the manager would put a stop-loss order on at that level. No adviser or wealth manager has been recorded as offering that protection. So, would a fairer and more realistic approach be for the basic 0%->20% question to be followed by a supplementary question which would say: "You have selected 10% as the maximum loss you would feel able to bear without discomfort. Market declines quite often last for two or even three years, and losses of up to 40% or more in a year are not uncommon. Knowing that a market fall of 10% might be the beginning of a sustained and deep fall, would you wish to change your original answer?"

A more experienced investor would be

unable to answer a question in that form. The answer he would want to give, but is not allowed to, would be: "Well, it all depends. If my portfolio had put on 70% in the past three years and you could persuade me that a 10% fall was just a technical correction, and all the fundamentals were in place for markets to resume their bull market then, yes, I might be comfortable with a 10% fall. But if I heard that there had been a massive

outbreak of bird flu or SARS in Asia, or that China and Japan had just gone to war over the Spratly Islands,

then I wouldn't want to wait for a 1% fall, I would want to be out immediately." These risk-profiling questionnaires are designed with questions framed to produce the answers the provider wants to receive, not what the investor probably wants to give.

All discussion and all feelings about risk are context dependent. Today one might be comfortable with a particular level of risk, as if one could actually order such a thing off the shelf or an adviser could really provide it. But 15 months from now one's life may have taken one unlucky turn after another, and the market may have fallen 35%. One would probably not think much of the risk-matching process in that case.

THE FALSE ALLURE OF BAR CHARTS

In the past three or four years there has been a change in the way many risk questionnaires describe expected future outcomes, and that is by means of brightly coloured bar charts. These almost invariably consist of five bars, each purporting to show one portfolio. The upper portion is in one colour and represents gains and the lower portion is in a different colour, showing losses. These five bars fan out across the page, each one showing progressively larger gains and losses, but with the eye being drawn irresistibly to dramatic increases in gains, beside which the losses look relatively trivial by comparison. The subliminal message from the framing is clear: "If you invest with us, you are going to make big profits without much risk of losing money."

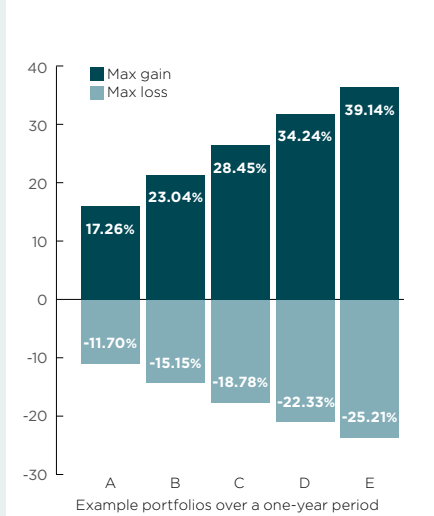
Reading the narrative attaching to the question confuses matters further. One example says: "The following graph

shows the results of five example portfolios over a one-year period. The best potential gains and worst potential losses are displayed. Note: the portfolio with the best potential gain also has the largest potential loss. Which of these portfolios would you prefer to hold?" The key shows a small block of each colour: 'Max gain' and 'Max loss'. How can anyone interpret the information displayed?

- The numbers are all in percentages to two decimal places. This makes them look as if they are the results from real portfolios. Are they?
- The bars show both gains and losses. What does this mean? Perhaps the portfolios made gains of 28.45% and also losses of -18.78% in this particular year? There is no explanation of what the numbers show or how each portfolio is composed.
- Are these real portfolios, or fictional? If real, are these more-or-less the portfolios investors could expect to be put into?
- What are the underlying data? Are the data genuine and taken from just one year, or some sort of composite?
- The key states that the chart shows the maximum gains and losses. Does this mean that if you invest in the first of these portfolios you will never have a loss greater than -11.70%? Or a gain larger than 17.26%? Investors are going to anchor on the big numbers shown.
- Why would an investor not expect his or her investments to show future returns like these?
- What is in these portfolios to produce

// MARKET DECLINES QUITE OFTEN LAST FOR TWO OR EVEN THREE YEARS //

MISLEADING BAR CHART EXAMPLE



such different results? Why are the results so different?

- How would an investor know what to expect if they decide to invest with the adviser who used this risk questionnaire?
- What do 'potential gains' and 'potential losses' in the narrative mean?
- The first bar, presumably representing the most risk-averse portfolio, shows a 'Max loss' of -11.70% in one year. Would a highly risk-averse investor really be comfortable with a portfolio that generated a loss of about -12% in one year? Would that investor really think that a gain of over 17% was 'normal' if he was used to holding cash?
- The framing of the question clearly raises expectations of rising good returns and, so far as one can interpret anything, the gains are always bigger than the associated losses so, overall, one might expect to make only net gains in the future.
- The 'gain' bars are visually more prominent and with a strong message of increasing profit. This plays to the availability heuristic.
- The first numbers one sees are the impressive 'gain' figures. One could expect novice investors to anchor on these.
- The data are complex and confusing to the point that no professional would be able to analyse exactly what this bar chart was showing. This plays to the lack of knowledge of an investor, who probably would not even be able to work out what questions to ask by way of clarification, let alone interpret the answers.
- Investors completing these questionnaires are expressly forbidden from asking for guidance or clarification when filling out their answers.

A different questionnaire provider uses a very similar format. In this case the gains and losses are shown as values in pound sterling, the bars blue for gains, red for losses. The question narrative states: "Suppose that you are considering investing £20,000. There is an equal chance that the investment will either increase or decrease by the amount shown." The numbers are heavily rounded, so an informed observer might assume these were notional or hypothetical portfolios, but the narrative does not say so. The gains, from left to right, are: £1,600;

£3,200; £5,200; £6,200 and £9,000. The losses are: +£200 (no loss); -£500; -£1,200; -£2,200 and -£4,000. The key states these are 'Lowest value' and 'Highest value'.

- Are these portfolios real?
- If not, how were they constructed?
- What are the underlying data used?
- Do these charts reflect what an investor with £20,000 can expect to earn each year if they select the adviser using the risk questionnaire?
- If "there is an equal chance that the investment will either increase or decrease by the amount shown", does this mean that a simple average of the gain and loss represents what these portfolios will generate each year?
- Why should there be an equal chance of the maximum gains and maximum losses each year?

The sector is unashamedly taking advantage of investors' limited knowledge and psychological vulnerabilities to push them through a process where the respondent can neither ask questions or for clarification nor give the answers they might want to give. This is done in the belief it will satisfy the regulator and allows the very fast processing of thousands of investors through what should be the most sensitive part of advice – a clear understanding by both client and adviser of what is meant by risk, how the client is likely to feel about things going wrong in the future, and how the adviser's approach to investment can protect the client. Advisers almost universally use risk profiling questionnaires like the ones exemplified and every one of many questionnaires examined in the past 15 years contains numerous questions that have been framed or constructed in some way to either 'lead' the respondent or to confuse them beyond understanding. If advisers are to act in their clients' best interests, why do they not challenge these absurd questionnaires and their associated processes designed to throw out a 'suitable' portfolio at the end, perfectly matched to every client's feelings about risk? The best chance of defending investors from these subtle attacks is if their own adviser warns them, alerting them to what is going on, and finding a more honest way to understand what their client thinks about risk.

REGRETS, WE'VE HAD A FEW

Regret changes lives deeply. From an adviser perspective its importance lies in its connection with risk. During the 2007-09 crisis, an adviser had clients almost completely in cash due to main asset classes being, in his opinion, too overvalued for it to be rational to invest. But after a year or so, around mid-2008 one client felt she was paying fees and nothing was happening. She was seriously ill and anxious to improve returns. Eventually she prevailed, and after much discussion some of her money went into risky assets, purchased after a clear analysis about the risks generally, and specifically at that time (markets were already sliding). The inevitable happened. The markets crashed in unison and she faced significant book losses. At an urgent meeting she said, "I had no idea these investments would be so risky," because that was what she perceived had happened. But it became clear that she did know there were risks in making the investments she had insisted on. The risk warnings and market analysis all confirmed the opinion that markets were fundamentally overvalued and at risk, as they had been at the time of the

// THE SECTOR IS UNASHAMEDLY TAKING ADVANTAGE OF INVESTORS' LIMITED KNOWLEDGE //

dot.com bust in 2000. It turned out that it was not the risk she had not understood

or anticipated, but the fact that when the losses were actually incurred, she had completely misunderstood just how badly she was going to feel about the whole situation when it happened. This was a profound lesson, sharpened by the fact she died before seeing her investments recover.

In finance, regret by any investor for an investment mistake should induce more than just a sense of gleeful schadenfreude from a professional. Understanding just how painful such events can be for those damaged as a result could usefully be incorporated into every adviser's process when discussing risk with clients.

We will be debating some of these issues, and much more, in a special CISI Fellows and Chartered Members masterclass in autumn 2019. For details please visit the CISI website.



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LAST WORD

Taming the dragons

EQUITY CROWDFUNDING WEBSITES ARE TURNING START-UPS INTO A PROPERLY INVESTABLE ASSET CLASS, OPENING THE SECTOR UP TO MORE RISK-AVERSE INVESTORS

“ The internet bubble that peaked two decades ago, as 1999 became 2000, has a lot to answer for. *Dragon’s Den*, for a start. This show, which has been through 16 series and 17 dragons to date, is based on a Japanese TV format, *The Tigers of Money*, with its roots in the internet boom years. Aired in Japan from 2001 to 2004, it was subsequently sold to producers around the world, reaching the UK in 2005 and going on to spawn local versions in around 30 countries.

The fascination with start-ups and multimillionaire entrepreneurs that took hold during the late nineties internet bubble, when vast paper fortunes were made and lost overnight, has embedded itself deeply in our popular culture. When the world’s first equity crowdfunding website, Crowdcube, launched on 15 February 2011, its British co-founders, Darren Westlake and Luke Lang, declared, “Instead of competing for limited business angel or venture capital funding, start-ups can use Crowdcube as a platform to connect with a nation of ‘armchair dragons’.” Crucially, the entrepreneurs vowed that anyone would be able to invest in start-ups with as little as £10.

Eight years on from its emergence, equity crowdfunding has attracted hundreds of thousands of private investors and hundreds of millions of pounds of equity to back early-stage, extremely high-risk ventures. There have so far been very few standout successes and numerous flops and failures – exactly as you would expect in what is undoubtedly the riskiest area of equity investment.

Many critics argue, with considerable justification, that making it easy for anyone who fancies it to put small sums into a start-up business is a recipe for losses and

disappointment. They are right. Trying to pick the winners from a menu of start-up pitches on a website is closer to punting on the horses than it is to investment.

But what about those – admittedly the minority – who want to invest in start-ups as a broad asset class, rather than trying to pick individual winners? Online equity crowdfunding websites make that possible, because they allow us to divide our money between scores or hundreds of pitches, committing as little as a few pounds to each. That was never possible before these sites came along. Instead, an angel investor would have had to put at least £10,000 into each venture: building a well-diversified portfolio of start-ups required six-figure sums.

“ Picking the winners from a menu of start-up pitches is closer to punting on the horses than to investment ”

However, while making it possible to invest in start-ups as an asset class, the crowdfunding websites do not make it easy. This is why I’ve been watching developments at a couple of the main equity crowdfunding websites with some interest. Over the past year or two, both SyndicateRoom and Seedrs have opened funds that allow investors to put their money into a single vehicle (with Enterprise Investment Scheme tax relief) that automatically spreads it across a large group of start-ups pitching for funding on their websites. The idea is to produce a well-diversified portfolio (100 businesses in the case of Seedrs, around 30 with SyndicateRoom) that gives decent odds of a positive return. While SyndicateRoom’s fund is aimed at

wealthy individuals able to subscribe a minimum of £10,000, investors can put as little as £1,000 into the Seedrs fund.

The key to both funds is obviously diversification – for all practical purposes, the start-up investor’s only true friend. High minimum investment thresholds are not the only reason diversification in start-ups has been hard to achieve historically. Another is that the specialist funds previously on offer had very concentrated portfolios, often containing fewer than ten companies. At that level, the benefits of diversification are limited.

The arrival of funds with much broader early-stage portfolios is a step forward. However, important questions remain. Are the charges reasonable? How diversified are they in practice? A fund that contains ten aspiring boutique spirit brands, for example, will be less diversified than its investors might suppose. To be more sceptical still, might managers of the equity crowdfunding website relax their criteria for accepting start-up pitches, telling themselves that diversification alone will be enough to protect their investors’ interests?

The best answer I can give is that I hope not. With funds like these we are seeing the start of something new: start-ups are becoming a properly investable asset class, rather than a collection of betting slips. The investors who use these funds won’t make ten times their money, but they can hope to make a positive, uncorrelated return by adding some venture capital-type risk to a more conventional portfolio.

Sadly, for most, that will prove far too dull a proposition – human nature being what it is, we will prefer to continue investing as though we were on *Dragon’s Den*. But if, instead, we put most of our stake on the sort of each-way bets these funds offer, the odd 100/1 shot wouldn’t hurt. ●

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