

REVIEW



THE MEMBERS' MAGAZINE OF THE CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

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Inside
Review of Financial
Markets – In-depth
and original academic
research

Land OF PLENTY

Strong economic growth, increased
foreign investment... what else does
Africa have in store? *page 12*

Banking reform

*CISI reacts to Sir Richard
Lambert's proposals, p5*

Saving pensions

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policy-makers, p15*





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REVIEW



**Review of
Financial Markets**
Turn to the centre pages
for the first edition of the
CISI's academic
journal

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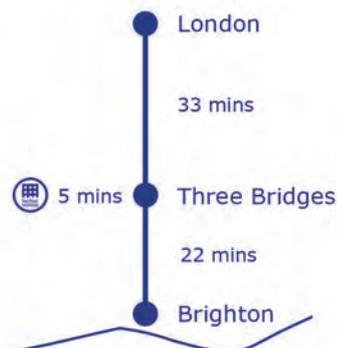


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CISI OPINION

Following the proposals on banking standards made by Sir Richard Lambert, the industry must strive to preserve his vision

Doing the Lambert Walk

THERE IS A visionary goal, then a tone of wistfulness and, finally, a plan – but with all the potential flaws resulting from a difficult compromise – in the report from Sir Richard Lambert FCSI(Hon).

The goal of making banking a profession is one we can all endorse as being in the public interest, particularly with the continuing public distrust of banks and bankers.

The wistfulness of noting that, years ago, banking qualifications and professional membership across the sector were the norm, and that something precious was lost in the boom decades up to 2008, is a reminder that professionalism, once achieved, should not be diluted. As members of a professional body, we all know that integrity, once gained, should never be compromised.

While the CISI has significant numbers of exam candidates who work in banking, we recognise that true professionals not only take exams, but also sign up to a code of conduct, maintain their competence once acquired and take care how they conduct themselves in and out of the workplace. We believe that is what professionalism means and, ultimately, that seems to be the way in which Lambert envisages banking should become a profession.

So, if Lambert is recommending an individual membership body, will he build on what we already have and recognise that the different professional bodies already offer much of what he sees as vital in the long term, or travel the long and difficult road of seeking to duplicate or merge?

Speaking after the launch, Sir Richard said: “Moving to individual members over time would enhance the body’s sustainability... in terms of funding, and stress the importance

of individual responsibility.” He hopes that senior staff will sign up to the body.

However, we perceive a hint of reinventing the wheel at this point: shouldn’t banks be encouraging their staff to become members of a relevant professional body already in existence?

The plan, therefore, contains some flaws. On the one hand, we applaud the stated desire to work with the existing professional bodies. On the other, it is clear that Sir Richard ultimately envisages a body of individual membership, and therefore a potentially divisive vehicle if he wishes to keep existing bodies on board.

The plan also has some flawless arguments: to have an independent board, which benchmarks standards across the whole sector, is a vision we endorse wholeheartedly. Applying self-regulatory zeal to both UK

Benchmarking standards across the whole sector is a vision we endorse

institutions and those foreign banks trading here will demonstrate a commitment from those banks that they intend to take ownership of the issues, sign up to a new culture and deliver tangible improvement.

Yet one of the strengths of professional bodies is that they exist to instil high ethical standards, irrespective of the might of any particular employing institution. Mark Bogard, Chief Executive of the National Counties



Building Society, simply commented on the Lambert report by quoting the 19th-century social philosopher Peter Kropotkin, who would ask “whose ethics?”.

It will therefore be particularly important for the new body to prove its independence from the banks and building societies that will be paying for it, by setting a clear limit on the number of board members who may have links with the board of the new body. This will allay fears that it is a sub-branch of the British Bankers’ Association. Consumer groups should also be represented, with perhaps one position allocated to a journalist.

The CISI supports initiatives that will restore trust and raise standards, and seeks to collaborate and partner with a wide range of institutions in doing so. Our concern is that an initially clear vision will be clouded by the establishment of a delivery vehicle that sets aside the good already being done in this area, and seeks to replicate it with a new idea. For example, why not encourage banks to sign up to the CISI/Institute of Business Ethics Investing in Integrity charter mark, or mandate the CISI’s existing individual integrity programmes? ■

INTEGRITYMATTERS

New grade requirements

Readers will recall that in April 2013 the CISI mandated that candidates for its level 3 Certificate in Capital Markets exams were required to take the IntegrityMatters online ethics test and achieve a grade A or B result.

Since this requirement was introduced, together with IntegrityMatters becoming a requirement for CISI membership, some 7,000 tests have been taken.

In total, the number of tests sat since the Institute introduced IntegrityMatters late in 2008 is now approaching 15,000.

The success of this programme has highlighted an anomaly between the CISI's requirements of exam candidates compared with that of members. This will become more significant as exam candidates move to become CISI members, and their pass for exam requirements may not be adequate for membership.

The CISI is now acting to remove these anomalies and move to a specific Pass/Fail grading system, which will become effective on 1 April 2014 as follows:

- There will be two grades only – Pass and Fail, which will represent these scores: Pass (19–24 marks) and Fail (0–18 marks).

- Certificates will be generated only for Pass results.

CISI Managing Director Ruth Martin said: "We are very pleased at the overwhelmingly positive response that greeted our mandating of IntegrityMatters as a prerequisite to taking our Capital Markets certificate exams. However, the anomaly between IntegrityMatters requirements for membership and those for exam candidates has been brought into sharper focus as successful exam candidates move into membership. This change will remove the anomaly, while the broadening of the Pass grade will ensure that exam candidates are not disadvantaged."

For further information about IntegrityMatters, see cisi.org/ethicsproducts



INDIA

Help for graduates



CISI staff in India outlined to graduates at a major business showcase the range of career options within the country's growing financial services industry.

Members of the Institute's Mumbai-based team offered information and advice at the TRANSCEM event held in Pune and organised by the Symbiosis Institute of Business Management. The event was attended by universities, colleges and business schools from around the country.

Ganesh Iyer, CISI Regional/Country Head, said that the event "gave us the opportunity to meet some of India's brightest graduates and postgraduates to introduce the CISI and to explain the choices available to them regarding a career in the global securities and investment industry".

The CISI organised a quiz with a cash prize and the award of CISI Affiliate membership. It was shared between the winning team of three from Narsee Monjee Institute of Management Studies in Mumbai.



60-second interview

The CISI's six professional forums are a key membership benefit. **Julian Sampson**, Chartered FCSI is Chairman of the Compliance Forum



Q How does the Compliance Forum benefit CISI members?

The Compliance Forum is the largest of the CISI professional forums, with more than 1,000 members. On their behalf, the Forum Committee runs a varied and interested programme of events with expert speakers. Importantly, we also ensure members' voices are heard in appropriate quarters.

Q What influence does the Compliance Forum have within the industry?

Over the past year, the Compliance Forum has had increasing input into regulatory thinking. The Forum has always given feedback to regulators on consultation papers and proposals where they affect our members. But recently, we've had more direct conversation with the FCA.

Q What form does this take?

Members of the Committee now meet on a regular basis with the FCA's Business Practitioner Panels' Secretariat. This has allowed the Committee to raise with the Panel members concerns about some practical elements of regulation. Issues we've raised have included the use of attestations, difficulties with the FCA website and regulation by speech-making. These meetings have proved very productive and have led to other openings.

Q Such as what?

In January we met with the FCA Enforcement Team (as reported in the S&IR, February) about the impact of its disciplinary notices and why firms do not always take notice of them. I'm really pleased that we're able to directly represent the views of our members – all of whom are practising compliance

professionals – to the FCA. It's important that the regulator understands how its policies and practices are working on the ground.

Q What aims do you have for the Compliance Forum in 2014?

We constantly seek to differentiate our offering from that of commercial training providers by tapping into the practical experience of our members. To help achieve this, we would like to run more round-table events where members can compare notes with each other on whatever subject we are looking at.

The CISI has produced a video for young people interested in pursuing a career in compliance that explains what this job area involves. Watch the video at cisi.org/compliancecareers

For information about the professional forums, visit cisi.org/pf

80%

The proportion of consumers who would get a better annuity on the open market than with their existing provider, according to the FCA. Turn to page 15 for ten ideas on pension reform



FEEDBACK

Your say

The S&IR is your CISI membership magazine and we want to hear your views. To get in touch, email richard.mitchell@cisi.org, leave a comment at cisi.org/sireview or follow @CISI on Twitter.



The Redmayne-Bentley team present a cheque to Macmillan Cancer Support

Dear S&IR,

The financial services industry gets a lot of bad press, so I'm pleased to report how the team at Redmayne-Bentley's office in Leeds has made a positive contribution to our local community.

The 150 staff between them raised £11,065.71 for our chosen charity of the year for 2013, Macmillan Cancer Support.

Funds were generated from a range of fun and gruelling activities. Among the highlights, staff drank more than 300 cups of coffee at the World's Biggest Coffee Morning, took part in a charity leg waxing and tackled the James Potter Eggs Yorkshire Marathon Corporate Relay challenge in October. There was also a sponsored pie-throwing contest and even a month of sponsored beard growing.

The fundraising effort was amazing and everybody really contributed. Macmillan Cancer Support does a brilliant job in supporting cancer patients and their families and we're delighted that we've been able to help it and raise awareness about the job it does and the people it helps.

We now have our sights set on another successful fundraising year in aid of St Gemma's Hospice, the Redmayne-Bentley head office charity of the year for 2014.

Keith Loudon, Chartered FCSI, Senior Partner, Redmayne-Bentley, Leeds

Dear S&IR,

Further to the nice Bitcoin article in the February edition, 'Bits of Bother', I thought I might share a quick insanity check. The five-year-old Bitcoin has a market capitalisation of \$8.5bn today, about the same market cap as the London Stock Exchange Group, which has a heritage dating back 200 years.

On a deeper note, I thought I might also share one definition of money – a technology that communities use to trade debts. The technology of money, like many other technologies, is growing increasingly open. Bitcoin technology is a case in point. Its essential innovation was a public blockchain of transactions, eliminating the need for a central bank.

When I explain Bitcoin, I ask people to imagine it as a new virtual element. We know what the supply is. We know where most of it is. However, it is not money. It is a virtual element; but only a community can decide whether to use this virtual element for trade.

There are now more than 40 alternative cryptocurrencies, AltCoins, experimenting with different combinations of features based around the idea of a blockchain. There is even intergalactic potential. Last autumn Travelex announced Quids: Quasi Universal Intergalactic Denominations, a space currency. Bitcoin technology has other applications, for example secure transfer of title or voting, perhaps even share voting. Bitcoin itself may fail, but the technology has a long way to go and some AltCoins are likely to succeed.

Professor Michael Mainelli, Chartered FCSI, Executive Chairman, Z/Yen Group, London

OBITUARY

Pen Kent CBE FCSI(Hon)



The CISI notes with deep regret the recent passing of Pen Kent, a long-standing Honorary Fellow. Pen spent his entire working life, from the early 1960s, at the Bank of England.

His career was marked by a range of increasingly important posts within the Bank prior to his appointment in 1988 as Associate Director, and in 1994 as Executive Director. In these latter two roles, he was responsible for much of the Bank of England's external relationships and was held at that time in particularly high regard for establishing and sustaining strong links between the Bank and the City.

Pen Kent's main legacy to the membership of the CISI, and to the securities industry as a whole, is CREST, the system for equity settlement.

By the early 1990s, the Stock Exchange had spent almost £400m in the development of TAURUS to replace its outmoded TALISMAN settlement system. A review by the Exchange determined that the TAURUS project had been overly ambitious and that, despite all the expenditure, it was unlikely to meet its objectives and should be abandoned. In the confusion that followed, the Bank, under Pen's direction, formed a steering group of potential users to define the core needs of the market. It then seconded a small group of its own executives, led by Iain Saville CBE FCSI(Hon), to develop and implement a system, later called CREST, to meet these needs.

Pen chaired and steered the project to successful implementation, on time and to a budget less than 10% of the expenditure on TAURUS. His contribution to the project, which relied on the co-ordinated activity of a wide range of market participants, was critical. He used his skills as planner and organiser, his natural authority and persuasive manner, which led even the most reluctant to fall into line.

When completed, CREST took much of the complication, risk and cost out of equity settlement. It also removed a barrier to capacity of the Stock Exchange, making possible the increased trading volumes that followed.

We owe much of this benefit to Pen Kent's foresight and leadership. In remembering Pen's contribution to the work of its members, the Institute sends deepest sympathy to his wife Jill and their family.

At the CISI's Annual Awards ceremony on 20 March, the highest achievement in the Investment Operations Certificate will be awarded in honour and memory of Pen Kent.

Peter Wills FCSI(Hon)



The Institute is sad to report the death of Peter Wills FCSI(Hon). Peter was a founding director in 1992 of the Securities Institute, forerunner of the CISI. A celebration of his life will be held at the HAC, Armoury House, City Road, London EC1 at 2pm on 12 March 2014. A full obituary will appear in the S&IR, April issue.

RESEARCH

Academic journal launches



Prof Moorad Choudhry FCSI

The first edition of the CISI's new academic journal, *Review of Financial Markets*, is included in this issue of the *S&I/R*.

The 12-page journal features original, blind peer-reviewed and cutting-edge research and analysis related to wealth management, capital markets and banking.

Professor Moorad Choudhry FCSI, Editor of the journal, chairs a panel of practitioners and academics who oversee content.

He said: "The creation of this academic journal is an important step forward for the CISI. Our vision is for *Review of Financial Markets* to establish itself as the research publication of choice for the securities and investment industry."

"The journal will act as a centre point for the generation of practitioner-led and practitioner-oriented research, while emphasising a robust and rigorous analytical approach.

"I hope our members will find the journal interesting, informative and an excellent way to maintain their competence. *Review of Financial Markets* provides an opportunity for members to put forward their own research papers for consideration for publication to a worldwide audience, and the CISI looks forward to receiving contributions."

Turn to the centre pages of this edition to read the first issue of *Review of Financial Markets*.

For further information about the journal and guidelines for submitting papers, see cisi.org/academic

CPD

Events preview



Ursula Marchioni



Stephen Cohen

BlackRock, the world's largest asset manager, is hosting a range of events for the CISI. This programme starts in the City on 28 April with Ursula Marchioni, Director of its iShares European investment strategy, on the essentials of investment in exchange-traded products. Stephen Cohen, Chief Investment Strategist for BlackRock International Fixed Income,

will give one of the main keynote addresses at the CISI's Annual Conference at the Grange St Paul's Hotel in the City on 17 June.

Elsewhere, Professor Moorad Choudhry FCSI starts a series on the core principles of banking at Swift's London headquarters on 9 April. CISI members are also welcome at Swift's acclaimed Business Forum, a day-long gathering at the Brewery, Chiswell Street, on 29 April. On 8 May, big data will be explored at IBM's South Bank offices.

April sees the launch of two exciting training courses: Nick Gibson, Chartered FCSI of Chase Cooper looks at FCA-controlled functions; and Paul Whittaker, Chartered MCSI, of Magic Bullet Associates, talks about preventing financial crime.

Full details at cisi.org/events

PROFESSIONAL REFRESHER

New module on NEDs

Non-Executive Directors' (NEDs) Roles is a new CISI Professional Refresher module.

It examines the functions and responsibilities of NEDs in financial services firms. Especially useful for those members who are already NEDs or aiming to become ones, the module will provide an insight into corporate

governance in firms and how NEDs operate within them.

Professional Refresher consists of more than 50 modules that are free to CISI members, or £150 to non-members. Modules are also available individually.

Visit cisi.org/refresher for more information



ONLINE

BEST OF THE BLOGS

1 tinyurl.com/gapper-lambert

Is there such a thing as the banking profession? John Gapper doesn't think so. Writing in the *FT* in response to recent cuts at Barclays and to Sir Richard Lambert's proposals for the banking industry, Gapper says: "The classic 'banker', an experienced, judicious loan expert, is a mythical figure." Gapper argues that to create the culture Lambert craves, it would take a lot more than instilling "professional pride". After all, "financial analysts already study for qualifications, and that did not prevent problems in the past".

Demos says that Lambert's proposals for criminalising reckless conduct by bank directors would be difficult to pursue without proof of intent.

2 tinyurl.com/demos-lambert

Demos, a top cross-party think-tank, is also critical of Lambert's report. Firstly, it questions whether the proposals for the Senior Persons Regime go far enough: "These regimes will make little difference if individuals are not vetted, performance monitored and sanctions enforced." Elsewhere in its assessment,

3 tinyurl.com/dmedland-standards

Financial journalist Dina Medland picks up a different point – namely, Lambert's ideas for banking league tables. These would "make it immediately about winning and losing" and defeat "the true enemy within: not the competitor/rival, but the unethical behaviour caused by the competition in the first place." Medland does believe, however, that Lambert is pushing in the right direction: "a professional body with individual membership is the answer".

For more on Sir Richard Lambert's proposals, turn to page 20.

Do you have a blog recommendation?

Send it to the Editor:

✉ rob.haynes@wardour.co.uk

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BACK STORY

Natalie Howman ACSI, Compliance Officer, Vartan & Son

In her role as a compliance officer at Vartan & Son, Natalie Howman ACSI has reason to celebrate. In November 2013, she was nominated for and won the CISI's compliance award – a recognition that confirms her professional achievements and points to her undoubtedly diligent, hardworking qualities.

Natalie's first thought on leaving school in Cambridgeshire in 1998 with A-levels in History, German and Business & Economics was to become a lawyer. However, she decided on financial services instead, as she would have built up too much debt by taking a law degree.

Natalie's strategy from the outset was "to work in as many departments as possible to get an overview of what I wanted to do – and get a qualification if I needed to".

Her first job was with Pearl Assurance as an assistant in the sales division, where she was able to observe different departments and get an overview of the roles that financial services offer. She was soon drawn to a field she had previously not heard of: compliance, where "the regulation side of things is most exciting".

To get there, however, she first needed a qualification. While working in her administrative role – not to mention becoming a mother for the first time – Natalie studied for the CISI's Financial Planning Certificate. She passed, and soon found herself working for Pearl in compliance.

The appeal of compliance is the challenge of being involved with new regulation from the outset, says Natalie. Few days are the same; the challenge lies in interpreting new regulations and embedding them in the business with the relevant team's support.

Following the sale of Pearl to Diligenta in 2006, Natalie gained experience dealing with a variety of regulation concerning money

"The appeal of compliance is being involved with new regulation"

laundering, outsourcing, risk, approved person management and data protection, until, in 2007, she left "for a change of career". This was spent at BPP, helping the college to write and edit some of its academic material. She found the experience "very interesting and challenging" and spent much of her time reviewing a variety of textbooks to bring them up to date with the latest regulatory or tax legislation.

By 2008, Natalie wanted to get back into industry and, following a spell at BNP Paribas, made her first move to a smaller firm of stockbrokers, Vartan & Son. Her experience until then had involved working for financial institutions employing large compliance teams; at Vartan, where the payroll numbers ten, she is a one-woman band.

"It is challenging and you have to be extremely organised. There are always

101 things to do, so you must prioritise – but not forget anything," she says. Like many compliance officers, Natalie is a self-confessed perfectionist, a trait that tallies with sentiments expressed by her CEO, Andrew Vartan, Chartered FCSI, who describes her as "extremely hard-working".

For Natalie, the advantages of operating in a small office far outweigh those of large firms. "I can knock on people's doors – in particular senior management – any time and chat to them about various things," she says. "It's easy for us to reach consensus in many areas and it's easier for me to create the compliance culture." In her words, "most regulation is created for larger firms, but nine times out of ten, the smaller companies have to comply", so it helps to have an adaptive set of colleagues.

Over the coming months, Natalie will be helping Vartan adapt to the rigours of the Foreign Account Tax Compliance Act and suitability practices.

Vartan & Son is currently merging with another firm of stockbrokers, Ravenscroft Ltd, which is based in Guernsey and Jersey and has assets of more than £1.5bn on its books. Natalie has been heavily involved in this process, liaising between the two firms and the FCA.

Natalie will still be based in the Precincts of Peterborough Cathedral and is looking forward to what the future holds – for her and the rest of the team.



Natalie Howman, ACSI

Compliance Officer, Vartan & Son

Do you have a back-office story?

✉ rob.haynes@wardour.co.uk

ONLINE POLL

Bitcoin here to stay, survey says



More than half of financial services players believe Bitcoin, the virtual currency, is here to stay, a CISI survey shows.

Some 15% of respondents to the online survey feel Bitcoin will one day rival conventional currencies, while a further 13% consider that it will in future become readily accepted by retailers. More than a quarter (28%) consider that while Bitcoin will survive, it will remain a little-used currency.

The remaining 44% think that Bitcoin is a passing fad doomed to die out. More than 450 people took part in the survey and several suggested that Bitcoin marked a historic turning point for the currency market. One said that Bitcoin was "far better" than the traditional fiat currency system.

"The future is for a global currency for consumers and business that cannot be manipulated by the

central banks. Maybe it is not Bitcoin, but it has shown the way for what is to come," argued another contributor.

However, major concerns were expressed about the instability of Bitcoin in the absence of backing for the virtual currency from a central bank and the risk of it being hijacked for financial crime due to lack of regulation and transparency in transactions.

"My gut feeling is that lots of people will lose their real money that they have put into it," said one contributor.

"There is simply too much risk involved as Bitcoins are designed to be untraceable," was a further comment.

📄 To take part in the latest CISI survey, see cisi.org

Patricia Jackson
Head of Financial
Regulatory
Advice, EY



Ask the experts...

WHAT IS SHADOW BANKING?

The Financial Stability Board (FSB) defines shadow banking as “credit intermediation involving entities and activities (fully or partially) located outside of the regular banking system”. I think it is arguably far broader than that and should include liquidity transformation and the provision of a payments system. Shadow banking is expanding, reflecting the search for yield by investors and deleveraging by banks.

Shadow banking has been part of many financial crises in the past. In the 1970s and 80s, most ‘non-bank banking’ (or ‘shadow banking’ in today’s language) was linked in various countries to property lending. In the 2000s shadow banks became involved in more complex securitisation structures, such as retail mortgaged-backed securities. This involvement was central to the financial crisis. According to the FSB, the size of the shadow banking system grew from \$26tn in 2002 to \$62tn in 2007.

However, FSB data indicates that although shadow banking reduced during the crisis it has now expanded above pre-crisis levels. This has been helped by some forms of lending, such as infrastructure finance, largely moving outside of the banking system.

One of the issues for regulators is that shadow banks move activities from inside a regulated, transparent environment to a more opaque one, where growth and the interconnectedness of risks can be harder to spot. Currently, shadow banking is acting as a safety valve, providing finance in areas where (post Basel III) it is too expensive for banks. But there are risks. The market could suddenly contract either because the participants see new opportunities arise in other areas and divert their focus, or they realise they have underestimated the risks and decide to withdraw from lending. Potentially, this means a gap in lending could arise that banks may not be able to fill, but could also mean a rise in rates or tougher lending conditions. The

questions to ask are whether these new players are transient and if any withdrawal will have a permanent effect? A ‘yes’ answer to either may mean wider economic consequences.

A more fundamental question is whether shadow banking structures could become more interlinked in risk terms. A key imperative is that the global authorities are aware of the growth in the market and the risks that are arising in it. There needs to be a body – such as the Bank for International Settlements or the International Monetary Fund – that maps the growth of opaque markets and assesses risks.

The players that have led the growth of the market are institutional investors such as insurance companies, as well as pension funds and private equity houses. Life insurers, for example, have been willing to go into illiquid secured lending given relatively stable long-dated liabilities. Peer-to-peer lenders also channel finance into the system.

Potential growth of all these channels and their importance to the economic system depends on several things. One important factor is low interest rates, which encourage longer-term investors to use credit exposures to access higher yields. Future long-term growth depends on whether the credit assessments being made have been accurate and whether the avenues prove profitable.

Growth also depends on accessing even wider sources of funding. Development of funds of funds sitting above shadow banking structures would help to funnel more finance from a wider selection of investors into the structures. Indeed, banks are themselves starting to invest in some shadow banking structures. This will, in turn, increase interconnections and risk concentrations in shadow banking.

Do you have a question about anything from tax to virtual trading? richard.mitchell@cisi.org

TECHNOLOGY

CISI launches mobile app

So You Think You Know About... Anti-Money Laundering is a new app launched by the CISI.

Available from the App Store, it features a 15-question quiz to challenge practitioners’ knowledge of the basic anti-money laundering rules, regulations and practices globally.

Estimates suggest that in excess of \$1tn each year is being laundered by financial criminals, drug dealers and arms traffickers worldwide. Combating money laundering continues to be a major challenge for the financial sector globally, and all financial services practitioners have an obligation to report illegal activity.

So You Think You Know About... Anti-Money Laundering is the second app released by the CISI, and the first available for the iPad.

Test your knowledge of anti-money laundering, gain a certificate of achievement if you pass and challenge your colleagues to take the quiz. For further information, see cisi.org/amlapp



QUICK QUIZ

Test your industry knowledge



Illustration: Cameron Law

The **S&IR's** Quick Quiz features questions from CISI elearning products, which are interactive revision aids to help candidates prepare for their exams.

Answers are on page 29.

To order CISI elearning products, please call the Customer Support Centre on **+44 20 7645 0777** or visit cisi.org

Q1. Which one of the following describes debt that is secured over a specific asset of a company?

A) Fixed charge B) Floating charge C) Subordinated D) Unsecured

Q2. What action must a fund manager take in the absence of satisfactory evidence of the identity of a client?

A) Delay the transaction until the next business day B) Freeze the transaction and make further enquiries C) Process the application and report it to SOCA D) Request further identity from a third party

Q3. Which one of the following statements relating to investment trusts is true?

A) Investment trust companies can issue only ‘ordinary’ shares B) They are open-ended investment vehicles C) The share price is determined by the value of its underlying investments D) Investment trust companies are allowed to borrow money

Q4. Which one of the following investments is outside the scope of the insider dealing legislation?

A) Commodity futures B) FTSE 100 Index options C) Gilts traded on the London Stock Exchange D) Shares traded on AIM

Back and forth

Investors are retreating from emerging markets while the Federal Reserve is withdrawing its support from the US markets. Christopher Adams looks at the implications

ANYONE LOOKING FOR the Next Big Thing in the latest lunch briefings investment banks put on for fund managers would have had to make do with a plate of puff pastry.

Fresh ideas have been in short supply. Indeed, it has taken a sudden and sharp reversal in emerging markets (EM) to shake things up – and unsettle January’s benign New Year consensus.

For once, the eurozone has been blameless. The ousting of Enrico Letta as Italy’s prime minister – which would have caused shockwaves in financial markets in 2011 – registered as barely a ripple. But a plunge in the Argentine peso triggered a swift sell-off across the wider EM universe that spilled over into developed markets, rattling Wall Street.

Expect a good deal more of this over the coming months.

As the Federal Reserve presses on with ‘tapering’ its emergency asset-buying plan and the dollar strengthens from recent lows on expectations that US interest rates will rise, more investors will unwind positions in riskier, high-yielding emerging market assets funded by the billions of cheap dollars the Fed has pumped into the financial system.

That process need not be calamitous, but neither is it likely to be a smooth ride. Currencies such as the Turkish lira, South African rand and Ukraine’s hryvnia – all under pressure from domestic, political and economic woes – have fluctuated sharply. A handful of central banks have raised interest rates to shore up their currencies.

The risk of an EM crisis can be overstated. EM economies

teetered on the brink last summer when talk about Fed tapering shook the markets. But helped by a significant devaluation in currencies, they have started to become more prudent, says Berenberg bank. As a result, the risk of contagion has receded.

Even so, set aside the Fed’s policy shift and there remain underlying concerns. Economic growth in the biggest EM economies – Brazil, Russia, India and China (the BRICs) – has been slowing. These grew an average 8% a year between 2000 and 2012, but growth last year was closer to 5%.

That rate of growth can pick up again, but wide-ranging rather than piecemeal reforms are required, says Capital Economics in a recent piece of analysis: “As things stand, it does not seem that Brazil, Russia and India are on the cusp of a major shift in policy. Meanwhile, China has announced a comprehensive reform package but, even if this is fully implemented, the best outcome will be that it prevents growth from slowing much further. The upshot is that a period of weaker growth in the BRICs now beckons.”

What, then, does this mean for the world’s big stock markets? Wall Street’s S&P 500 Index, after a 30% Fed-fuelled gain last year, is hardly cheap. But it still looks too early to be talking about bubbles. Yes, the Shiller cyclically adjusted price-to-earnings multiple has risen to about 25 times earnings, above its long-term average of 16.4 times. Yet this is well below the peak it hit before the dotcom crash.

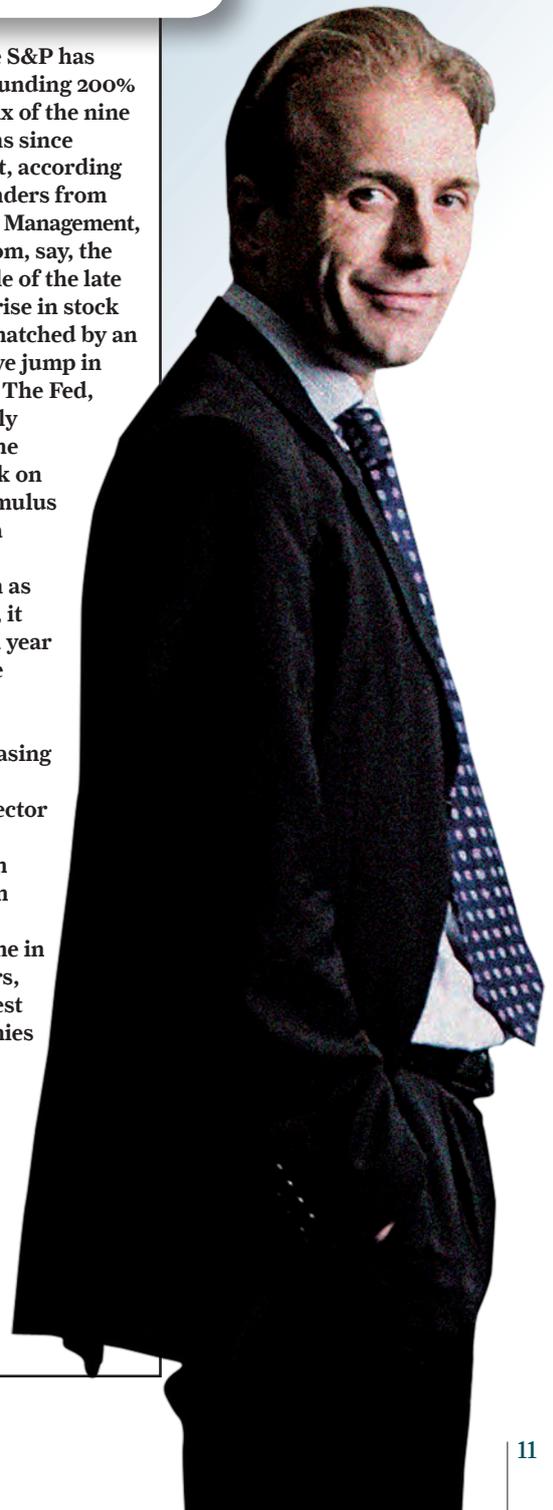
“ The Fed, then, is only partly responsible for the rally in equities ”

Since 2009, the S&P has delivered an astounding 200% return, beating six of the nine previous bull runs since World War II. Yet, according to Stephanie Flanders from J.P. Morgan Asset Management, the difference from, say, the technology bubble of the late 1990s is that the rise in stock prices has been matched by an equally impressive jump in company profits. The Fed, then, is only partly responsible for the rally. Pulling back on the monetary stimulus need not lead to a big correction.

Moreover, even as EM growth dims, it looks like being a year of recovery in the developed world. Closely watched surveys of purchasing managers in the manufacturing sector point to a swifter pace of expansion in America, Japan and the UK.

For the first time in almost three years, all of the six largest eurozone economies grew in the final quarter of 2013. That feels like an advance after the sovereign debt crisis. ■

Christopher Adams is the Financial Times’ markets editor



The background is a solid yellow color. It features several black silhouettes: a hand holding a bundle of wheat at the top left, a hand holding a coin at the bottom right, and an oil pump in the bottom left. There are also several stacks of silver coins scattered across the scene. The title 'Out OF AFRICA' is centered in white text, with 'Out' in a large, elegant script and 'OF AFRICA' in a bold, sans-serif font.

Out OF AFRICA

Adventurous investors are flocking to sub-Saharan Africa, finds **Chris Alkan**

Casablanca – A new financial gateway to Africa?

Many cities have aimed to establish themselves as transnational financial hubs. But few manage to attract the top global institutions and so join this elite group. Casablanca, Morocco's largest city, is hoping to follow in the footsteps of places like Dubai, which now punches far above its economic weight as a financial centre.

The Moroccan king Mohammed VI launched the project in 2010, with the goal of turning the city into a regional hub and an entry point for Morocco's fellow north African states, as well as countries in western and central Africa. The Casablanca Financial City zone was still under construction at the end of 2013, but it has already attracted some important residents and partners.

In June 2012, the Abu Dhabi-based asset manager Invest AD obtained a licence to operate in the Casablanca hub. FinanceCom, an investment company controlled by Moroccan billionaire Othman Benjelloun, has also signed up. The CISI has agreed to work with the city to promote the highest standards of financial professionalism by offering training and a range of diplomas.

The city has several significant advantages, according to Jason Tuvey, an economist who specialises in the Middle East and north Africa at research company Capital Economics. The first is Morocco's political system. "The nation has been moving towards a constitutional monarchy with a strong parliament," he says. "That reduces the chances of sudden changes of policy if the leadership changes – a worry in many other nearby states." Aside from a friendly tax regime, the financial centre will benefit from Morocco's relatively relaxed capital controls compared with neighbouring countries. "It is possible to open accounts in foreign currencies and withdraw money," says Tuvey.

Should Casablanca prove a success, the rewards could be great. "Financial hubs create plenty of highly paying jobs and tax revenue," says Tuvey. "What's more, success could encourage even more business-friendly reforms, creating a virtuous cycle."

For investors, this could be the beginning of a beautiful friendship.

AS ENTHUSIASM FOR the more popular emerging markets has faded, investors have been in search of the latest frontier. One result has been an increasing interest in sub-Saharan Africa – beyond the already established South Africa. A fund launched by Bob Diamond, Barclays' former Group Chief Executive, raised an unexpectedly large \$325m to invest in the continent's nascent banking industry.

Diamond has not been alone in spotting Africa's rising promise. Net foreign direct investment (FDI) jumped 16% last year to \$43bn, according to the World Bank. It predicts that by 2015, FDI will reach \$54bn. Even securities investors have been doing well in Africa, with sharp rises in the largest stock market indices of Nigeria and Kenya.

"Africa has finally started to appear on the radar of investors," says Shilan Shah, analyst for the continent at Capital Economics. "Yet there are still plenty of dangers as well as opportunities."

Over the past decade, eight of the top 20 fastest-growing economies in the world have been African. This seems to be due to more than a long rally in commodity prices. Even as the price of these has faded, Africa's expansion has continued. Excluding South Africa, sub-Saharan Africa's economies grew by 6% in 2013, according to the World Bank. It expects this pace to be maintained for at least the next three years. Demographics are also in Africa's favour. More than half of its population is younger than 20 years of age, so Africa will have a

working-age population as large as China's by around 2040.

From strength to strength

This rapid growth is still from a small economic base. At \$1.3tn, the annual output of sub-Saharan African nations combined is still only about half that of the UK. Yet there are good reasons to expect the growth to continue. The consumer market in the region has quadrupled in size since 2000 and is now worth \$650bn a year. This burgeoning household market appears to be part of the reason that investors such as Diamond are attracted to the continent. Of the region's billion inhabitants, only about a quarter have a bank account and fewer than 5% have a credit card.

"The rising number of Africans with disposable income means good prospects in sectors such as consumer goods, financial services and construction,"



says Philip Boulton, a senior managing director at consultancy FTI. “Large discoveries of oil and gas – from offshore west Africa to Tanzania and Mozambique – are also creating opportunities.” An abundance of natural resources helps explain a surge of investment from China, which is interested in securing access to the continent’s oil and gas in particular. FDI from China has climbed from around \$392m in 2005 to \$2.5bn in 2012, according to data from the Chinese Ministry of Commerce.

In other areas, China has supported infrastructure construction in transportation, communications and electric power projects, including hydroelectric facilities. In 2012, Chinese enterprises completed construction contracts worth \$40.8bn in Africa, an increase of 45% on 2009 levels.

Pitfalls for investors

In financial markets, the variety of securities in which investors can place their money has also been expanding. More African governments have started to issue dollar-denominated bonds – removing the currency risk associated with investing in the region. In the first nine months of 2013, African nations raised a record \$6.2bn in international debt markets, a three-fold increase on 2011, figures from Dealogic show. African stock markets also offer an increasing diversity of choice. Nigeria’s stock exchange, for example, now offers a market in around 200 stocks.

Yet even some of the most traded African shares suffer from low levels of liquidity, making them hard to sell quickly. Such problems led to the closure of New Star’s Africa Fund in 2009 – just a year after it was established.

Aside from illiquidity, investors also face political risk. “In recent years, there have been encouraging signs of stability in nations like Ghana, Zambia and Kenya,” says Shah. “But solid institutions are not yet firmly established in most countries.”

The World Bank’s *Doing Business* report, which measures the quality of the environment for companies and investors, still ranks sub-Saharan African nations low – with the exception of stars Rwanda and Botswana, which have strong and relatively well-functioning institutions, low levels of corruption and efficient labour markets. In terms of offering protection to shareholders, for example, the organisation ranks Kenya, one of the continent’s main markets, a mediocre 98th out of 189 countries. Investors in companies lack such basic rights as the

such as Chad and Nigeria, also linger near the bottom.

An additional worry is that a sharper fall in commodity prices could take the steam out of growth. “Many economies are more than mere resource plays,” says Shah. “But that doesn’t mean the continent could easily weather a steep decline in the price of minerals and oil.”

Despite such caveats, interest in the continent is building. The World Bank expects net private inflows to sub-Saharan Africa (excluding South Africa) to climb above \$72bn by 2016 – almost double the level of 2008. If that proves the case, the continent could finally be on course for sustainable development. ■

“Solid institutions are not yet firmly established in most countries”

ability to hold directors responsible for deals that fail, the World Bank says. In terms of corporate transparency, it gives Kenya just three out of a maximum ten, compared with an average of seven for rich member nations of the Organisation for Economic Co-operation and Development.

The continent’s poor infrastructure is also a handicap for some businesses. In the World Economic Forum *Global Competitiveness Report* 2013–2014, Angola was rated as having the globe’s poorest overall infrastructure out of 148 countries in the index. Other sub-Saharan peers,

Africa: Factfile

1. According to China’s Ministry of Finance, more than 2,000 Chinese companies are active in more than 50 African countries.
2. Africa accounts for 35% of China’s completed overseas contract work, and is now China’s second largest overseas contract market.
3. In the past decade, use of telephones in Africa has grown from 0.7% of the population to 70%, owing to the advent of mobile phones.
4. A quarter of Kenya’s economic activity is done via M-Pesa, a mobile-phone-based payments system.
5. New construction and service projects have contributed more than 60% to the growth of Uganda’s economy.

Ten ideas to SHAKE UP PENSIONS

Amid serious concern for the UK's saving regime, **Andrew Davis** suggests ten ways to avert a pensions meltdown

THERE IS NO shortage of detailed analysis showing that Britain faces a 'pensions timebomb'. In 2012, the Department for Work & Pensions estimated that 40% of people aged between 22 and the state pension age would not save enough for their retirement. More recently, the Pensions Policy Institute suggested that even those who save the minimum recommended percentage of their earnings over their working life have less than a 50% chance of amassing a large enough fund.

Pensions, by common consent, are in a mess – but how might we turn things round? Here are ten suggestions.

1 Stop tinkering
This will be hard to achieve given that things need to change, but it's a widespread view among pension experts. The rules for pension saving are in a near-constant state of upheaval, which leads to an increasingly complex system and also creates a strong disincentive for people to lock their money away for several decades. Even if they are acting prudently and trying to provide for their own old age, they face the constant risk that they are investing on a false prospectus.

"The first thing the Government could do is stop interfering," says Lee Robertson

of the advisory forum Investment Quorum. "It could deliver some certainty for people who need to plan." So giving people a far more solid idea of the long-term rules that will govern their retirement saving should be a top priority. Once cash has been paid into a pension and is therefore inaccessible, it should not then be possible for the Government retrospectively to change the rules governing that investment.

2

Make all pensions personal and transparent

The British system connects a person's pension to their job – the employer runs the scheme and decides what investment choices members have and what management costs members will pay. The problem, as Robertson observes, is that we no longer live and work as we used to. "There used to be a fair degree of certainty that you had a job for life, but that's all gone – we haven't adapted the pension system to reflect that," he says. The result is that as people move jobs, they usually end up with small sums scattered here and there with previous employers. This leaves them with no idea what their overall savings are worth, what charges they are paying and whether they are well placed to retire or face old age by candlelight.

Both the US 401(k) system and the Australian MySuper pension system have the virtue of giving savers a single retirement pot that is personal and so can be taken with them from one job to the next. Ensuring everyone saves through dedicated, portable accounts will make it much easier for them to see how much they have built up and whether or not they are on course for the retirement income they hope for.

3

Make the rules more flexible

Another major criticism of pensions is that they are extremely inflexible. Once money goes in, it cannot be released until the saver retires, and even then almost

everyone will be forced to convert their fund into an annuity, an irrevocable, one-off decision that determines their income for the rest of their life.

US pension savers are able to borrow funds from their 401(k) account for up to five years on an unsecured basis for specific purposes including buying a main residence, paying for education or medical expenses, and to alleviate severe hardship. These loans can be repaid from untaxed income. Although many people are adamantly opposed to the idea of allowing savers to dip into their pension pots before retirement, the option to do so under limited circumstances and with strong rules to enforce repayment could provide a greater incentive to save.

4

End compulsory annuitisation

Annuity rates are extremely low and, because they are linked to interest rates, they could stay that way: in January 2014, Bank of England Governor Mark Carney suggested that

rates may well not return to their pre-crisis levels for some years. Locking away your



money for decades becomes an even less attractive option if savers must buy an annuity that yields a derisory income. According to the Association of British Insurers, the average pension fund today is £36,200, which at current annuity rates would buy an annual nominal income of about £1,340.

Removing the compulsion to convert a pension fund into an annuity by age 75 – no such compulsion exists in the US, for example – might make the idea of pension saving more attractive for some people.

5

Expand the choice of ‘annuity-like’ products

The think-tank Policy Exchange recommends the creation of ‘annuity-like’ products, such as fixed-term ‘government annuity bonds’ with durations

ranging from ten to 25 years. Under this plan, savers would buy a government-issued bond with a guaranteed level of income that would be higher than the conventional gilt of the same tenor because there would be no repayment of principal at the end of the term. It argues that this would remove the interest-rate risk that insurance companies take by holding gilts to back their liabilities on annuities. By forcing savers to purchase one sort of retirement income product by law, as we do today, our system ensures that we have a market that contains insurmountable barriers to innovation.

6

Share the risks

Defined Benefit (DB) schemes give the employee certainty over what they will receive and leave the employer with the responsibility of making up any shortfall

in their retirement savings. Defined Contribution (DC) schemes, however, give the employee no certainty over what they can expect to receive and leave them bearing all the risk that their savings might not grow as hoped. Given that most experts believe DB pensions will disappear, finding ways to share risks between employer and employee in DC schemes may encourage more people to save. The Netherlands has so-called Collective Defined Contribution schemes, under which the level of benefit savers can expect is directly related to their salary and length of service (as in a DB scheme) and the employer’s contributions are fixed. These schemes can provide better risk sharing between employers and employees, and between members nearing retirement and those already receiving pensions. During the financial crisis, contribution levels were raised for employees still paying into Dutch schemes, while retirees had their pensions cut by an average of 1.9%.

7

Create new incentives to save

The main incentives to save are employer contributions and tax relief. If the UK must encourage younger people to save earlier, they need to be encouraged

further – for example, a minimum of 30% tax relief on pension contributions from those aged 35 and under. “The main thing the Government has got to do is to get younger people more involved,” says Robertson. “It’s the early money that goes in that makes the money.”

8

Provide better information

The numerous options for pension savers need to be better promoted. For example, any saver can defer receiving their state pension and receive a higher weekly payment as a result when they do

begin to draw it. Equally, contributions to pensions set up for children still attract 20% tax relief even though they do not pay tax (contributions are capped at £2,880 per year, per child). This offers a tax-efficient way for people to remove their wealth from the inheritance tax net and pass it on, while at the same time attract a tax subsidy from the

state. Greater awareness of such options should be a priority for policy-makers.

9

Merge pension schemes

The UK has too many small pension schemes – about 40,000 DC schemes in total, 39,000 of which have fewer than 1,000 members. The Office

of Fair Trading recently identified about £40bn of pension assets that is at risk from high charges or because it is in small, poorly governed schemes. Australia has concentrated on creating a much smaller number of much bigger pension schemes – sometimes called ‘super trusts’ – which benefit from economies of scale, such as buying power in securing asset management services.

10

Focus on compulsion

In Australia, pension contributions from employers are obligatory – the level currently stands at 9.25% of salary, which will rise to 12% in 2021. The country also recently introduced the MySuper pension product, which carries legally binding standards of governance, costs and investment approach, as well as an obligation for trustees to consider economies of scale. Policy Exchange in the UK recently called for a universal, obligatory 12% per year level of contributions, comprising 6% from employees, 4.5% from companies and 1.5% from government. Given that research suggests many people will fail to achieve a decent retirement income on the current (voluntary) minimum contribution level of 8%, it may well be that creating incentives to save will not be enough. The rules might need to get a lot tougher. ■

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EDITORIAL

It is a pleasure to welcome readers to this, the inaugural issue of the CISI's *Review of Financial Markets*. These are challenging times for everyone in finance and banking, and as a reflection of this we are proud to be able to launch a new publication dedicated to the industry. There are of course a number of excellent journals already in existence that devote their attention to this topic; where we would like to add value is in making the very high quality of research that is currently undertaken at academic and market institutions more accessible to a wider readership. This must be achieved with no reduction in qualitative rigour. Robust thought and clarity of message are everything, rather than a desire for overly quantitative description. Our objective is to introduce leading-edge research and practitioner-orientated material to anyone with an interest in financial markets. The Editorial Panel for this journal reflects this objective and is an impressive mix of leading names in both academia and industry from around the world. Panel members are all experts in their field and it's a pleasure to be working with them.

We kick off Issue 1 with thought-provoking pieces on flash crashes and high-frequency trading, and a challenge to portfolio management orthodoxy.

I'd like to take up the theme of this issue's second paper. Although it has been more than five years since the crash, the bank crisis of 2008-09 is still the dominant theme in industry debate. In part this has been because western economies have struggled to escape from recession. But the idea that once we are back on a growth cycle everything will be okay is dangerous and fallacious thinking. The central debate on the causes of the crisis remains topical, mainly because the primary determinants of the crash have not gone away. Imbalances between East and West, a continuing reliance on models that are proven to provide an inaccurate estimation of asset price dynamics, herd mentality, over-emphasis on short-termism – these issues are still with us. But the fundamental problem remains one of economic orthodoxy.

A number of economic theories, such as the portfolio diversification theory of Harry Markowitz and the efficient market theory (EMT) of Eugene Fama, were the subject of criticism during and after the financial crisis. These criticisms were not new: the models had been the subject of debate in academic circles from virtually their publication date. However the crisis brought the debate out of academia and into the world of practitioners.

The wider picture concerned capitalism itself. Up until the crash it had been almost a kind of dogma, fostered during the Reagan and Thatcher era, that markets were efficient enough to take care of their own problems, and that as far as possible governments should not intervene in the market process. Thus *laissez-faire* capitalism was re-introduced to the world. After the fall of the Berlin Wall, this thinking was raised to a higher level and globalisation kicked off as a result. But the experience of markets themselves in the post-war period threw up an intriguing paradox: if markets take care of themselves, why is it that, although between 1950 and the late 1980s we observed asset bubbles and crashes, from the 1990s onwards the frequency of such bubbles increased? After all, shouldn't globalisation and greater interconnectedness have made the markets yet more efficient? But as Figure 1 shows, the number of market 'failures' rose the more globalised we became.

Period	Bubble
1637	Tulip crisis
1720	South Sea Company crisis
1720	Mississippi Company crisis
1840	Railway hysteria
1927	Florida real estate bubble
1929	Stock Market bubble
1966	US credit crunch
1972	US banking crisis
1980-1982	US saving & loan crisis
1982	Latin America crisis
1987	Stock Market bubble
1988	Japan bubble
1997	Asian crisis
1998	Russian crisis
2000	Dotcom bubble
2001	Argentina crisis
2007-2009	Great credit crisis

Figure 1 Financial market bubbles

Professor Fama's EMT, written in the 1960s, triggered a heated debate between market practitioners and academics from the start. The core philosophy of EMT is that all information is priced into every asset at each moment of time and therefore it is impossible to create a portfolio that would outperform a randomly chosen portfolio with an equal risk profile. Only by adding additional risk can one beat the market.

But this in itself undermines the theory: if this was possible, one is stating that there are periods of moving in and out of assets where, at inception, not the full upside is priced in, and when this materialises one moves out of the asset. However, at inception this asset would have been mispriced and thus by definition not all information is embedded in the price.

EMT continues by arguing that even if one could perform better than a randomly chosen portfolio, it would be impossible to do this on an individual basis. As a consequence, the theory concludes that markets are not predictable, and this makes them ultimately efficient. Therefore the fact that markets are not predictable, as this is another conclusion, in turn means markets are efficient. If markets are unpredictable, one cannot beat the market, because there is no possible upside in hand-picking assets: all assets are correctly priced at all times.

I surmise that this thesis has damaged the financial industry over time. A failure of belief in that theory occurred in 1998 when the hedge fund LTCM collapsed under the weight of its excessively leveraged positions. The fund's managers believed that they were smarter than the market, backed no doubt by their undoubtedly impressive academic track record.

Strongly believing in the EMT, LTCM was convinced it could take advantage of the inefficiencies of the market. In fact the market was actually taking advantage of LTCM's own inefficiencies. The mistake the fund managers made was that they believed in the mathematical modelling approach of financial markets, which is not always accurate – it is particularly inefficient in allowing for outlier events, something that Mr Nassim Taleb has dined out on ever since he pointed it out in *Black Swan* – and is actually a completely different subject.

Notwithstanding the LTCM experience, the trend in approaching markets more scientifically continued and soon many bank dealing rooms included mathematicians and financial engineers. These individuals, the so-called 'quants', possessed a similar background and invariably use the same models, mathematical approaches that originated in statistical physics.

A similar approach was made by the credit rating agencies. These firms implicitly assumed that real estate prices could never fall on a national scale, simply because statistical evidence suggested this was so. Economic shocks or changes in economic states were typically ignored, since random behaviour can be used to expect future states. If enough market participants ignore the same states of the world, the market price is automatically incomplete, thus not all information is priced in, and hence markets are not efficient.

The danger is however, and this came to the surface during the crash of 2008-2009, that if every derivative trader is using the same model, everybody is going to take the same price (which is produced by the model) for granted. The issue here is that at the moment the market drops out of the comfort zone or interval of what the model is used to, one is faced with substantial systemic risk. An analogy would be this: as long as all the cars on the highway are driving at 100 mph, there is nothing wrong; but from the moment that one of them has to stop then this causes serious disruption.

As EMT discourages an investor from deviating from the benchmark, it has a strong influence on how the financial industry is obsessed with benchmark assessment, unless one adds new risks. One could argue that the fact that many, if not all, large investors follow the same principle increases the inefficiency of the market. It potentially creates bubbles, since there is too much money chasing the same type of assets and all institutions have virtually the same type of portfolio and are all vulnerable to the same type of risk. If this type of risk emerges, the very scale of these institutions tends to transform a potentially minor risk into a major event due to the same end-reaction of all investors.

A benchmarking approach becomes a self-fulfilling prophecy as investors do not want to jeopardise their career prospects and move outside the benchmark. But just as diversification was highly criticised immediately after the crash, so-called 'alpha' was criticised as well. Consider Figure 2 which shows the performance of the hedge fund industry at end-2008.

We observe that almost every hedge fund manager lost money during that year. All the strategies shown (except for dedicated shorts and managed futures) showed a negative performance for 2008. We can argue that both dedicated shorts and managed futures are pure directional plays, like betting in a casino, and anticipate a negative downturn, and so would always perform positive in the environment of 2008. Such strategies do not represent the application of Markowitz and EMT. The immediate circumstantial evidence from Figure 2 suggests that 'alpha' is a myth as well. But this issue would also suggest that markets are efficient, and I am not entirely convinced that this is the case.

In any case, a Nobel Prize awaits the person or persons who articulate a model that eclipses Markowitz and EMT.

I would like to thank the Editorial Panel for their involvement, the CISI, the contributing authors and of course you the reader. I hope everyone has as much fun reading this as I had working on it.

Professor Moorad Choudhry FCSI, Editor

	Currency	Index Value		Return		YTD
		Dec-08	Nov-08	Dec-08	Nov-08	
Credit Suisse/ Tremont Hedge Fund Index	USD	351.08	351.2	-0.03%	-4.15%	-19.07%
Convertible Arbitrage	USD	221.62	223.82	-0.98%	-1.88%	-31.59%
Dedicated Short Bias	USD	88.94	90.46	-1.68%	3.04%	14.87%
Emerging Markets	USD	264.49	263.92	0.22%	-1.87%	-30.41%
Equity Market Neutral	USD	225.47	224.54	0.41%	-40.85%	-40.32%
Event Driven	USD	395.52	400.56	-1.26%	-3.21%	-17.74%
Distressed	USD	452.18	463.96	-2.54%	-5.00%	-20.48%
Multi-Strategy	USD	371.03	372.86	-0.49%	-2.17%	-16.25%
Risk Arbitrage	USD	277.63	273.26	1.60%	-0.02%	-3.27%
Fixed Income Arbitrage	USD	166.79	168.13	-0.80%	-5.60%	-28.82%
Global Macro	USD	582.69	576.3	1.11%	1.54%	-4.62%
Long/Short Equity	USD	401.98	397.78	1.06%	-1.41%	-19.76%
Managed Futures	USD	284.19	277.61	2.37%	3.22%	18.33%
Multi-Strategy	USD	275.79	280.04	-1.52%	-4.63%	-23.63%

*Figure 2: Credit Suisse/
Tremont Hedge Fund Index
Performance, 2008*

*Source: Credit Suisse /
Tremont Hedge Fund Index,
Bloomberg.*

A REVIEW OF HIGH-FREQUENCY TRADING & FLASH CRASHES

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ABSTRACT

We review recent literature and discussions surrounding the 6 May 2010 Flash Crash, the implications on high-frequency trading (HFT), and flash crashes in general. Different interpretations of the event lead to a split opinion on whether HFT should bear the main responsibility for the crash. The conclusions of two main schools of thought are presented, followed by an in-depth exposition of recent work on mini flash crashes.

INTRODUCTION

In 1971, even before the celebrated Black-Scholes formula was published, Fischer Black was already thinking about automation and computer trading systems (Black, 1971). In a two-part article titled 'Toward a Fully Automated Stock Exchange', he provided an intuitive definition of liquidity (existence of a two-way market, small bid/offer spread, execution volume's impact on market price, etc), and asserted that a liquid market is both continuous and efficient. He went on to make the prescient argument that executions of sizeable order volume will always exert pressure on price, regardless of method or technological advances, and that price continuity is guaranteed only when trading is characterised by volumes of small, individual trades.

6 May 2010 Flash Crash

Today, we live in a world where high-frequency trading (HFT) is increasingly gaining prominence as the financial market continues to move towards higher level of automation by leveraging on technological advancements and pursuing algorithms with growing sophistication. Over the past few years, there have been a number of sizeable flash crashes, with the 6 May 2010 Flash Crash being the most notable and obvious one. On this day, the US stock market experienced one of its most severe intra-day price drops in history, with the Dow Jones Industrial Average (DJIA) index tumbling 900 points within a time span of 20 minutes before rebounding and recovering much of its losses. Several stocks (eg, ACN, CNP, EXC) crashed within the space of a few seconds and traded at a penny before shooting back up to their prevailing market prices.

Huge effort has since been exerted to make sense of all this, with academics, regulators and practitioners in the financial market teaming up to conduct in-depth investigation and analyses of the Flash Crash. Although the crash took place within a single day, to gain a qualitative and quantitative understanding of it is no easy task. The trading activity in the US equity market is split among over 13 public exchanges, more than 30 dark pools and over 200 internalising broker-dealers, making it difficult for all participants of the capital markets to access liquidity in an organised manner¹. It should be no surprise that the sheer scale of the market and its complex dynamics and interactions render any investigation effort extremely challenging.

Should we blame HFT? Opinions are split between two main conclusions

Despite the difficulties, more than three years after the 2010 Flash Crash, we are now in possession of a respectable volume of literature covering the events leading up to it, along with numerous 'post-mortem' analyses to investigate what went wrong in the system to cause such an extreme event. The key question which every researcher tried to answer is obvious: 'Should we blame HFT for the flash crash?' We surveyed the literature in this field and found that opinions are split between two main conclusions. One school of thought concluded that HFT is the culprit, while the other concluded that HFT should be credited with improving market conditions, and that human errors are largely to blame for flash crashes. To get a feel for these contradicting views and opinions, let's compare these two magazine articles in November 2013, one in *Bloomberg Business Week* and the other in *Financial Post*, published just one week away from each other. The first article, titled 'The Nemesis of High-Speed Traders', vilifies HFT and makes harsh criticisms about it², while the second article, titled 'In Praise of High-Frequency Traders', praises the practice and points out that the market as a whole is a better place thanks to the participation of HF traders³. As a concise summary: the school of thought critical of HFT thinks that HFT poses a threat to all other market participants because traders react so quickly to price movements, to the extent that they are either consciously using their speed to gain unfair advantage, or impetuously reacting to price movement, which might potentially cause the market to spiral out of control.

¹ Speech by the 29th SEC Chairperson Mary L. Schapiro, available from: <http://www.sec.gov/news/speech/2010/spch090710mls.htm>

² Regan, M. P. (2013) *The Nemesis of High-Speed Traders*, *Bloomberg Business Week*, Nov 2013, available from: <http://www.businessweek.com/articles/2013-11-27/high-speed-traders-nemesis-nanex-eric-hunsader>.

³ MacIntosh, J.G. (2013) *In praise of high-frequency traders*, *Financial Post*, November 2013, available from: <http://opinion.financialpost.com/2013/11/20/in-praise-of-high-frequency-traders>.

The other school of thought uses empirical evidence to show that the presence of HFT leads to improvements in the market microstructure by reducing price volatility and shrinking bid/offer spreads. Furthermore, it argues that even when some of the high-frequency (HF) traders are 'informed' traders, their presence in the market actually leads to improved price discovery.

FLASH CRASH & HFTS

With that in mind, let's take a high level review of a few key interpretations of the 2010 Flash Crash. The 'official' version is based on the report published by the US Commodity Futures Trading Commission and Securities & Exchange Commission⁴. In this version, the source or trigger of the crash is traced to Waddell & Reed (W&R), an asset management and financial company applying fundamental trading strategies. On 6 May 2010, W&R placed a large sell order of 75,000 June 2010 E-mini contracts as a hedge via Barclays' automated execution algorithm. The order was placed with an execution rate of 9% of trading volume (over the previous minute). This was a precautionary measure to avoid causing adverse market movement. On any normal business day this would have been fine and gone through smoothly. Unfortunately, this took place on an already jittery day carrying negative market sentiment due to concerns arising from the European sovereign debt crisis. The large sell order was initially absorbed by HF traders and intermediaries. However, when they in turn tried to unload their inventory not much later on, liquidity dried up and volatility shot up, snowballing into the infamous Flash Crash as we know it. The findings in the SEC report are partly based on Kirilenko, Kyle, Samadi and Tuzun (2011), whose main conclusion is that HFT was not the trigger of the Flash Crash. Rather, it was the responses to the large selling pressure on that day which exacerbated and aggravated market volatility. To cut a long story short – the large sell order was the trigger of the whole Flash Crash, its effect cascading and tumbling down the system, dragging the whole US financial market along. For a bird's-eye view of recent progress and development in this field, we refer the reader to Kirilenko and Lo (2013).

On the other hand, the opposite school of thought maintains that W&R never drained liquidity away from the market⁵. This points to the fact that the sell orders W&R posted via Barclays' algorithm never crossed over the bid/offer spread to hit a bid. Instead, they were always posted above the market and executed with prudence, taking the effort to minimise market impact by stopping trade execution on downward market movement. It was the buyers of these futures who were reckless when they began to unload their accumulated position. Unlike W&R, they agitated the market with successive bursts of sell orders hitting the bids in the order book, draining liquidity away from an already fragile market and adding

further strain to it. Consequently, W&R was not at all the source of the 2010 Flash Crash. Instead, HF traders and intermediaries should bear the majority of the responsibility, since they took liquidity away from the market, causing it to spiral downwards. In short, HF traders caused the Flash Crash⁶.

The SEC sees human error as the cause of most flash crashes, instead of malicious HFT algorithms

Despite a further number of contrary opinions published after the release of their original report, the SEC has stood by its report and findings⁷. Its position is that these crashes, especially on single stocks, are generally caused by human error, instead of malicious HFT algorithms wreaking havoc on the market. In its opinion, what is more disturbing is the chronic sloppiness and the lack of due diligence in the human agents maintaining the HFT systems. To support its position, the SEC cited Menkveld and Zhou (2013), one of the latest examples of independent academic research, whose findings and conclusions are consistent with its own. In this paper, the authors used empirical studies to show how a large sell order in the futures market trickled down into the whole financial market. The conclusion of this work is in the same vein as the SEC's: that the blame can't be put on a single market agent. The Flash Crash was the product of the interaction and dynamics among market participants. As a result, it's not a trivial task to formulate a clear-cut recommendation. More work is required to understand the interaction mechanism and the potential pitfalls. This is consistent with the SEC's finding that W&R's execution of the large sell order indirectly caused the Flash Crash through the response of other market participants.

In general, the majority of the academic research is sympathetic towards HF traders and finds them benign. For instance, in a highly cited paper, Hendershott, Jones and Menkveld (2011) investigated the empirical relationship between high-speed algorithmic trading and liquidity. They found that for large stocks in particular, algorithmic trading can be credited with narrowing bid/offer spreads and reducing adverse selection. These go to show that algorithmic trading is capable of improving liquidity and enhancing the information content of market quotes. More importantly, algorithmic trading contributes to enhanced price discovery

⁴ The US Commodity Futures Trading Commission and the US Securities and Exchange Commission, "Findings Regarding the Market Events of May 6, 2010," <http://www.sec.gov/news/studies/2010/marketevents-report.pdf>.

⁵ http://www.nanex.net/FlashCrashFinal/FlashCrashAnalysis_Theory.html

⁶ <http://www.nanex.net/FlashCrashFinal/FlashCrashSummary.html>

⁷ Speech by Gregg E. Berman, Associate Director at SEC,

<http://www.sec.gov/News/Speech/Detail/Speech/1365171575716#.UqAsprUW2lg>

without trading by increasing the information content of the quotes. This highlights the importance of algorithmic traders as liquidity suppliers, given their role in lowering the costs of trading and increasing the informativeness of live quotes. In another similar study, Hasbrouck and Saar (2013) investigated the impact of low-latency trading activities on the quality of the market under both normal and stressed market condition. They concentrated on market events in the millisecond environment, and discovered that increased low-latency trading activities lead to an improvement in liquidity and reduced short-term volatility, suggesting that increased low-latency activities do not invariably cause a detrimental effect on fundamental investors and other market participants. Even more interesting is the fact that the same conclusion applies whether the market is under stress or not.

The endeavour to identify the cause and implication of flash crashes aside, preventive and contingency measures have also been proposed and tested for robustness. In a speech by then SEC Chairperson Mary Schapiro, she called for a re-examination of the circuit breaker mechanisms that directly limit price volatility. Nevertheless, circuit breakers should be considered only as a last resort. From a practical perspective, it is a lot better to promote and ensure reliable price discovery with effective monitoring, and only fall back to circuit breakers as a fail-safe mechanism. One popular method proposed to address this issue is the Volume-Synchronised Probability of Informed Trading (VPIN) flow toxicity metric proposed by Easley, Lopez de Prado and O'Hara (2012). This method monitors flow toxicity⁸ and has significant forecasting power over toxicity-induced volatility. To show that VPIN is a useful indicator of short-term, toxicity-induced volatility, the authors applied this metric to the period just before the 2010 Flash Crash and demonstrated that their metric is capable of correctly capturing the increasing toxicity of the order flow prior to the May 2010 Flash Crash.

A large number of academic researchers credit algorithmic trading with improving liquidity and enhancing price discovery

FROM FLASH CRASH TO MINI FLASH CRASH

Ever since the major 2010 event, flash crashes have been receiving a constant stream of publicity due to their incessant occurrence. We list below a handful of recent ones which have received journalistic coverage:

- 23 April 2013: a false (and worrying) tweet caused the Dow Jones to quickly plunge 140 points, or roughly 1%, before bouncing back⁹
- 25 July 2013: Whirlpool Corp's stock rocketed 5% higher, only to fall back to the previous level within seconds¹⁰
- 30 Aug 2013: an errant trade caused P&G's stock to plunge by 5% before instantly snapping back within that minute.¹¹

Given the polarised nature of the general consensus, it seems certain that flash crashes will continue to be investigated by academics and practitioners alike. The 'scarcity' of major crashes implies that theories formulated on these events are difficult to test and validate. To find a more common platform for testing, we need to broaden our horizon by considering all the 'mini' or 'micro' flash crashes, ie, crashes which might go past unnoticed unless we actively look for them. Nanex, a trading technology company and data service provider, proposed a rule-of-thumb definition for what qualifies as a mini flash crash:

- Uni-directional tick for at least ten times
- Time window does not exceed 1.5 seconds
- Price change exceeds 0.8%.

Using these criteria, it scanned its database and found a surprisingly large number of these¹². This obviously stirs up a reasonable amount of research interest, as it allows us to analyse a large sample of crash data in bulk, as opposed to focusing on sporadic major crashes, which are fortunately relatively rare.

INVESTIGATIONS OF MINI FLASH CRASHES

What causes all these 'mini' flash crashes? If we view a major flash crash as the amplified version of its 'mini' counterpart, then it's reasonable to expect that a good understanding of these events, which are in abundance, can arguably lead to a deeper insight of any potential weakness in the current system. Once again, opinions are split. In a recent paper, Johnson & co-authors (2012) suggest that these crashes may be a result of interaction among several trading algorithms, or a positive feedback loop induced by market environment. Their paper highlights the inherent danger in the transition from a mixed human-machine to all-machine ecology, which is beyond the limits of human response times. A fundamental revamp in regulation is necessary to tackle these ultra-fast extreme events across a wide class of systems. They also point out that effective regulation is impossible without a quantitative

⁸ Order flow is said to be toxic from a liquidity provider's perspective if the people you trade against have a better idea than you about the fundamental 'true' price of the asset.

⁹ <http://money.cnn.com/2013/04/24/investing/twitter-flash-crash/>

¹⁰ <http://www.nanex.net/aqck2/4379.html>

¹¹ <http://blogs.marketwatch.com/thetell/2013/08/30/pg-mini-flash-crash-trades-will-stand-company-says/>

¹² Nanex Research, http://www.nanex.net/FlashCrashEquities/FlashCrashAnalysis_Equities.html

understanding of the dynamics, and a scientific theory for the underlying human-machine ecology.

On the other hand, another recent study conducted by Golub, Keane and Poon (2012) on a comparable set of mini flash crashes identified another possible cause of these events – the Intermarket Sweep Order¹³ (ISO) exemption to the Order Protection Rule¹⁴ in the new market Regulation NMS¹⁵. They found evidence pointing to the fact that mini flash crashes are the result of regulation framework and market fragmentation, in particular due to the aggressive use of ISO, with Regulation NMS protecting only the top of the book. It is not difficult to envisage the detrimental effect of ISO on the market microstructure when it is abused and used aggressively. In principle, this exemption is meant for large orders to sweep through the order book, yet in practice it could be exploited by HF traders attempting to outpace the Stock Information Provider¹⁶ (SIP). For instance, consider a pernicious HFT algorithm sending an Immediate-Or-Cancel¹⁷ (IOC) ISO to a list of exchanges on the same stock. If the SIP is slow, its NBBO could be pointing to a stale quote which no longer exists when the order book is swept. A HF trader using ISO orders will therefore be able to snap up liquidities while the rest of the market participants conforming to the trade-through test will have their orders rerouted and rejected due to the quotes being stale and invalid.

Naturally, the impact of the new regulatory system on the financial market has also become the focus of growing research effort. An interesting study carried out by Chakravarty, Jain, Upson and Wood (2012) on the intermarket sweep order statistic of 120 equities listed on NYSE or NASDAQ found that ISO orders represent 47% of the 587 million trades and 42% of the 167 billion shares traded in the sample under study. These proportions remain consistent for all capitalisation segments. Using the definition of information content defined in Hasbrouck (1995), the authors also investigated if ISO orders are used by informed traders when there is information in the market. If the information share of ISO orders is higher on days with high information, then their interpretation of ISO orders as the preferred order of informed traders is supported. The overall finding is that ISO orders are indeed dominated by informed traders, trading on time sensitive information. This conclusion complements the point of view that aggressive use of ISO might potentially be the cause of the mini crashes we observed.

In addition to all this work, we're also beginning to see an increasing amount of research going beyond empirical studies and focusing on simulating trading activities and studying the dynamics and interactions among market participants. For instance, in a recent study, Brewer, Cvitanic and Plott (2012) used a simulation approach to study order flow and its interaction with the market microstructure. They simulated random arrival of buyers and sellers to the market submitting bid or ask orders. They then artificially induced a flash crash by the submission of an extremely large order, and analysed the impact on both the liquidity and the stability of the market. They used this as a platform to evaluate the efficiency of different methods typically used to restore liquidity to the market immediately after a crash, including double-auction, trading halt and call auction. While taking a simulation-based approach to study the impact of HFT isn't without its critics¹⁸, it does seem like the industry on the whole is open to using innovative ways to study market interactions and is committed to invest in this direction¹⁹.

Broadening our attention to include mini or micro flash crashes allows us to see the bigger picture

CONCLUSIONS

We have now entered the era where high-speed machines and algorithms are operating in a time scale that is well beyond the limit of human response time. The debates and research in this space are expected to go on for time to come. Is HFT a force for good or evil? As far as we can gather, the jury is still out. Nonetheless, whichever school of thought you are in and whatever your theory is, we believe we all agree that more work needs to be done to gain a better understanding on the ultrafast dynamics. Only then can we expect to form an impartial and objective opinion on this fundamental question, and use that as a basis to formulate an effective and prudent regulatory framework.

¹³ Intermarket Sweep Order: Sweep through several exchanges and execute as many buy or sell orders as possible. The responsibility falls on the sender to ensure that the trade-through test is satisfied.

¹⁴ A rule to ensure price priority and protects quotes at the top of the book.

¹⁵ A set of rules formulated with the aim to improve fairness in transaction and effective quotes dissemination.

¹⁶ A processor maintained by NASDAQ which constructs a National Best Bid and Offer (NBBO) from all US equity exchanges.

¹⁷ An exchange receiving an Immediate-Or-Cancel ISO order will either execute immediately or cancel it without having to check on potential trade-through of protected quote

¹⁸ <http://blogs.reuters.com/felix-salmon/2011/12/30/why-we-wont-build-a-stock-market-simulator/>

¹⁹ <http://www.businessweek.com/articles/2013-10-10/will-nasdaq-s-new-high-speed-trading-simulator-make-the-markets-safer>

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MODEL PORTFOLIOS: A CHALLENGE TO THE PREDOMINANT PROCESS

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ABSTRACT

Retail investment advisers rely increasingly on outsourced or in-house model portfolios which, in the absence of industry-standard datasets, tend to be exemplified by data from within the last 20-30 years. Unless data are selected from periods (eg, pre-1975) which include bear markets in all major financial assets, expectations may be over-optimistic. The use of average return and variance data obscures differences among different assets and ignores the cyclical nature of all asset markets, making automatic rebalancing of portfolios irrational, problematical and almost certainly sub-optimal.

This may work for apples and automobiles, but...
...different financial assets may be doubtful

LITERATURE REVIEW

This paper briefly examines the principles underlying modern financial theory (MFT) and analyses logical and practical flaws in its current application. The genesis of MFT can be found in pre-war analytical work (eg, Williams 1938; von Neumann & Morgenstern 1944) developed by Harry Markowitz (Markowitz 1952, 1959), via modern portfolio theory (MPT), into quantitative finance. CAPM, the capital asset pricing model (Treyner 1961, 1962; Sharpe 1964; Lintner 1965), and the efficient market hypothesis (Fama 1965, 1970; Samuelson 1965) were joined finally by the Black-Scholes option pricing formula (Black & Scholes 1973) to complete the key elements comprising MFT. While currently still entrenched in the teaching of finance and investment, all parts of MFT have been under attack since at least the 1980s, though contradictory evidence had been around since the early 1960s, principally Benoit Mandelbrot's discovery of power law distributions in a range of financial market data (eg, Mandelbrot 1963, 1964 etc.). The aftermath of the LTCM fiasco and the bursting of the dot.com bubble caused a massive reassessment and criticism of the underlying assumptions and practical application of MFT (eg, Shiller 1992, 2005; Shleifer 2000; Lo & MacKinlay 2002; Sornette 2004; Mandelbrot 2004, 2008; Taleb 2007a, 2007b; Fox 2010, etc.)

INTRODUCTION

In retail markets, the ubiquitous model portfolio approach to asset allocation, with systematic rebalancing, seems unimpeachable. However, this paper challenges that consensus, and argues that practitioners should be aware of the dangers of thinking in averages, and be open to the reality of the cyclical nature of asset prices and the resulting implications for investment theory.

CURRENT COMMON PRACTICE

The use of model portfolios with rebalancing is predicated on a number of assumptions and beliefs:

- Diversification is 'a good thing,' derived from modern portfolio theory (MPT).
- Asset allocation is the primary determinant of long-term returns.
- Some pro-forma and empirical evidence indicate diversified portfolios can, on average, generate superior returns with lower volatility over the long term compared to any one component asset class.
- "Nobody can predict the market," so automatic periodic rebalancing avoids subjective judgment and ensures the 'policy' asset allocation is maintained fairly constantly.

Providers of model portfolio 'solutions' cite historical performance data showing generally enviable outcomes from a selected dataset. It is typically implied that this general methodology is robust and 'scientific'. A range of portfolio asset allocations is constructed across a range of 'risk profiles' which are matched to each client's score on some species of risk-profile spectrum – typically from a questionnaire. This process is believed to meet the regulator's 'suitability' criteria.

Model portfolio asset allocations vary significantly among providers across a range of 'risk profiles', 'risk tolerances' or other metric. This is caused by subjective data-selection, evidenced by the fact that the range of datasets, asset classes, as well the asset allocations for each 'risk level' is remarkably varied among providers. Datasets can be selected from periods which either exclude severe or extreme market events, or use long data points which tend to generate a normal distribution. Effectively each provider's 'solution' is different, while a genuinely scientific approach would not be expected to generate such a heterogeneous mix¹.

For an adviser, whether or not outsourcing this function, selecting a suitable asset allocation is a subjective decision to pick from a subjectively created range of model portfolios. It is not a scientific or objective approach to managing clients' assets, but a doubly subjective choice.

WHERE DID MODEL PORTFOLIOS COME FROM?

The concept of model portfolios, as well as rebalancing, is derived directly from Harry Markowitz's modern portfolio theory. Markowitz was aiming to find a mathematical way of selecting the best shares to mix together into a stock market portfolio. To do this he adopted a reductionist approach, to keep the maths relatively simple, based on two metrics: the mean return and the variance from that mean of each stock for selection. To those two factors he added the covariance, or correlation, between every pair of stocks because, if the component stocks correlated with each other perfectly, it would be no better than selecting just a single stock.

Markowitz's logic was, in a portfolio you want to hold the stocks which have historically given the best returns because it is reasonable to expect them to do so in the future. Similarly, you don't want stocks that go up and down in perfect synchronicity because that would appear to negate the diversification effect, and it is better to hold stocks whose prices have historically tended to vary from the average as little as possible, because there may be a smaller chance they will suffer large falls relative to the portfolio or market. For all this to work mathematically he assumed a linear relationship between return and 'risk', returns from financial markets formed a Gaussian (bell curve) distribution and settled on the standard deviation (volatility) – the square root of the variance – as a 'catch-all' for risk.

The problem of how much of each stock to put into the portfolio was addressed by mean-variance optimisation (MVO). Other things being equal, you would want to weight the portfolio to the stock(s) which had the best returns, subject to their not being too volatile and not correlating too much with any other component stocks. MVO is a piece of iterative mathematics where, knowing the mean return, the variance (volatility), and the correlations between each pair of component stocks, you add a bit more of this or a bit less of that, until you find the mix of shares with the lowest correlations but highest weighted average return, for each level of volatility shared by the components. This mean-variance optimisation produces an 'efficient portfolio'. By repeating the process for the entire range of volatilities in the data you get a set of portfolios, each with different asset weightings and, by joining the dots together graphically, with return up the y-axis and volatility along the x-axis, you plot the well-known 'efficient frontier'. The data used for these purposes are not standard, but selected subjectively by each portfolio manager.

¹ For quantitative finance purposes the key metrics are mean return (μ), volatility/risk (σ), and the correlations between each pair of assets. Remarkably, there is no agreement on what dataset (or data intervals) truly reflects the inherent characteristic values of (μ) and (σ) for any asset; correlations are notoriously unstable. Each manager is therefore free to select data which demonstrate the point he wants to make. This is data-mining.

CAN MPT BE EXTENDED TO MULTI-ASSET PORTFOLIOS?

Model portfolios are derived from MVO principles, with the added theoretical assumption that, if MPT works for stocks, it will work for a mix of different asset classes also, though Markowitz himself did not make such a claim. This leap of faith is derived from the Law of One Price. It is a fundamental principle of classical economics and states that identical goods should share an identical price. Sellers will tend to gravitate to the highest price prevailing and buyers to the lowest; in an efficient market these will almost instantly converge to the 'market price'. This may work for apples and automobiles, but whether it holds true for the behaviour of different financial assets may be doubtful. Given very different long-term real returns and volatilities attaching to public equities, property, bonds, cash and commodities, etc, it is challenging to accept that sharing a common volatility means you can expect to get the same return from every asset in the mix.

For example, a bond is a contract enforceable in law – an undertaking by the issuer to deliver regular interest payments and return of nominal capital at redemption. If you own property you possess legal title and you can expect both growth in real value over time and a continuing stream of future inflation-linked cash flows from rents. Equities, by contrast, entitle you to absolutely nothing with certainty. You may hope for dividends and capital growth, but you cannot sue the company if it fails to provide either. Given these fundamental differences, it is hard to reason that a shared level of subjectively selected volatility means all asset types share identical levels of risk and return.

The methodology of model portfolios relies on averages – but ignores the cyclical nature of markets in the real world

Even if that approach did apply perfectly to all asset classes, the assumptions needed for the whole of modern financial theory (MFT) to work are highly problematical. MFT comprises theories, all of which rely fundamentally on the assumptions that financial markets are 'frictionless' and costless with no chance of market impact, agents act rationally with relevant information instantaneously universally available, all price changes are random and independent (leaving bubbles and crashes unexplained), and the price changes or returns from all financial markets form a normal distribution. These assumptions have been increasingly criticised and largely discredited.

The use of volatility as 'risk' is central to MFT, and feeds directly into the mathematical (as opposed to common sense) theory of diversification. MFT describes the character of any investment with just two metrics – its volatility and expected return. Combining the tenets of MFT with the Law of One Price leads logically to the notion that any two investments with equal volatility will have the same future expected return and vice versa. Thus, in the assumed efficient markets of MFT, future price behaviour of all securities is entirely described by their expected return (μ) and volatility (σ) and any two securities with the same foreseeable volatility should have the same expected return (Derman 2002). Since only the values of μ and σ are required to describe a security, it must follow that higher expected returns can be captured only by accepting higher volatility/risk and the corollary, accepting higher risk, brings the expectation of higher returns. This is a central tenet of the efficient market hypothesis: that the only way to 'beat the market' is to take on more risk than the market average.

This theory crystallises as high volatility = high expected return, and low volatility = low expected return. If volatility truly reflects all risk, that relationship between risk and reward might be rational. Volatility, even though expedient for the original construction of MPT, does not in fact exhibit a linear relationship to returns when tested empirically; the exact opposite is true. The evidence is voluminous and compelling (eg, Fama & French 1992, 2004; Haugen 2002, 2010; Ang et al 2006; Clarke et al 2006; Montier 2009). In exact contradiction to theory, low volatility stocks (typically 'value' stocks measured on a range of metrics and reflecting relative cheapness in the bottom, say, 10% or 20% of the stock universe) in aggregate tend to generate higher future growth rates with less volatility than high volatility growth stocks (top 10% or 20% of stock universe) which tend to significantly lower future growth rates. It is therefore not necessary to take on higher risk in order to obtain higher expected returns; stock selection among low volatility value stocks can be expected to provide higher returns with less volatility over time. Nevertheless, model portfolios will weight progressively to equities as a class (without further refinement) as risk appetite increases, and to bonds as risk aversion increases.

However, the methodology of model portfolios relies on averages – (μ) and (σ), plus correlations which are unstable and unreliable – but ignores the cyclical nature of markets in the real world. Given the present macro-economic background, it might be unwise to assume that interest rates will never rise. If they did, then falls in both equity and bond markets would be unsurprising; what then for risk-averse clients who have been heavily weighted to bonds? To uncritically rely on the theory that historical long-term averages will persist into the future may bring nasty shocks for clients.

AUTOMATIC REBALANCING – GOOD ONLY FOR CLUELESS MANAGERS

It is assumed that automatic rebalancing of diversified portfolios avoids market timing risk. Ignoring the fact that each manager likely has a different asset allocation, the rationale is that the policy (initial) portfolio is optimal and, if some component(s) rise or fall faster than the others by value, then an appropriate portion of that holding is sold or bought in order to return the asset allocation to policy levels by value. This process generates conflicts of interest through dealing charges and commissions; one major platform reports that over 75% of all deals are now placed by managers of model portfolios. Logically, the process is almost certain to be sub-optimal and makes no sense unless an investment manager is literally clueless about what else to do.

The future return from any investment is determined by a single factor – the entry point into the asset price cycle

Prices of all real asset classes and markets are cyclical: all go up and down over time, either in real terms or relative to 'fair value', and some markets display mean reversion. The future return from any investment is determined by a single factor – the entry point into the asset price cycle. If you buy at a relatively low point in the cycle you can reasonably expect to do quite well in the future; if you buy near the top, you will probably have to wait a very long time for a real return, and may face hefty losses in the meantime. If he has no idea of the current point in any asset price cycle then rebalancing is probably the only thing a manager can do, but it is almost certain to result in a sub-optimal outcome.

Consider a diversified portfolio equally allocated to bonds, equities and property – i.e. $33\frac{1}{3}\%$ in each – to 'match' a given level of 'desired risk' or 'risk profile'. Initially you have no view as to where any of these markets is in its price cycle and so have a policy of rebalancing every, say, three or six months. Over an investing life of perhaps 20 years or more, assume you will experience at least one full cycle in each asset class, but that the cycles are not necessarily synchronous or of equal length. As each asset is in the rising part of its cycle (relative to at least one of the other assets), you will be selling and reducing your holdings, although by value you will always rebalance to $33\frac{1}{3}\%$ of the portfolio, whatever its total value is. The strategy automatically decreases your average selling price, and reduces your ability to stay with the trend and run profits, while holdings become ever smaller over time. You may have very little left at the top of the cycle, and be forced by

policy to start buying at top prices immediately after that market peaks. Conversely, in a bear market you will force yourself to start buying too soon while prices are still falling, this time raising your average buying price so you may have to wait, after the bottom is reached, for a significant market rise before your average entry price is reached. Except you might never get there, because you would start selling as soon as the asset price turns up. Follow this strategy long enough, and you may count it a success to finish up with your original nominal capital. It is entirely feasible, particularly with dealing costs added, to systematically lose money over time.

The process is sub-optimal, in aggregate selling too soon in a rising market and buying too soon in a falling market: you will always be on the wrong side of the trend. The only circumstance in which you will do well is if a market reverses sharply between one rebalancing and the next, when there is a unique possibility you may have bought immediately after a market has bottomed or sold just after the top. However, if the new trends continue, you will be back on the treadmill of selling and buying too soon, quite possibly selling below your average buying price, and buying above your average selling price. To meet TCF² requirements, these possibilities should be explained clearly to investors.

Although the very suggestion that automatic rebalancing is irrational will be seen as heretical by some practitioners, the empirical evidence is clear. These strategies first started to become used around the late 1980s and early 1990s, when computing power and MVO software became accessible. Using data from the preceding ten or so years, the best-performing asset had been Japanese equities so, in accord with MFT, optimisation engines weighted heavily to these assets. In a quantitative world of efficient markets, that asset allocation was rational and could be expected to generate the highest future returns. Had markets continued as previously, optimisation would have allocated more to Japan but, as it happens, from 1990 the asset started more than a decade of steep decline.

Sticking to the theory, rebalancing say every six months, produced an interesting effect. At each rebalancing point, the dataset was rolled forward six months to incorporate recent market returns. This being the case, the mathematics found Japan to have slightly lower mean return values after six months, and so resulted in some Japanese holdings being sold and re-allocated elsewhere. At the next rebalancing that happened again, and the next, and so on. By the millennium, Markowitz's portfolio theory and optimisation methodology had achieved the remarkable feat of being long at the top of the Japanese market and selling steadily all the way down, until finally such optimised portfolios were left with effectively no holdings in Japan at the bottom.

² TCF – 'treating customers fairly' is a high-level regulatory principle in the UK.

Optimisation sounds more impressive than systematic rebalancing of standard or model portfolios, but they share essentially similar flaws. Both rely, as the principal determinant of asset allocation, on the mean return. But the mean is a lagging value, always behind the curve of what the market is doing now. An optimisation approach must logically result in always playing 'catch-up', always failing to buy more when cheap, chasing the price up, and then selling on the downward leg. In terms of the average buying price and selling price over a market cycle, this is obviously inefficient.

A model portfolio approach may avoid the most egregious consequences of optimisation, but at a price: everything depends on the initial policy asset allocation being 'right' in the future, and automatic rebalancing destroys the very possibility of benefiting from cyclical market trends, either up or down. It compels you to sell too soon in a rising market and to buy too soon in a falling market.

WHAT CAN BE DONE?

Before acquiescing to purveyors of model portfolios who insist market timing is impossible, and that a diversified 'risk-targeted' model portfolio is a better bet, practitioners must pause to consider. Timing the tops and bottoms of markets may be practically impossible, but that is not the same as denying the possibility of a rational assessment of where we are in asset price cycles. There are fundamental valuation methods available for some asset markets and common sense for others. It may not be sensible to buy an asset class on the basis of average expected return; in the upper parts of its cycle an asset will almost certainly generate below-average future returns. There can be rational reasons for not buying, even if that means not following the consensus.

CONCLUSION

Professional training and exams continue to embrace orthodox modern financial theory, now more than half a century old and still predominant. The tyranny of averages means students and practitioners can easily overlook the cyclical nature of financial markets, missing rational buying opportunities and sustaining the Panglossian myth that every day is a good day to buy, even though for extended periods buying will almost certainly result in below-average long-term returns. Society and investors might benefit if examination curricula and syllabuses required the teaching and examining of the weaknesses in MFT, asset price behaviour, and the economic history of financial markets.

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Articles must be:

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All papers submitted will be refereed by the journal editorial panel or its recommended reviewers.

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Search's engine

John Williamson FCSI, Senior Managing Director at Search Investment Group, talks to **Rob Haynes** about the virtues of hard work – and kick-boxing

BY ANYONE'S STANDARDS, John Williamson FCSI has come a long way. The son of parents who ran a newsagent and bakery business in Edinburgh, Williamson has spent the past 20 years living and working in Hong Kong, succeeding in top roles at some of the world's largest financial institutions.

"I worked in my parents' business from age nine until I was 21," he says, keen to add that he was given time off for school and university. "That was my introduction to business and dealing with people – any work ethic I may have inherited from my parents."

This ethic includes being level-headed, hard-working and preserving high levels of integrity – qualities that helped him at the beginning of his career as an accountant and, more recently, as Chief Financial Officer and Senior Managing Director at Search Investment Group, the private investment company of Robert W Miller and his family. Miller is a founding shareholder in Duty Free Shoppers, the world's leading luxury retailer to the travelling public.

Williamson implements the Group's business strategy and vision, maintains

CV snapshot

- 2008** – Appointed as an independent non-executive director of Hong Kong Exchanges and Clearing Limited
- 2007** – Becomes Chief Financial Officer at Search Investment Group, rising to Senior Managing Director
- 1998** – Joins Morgan Stanley Asia as Managing Director and Head of Infrastructure
- 1994** – Moves to Hong Kong and becomes Chief Operating Officer of NatWest Securities Asia Holdings
- 1992** – Assumes responsibility for NatWest's Global Custody business
- 1983** – Joins stockbrokers Wood MacKenzie & Co., which was sold to County NatWest in 1987
- 1983** – Qualifies as a Chartered Accountant with Edward Moore & Sons
- 1980** – Graduates from Heriot-Watt University with a degree in accounting and computer science

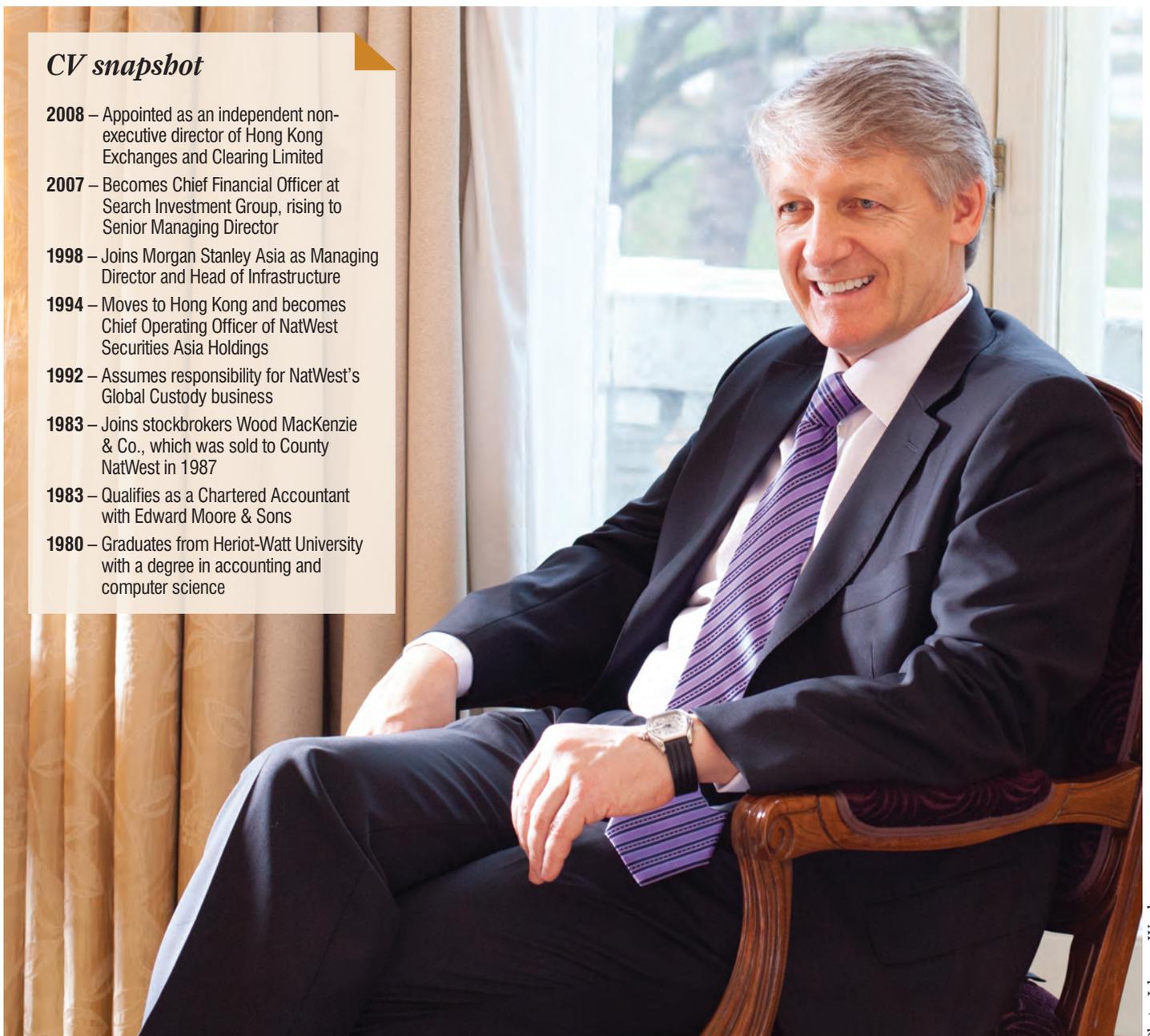


Photo: Johanna Ward

corporate culture and manages the day-to-day operations of this family-owned institution. He is also CEO of SAIL Advisors, a subsidiary of Search and one of Asia's top fund-of-hedge-fund managers.

"I deal with a range of investment and finance-related issues, and I'm also involved with one of the world's most successful retail operations, so I feel very privileged," he says. Yet his position at Search offers more than the chance to leverage his three decades of experience in the financial services industry. "The opportunity to work directly with the chairman was the key attraction of the job. As expected, I have learned much from him not only about many different aspects of business, but also about life in general."

At 80, Williamson's boss Miller is still fully involved in his Group's activities, and continues to be a source of inspiration for his younger colleague. This is no more true than throughout the recent financial crisis, which struck a year after Williamson joined Search.

"In 2008, when the markets were falling, our Chairman was extremely concerned but, unlike many people, he remained remarkably calm. He said, 'John, the sky's not going to fall in.' He had a pragmatic view of what was happening in the markets and didn't succumb to the media view of doom and gloom. In the end, the financial decisions we made turned out to be sound."

"Crises always start when people least expect

"The first rule of business should be 'Don't panic'. Unfortunately, that's what most people do"

them," says Williamson. "So the first rule of business should be 'Don't panic'. Unfortunately, that's what most people do."

Other investors did panic and Williamson points out that many sold a lot of their holdings at substantial discounts. He adds: "When the upturn came in 2009, we were able to capitalise on that, where others left it too late before getting back into the market."

Plain sailing

The ability to weather the storm is a testament to the broader investment philosophy of SAIL and its parent.

"Our approach is characterised by a strong emphasis on research and selection of alpha-generating hedge funds," says Williamson.

"We identify hedge funds early in their lifecycle and it is critical for us to understand the risk/return sources of each hedge fund. We are also very focused on portfolio transparency and liquidity."

At SAIL, the portfolio managers strive to find the strongest alpha generation among medium-sized managers. Crucially, the funds they invest in must be at an optimum size of assets under management relative to their strategy.

"The ability to control and limit directional risks is a key consideration when we construct

our portfolios in terms of being able to reduce volatility when necessary," claims Williamson. "Our investment philosophy has worked well over the years and our funds have consistently generated attractive returns for investors."

Typical of those who are both accomplished and modest, Williamson is full of praise for his colleagues, who manage more than \$2bn of assets: "Our strong work ethic, client-focused approach and desire to act with integrity at all times are the foundation of our business."

He is also very complimentary about the colleagues he met some 30 years ago at Edinburgh stockbrokers Wood MacKenzie & Co. Ltd. Having joined the firm in 1983, Williamson soon thrived in a workplace that placed achievements and skill over family heritage and class. "In terms of watershed moments, joining Wood MacKenzie was one of the most significant in my career. It was run as a real meritocracy: as long as you were adding value, it didn't matter what your background was." More than three decades after joining the firm, Williamson is proud of the strong relationship he still enjoys with one of his superiors and mentors at the firm – and former CISI Chairman – Scott Dobbie FCSI(Hon).

"I was very fortunate to work for Scott Dobbie for many years," Williamson says. "He remains one of the most highly respected figures in the City today. Scott always acts with the highest level of integrity, is decisive, stands firm, speaks frankly and leads by example. He always had authority, but it was his behaviour that gave him my, and so many others', respect."

From Wood MacKenzie, Williamson's career progressed, and in 1994 he moved to Hong Kong, becoming Chief Operating Officer of NatWest Securities Asia Holdings. Surviving the rigours of the East Asian financial crisis that befell the region in 1997, he moved the following year to become Managing Director and Head of Infrastructure of Morgan Stanley Asia.

"When I moved out here with my family, we only really intended to stay for three years," he says. "It's such a great and fascinating place to live and work. We've had a number of financial and non-financial crises – including bird flu and SARS – not to mention the handover of Hong Kong back to mainland China. If nothing else, I've enjoyed the challenge."

Healthy interests

Where hard work forms part of Williamson's professional motto, it features heavily in his personal life. Having trained in judo to black-belt level in his younger days, he still appreciates the virtues of exercise. "As you approach 50, things start to go south, so exercise is vitally important in life. Luckily I was always interested in sports." Nowadays that interest spans skiing, yoga and kick-boxing – "a great tension reliever".

He says: "Being at least reasonably fit helps you stay alert. It helps you sleep better, so you can hopefully make better decisions. No matter what age you are; staying fit is important."

So much for the physical. To relax mentally, Williamson is a keen reader of biographies and

points to Sir Winston Churchill as a source of revelation. "Despite some of the handicaps he suffered – his depression and speech impediment – Churchill had a remarkable life and career, and not just in politics." The image of a seemingly indefatigable Churchill toiling relentlessly during the darkest hours of World War II probably strikes a chord with many overworked financial services professionals, and you get the sense this isn't lost on Williamson.

"There are times for all of us when your workload becomes challenging," he confesses. "Learning how to deal with stress and to prioritise is important, and to be honest you learn from experience. If there is a benefit of getting older, then gaining that experience is certainly one of them." ■

On exchange

In 2008, Williamson was appointed to the board of Hong Kong Exchanges and Clearing Limited (HKEx) as an independent non-executive director. Aside from the kudos, this position helps him stay connected with the securities industry and its key stakeholders, both locally and internationally. Williamson was involved in HKEx's successful \$2.2bn acquisition in 2012 of the London Metal Exchange (LME) – a deal that clearly enthuses him.

Williamson says: "While LME's exchange had been global for a long time, it had not realised all of its growth opportunities in Asia, particularly in China – a market HKEX knows well."

Williamson is confident that HKEx can continue to be the entrepôt between the West and China. "There are many opportunities for Hong Kong's financial markets as China's economy evolves," he says. "Since the mid-1990s, their growth has been driven by China's economic growth and its increasing use of Hong Kong's equity market. Those trends are unlikely to change soon. Hong Kong remains very attractive for Chinese companies that want to raise funds in an international IPO and have a listing in a truly global market."

Williamson believes that, beyond capital formation, China's needs are likely to shift increasingly to investment diversification and risk management across all asset classes, reflecting its transformation from an importer of capital to an exporter of capital. "As HKEx builds a presence in multiple asset classes, it will be well positioned to offer products and services to support China," he says. "HKEx expects to benefit from the internationalisation of China's currency and Hong Kong's position as the leading offshore renminbi centre."

Another report, 19 QUESTIONS... ANY CHANGE?



Image: Getty

Lambert in 20 seconds

Sir Richard's proposed new organisation, whose aim is to raise standards in banking, would be open to all banks and building societies in the UK, acting as an independent champion for better banking standards. Participating banks and building societies would commit to a programme of better standards, covering both conduct and competence, and would agree to report publicly on their progress each year.

The first task would be to define standards of good conduct that would be built on – and closely aligned with – the general principles being developed by the regulators. The new organisation would then work with individual banks and building societies to help drive these standards into all business activities. Over time, it would define the standards of competence that are required in specific roles in banking. This would be done by panels of industry practitioners.

The full text of the paper, including the 19 questions and the CISI's response, is available at cisi.org/lambert. The CISI – and Sir Richard's review body – would be delighted to hear your opinions, and we have provided a simple online form for you to give them easily.

The apparently muted response to Sir Richard Lambert's proposed Commission on Banking Standards disguises strong demands from the public and politicians for a better financial services industry. **George Littlejohn MCSI** monitors the initial reactions

WITHIN DAYS OF the banking standards consultation paper, by Sir Richard Lambert FCSI(Hon), seeing the light of day, two tales of woe underlined the need for reform. Barclays announced dismal investment banking results – and promptly upped bonuses. Then on 14 February the FCA lambasted pensions providers, saying most annuity buyers got financially damaging advice.

The aim of Sir Richard's review – funded by, but independent from, seven big banking institutions – is to “contribute to a measurable and continuous improvement in the conduct and culture of banks doing business in the UK, and to support high standards in the future”. The details of the review and Lambert's 19 key questions –

together with the CISI's response – are available at cisi.org/lambert.

Is the Lambert review process working? Lambert's own, final, acid-test question was whether his reforms would have prevented the financial crisis if they had been in place a decade ago. At a vote on that last question in London's Mansion House a week after the paper appeared, at the annual CISI/CSFI City Debate, just 12% of the gathered great and good thought it would have kept us from harm.

Lord Burns, Chairman of Santander UK, is clear on the need for reform. He told the *S&IR*: “I very much welcome the publication of this consultation and am pleased with the progress made to date by Sir Richard



“Our objective: To contribute to a measurable and continuous improvement in the conduct and culture of banks doing business in the UK, and to support high standards in the future”

Sir Richard Lambert FCSI(Hon)



"I very much welcome the publication of this consultation and am pleased with the progress made to date by Sir Richard Lambert"

Lord Burns, Chairman, Santander UK

Lambert. It is important that we now encourage as many organisations as possible to respond to the consultation."

Santander got through the banking crisis better than most and, as a former Permanent Secretary at the UK Treasury, Lord Burns brings a unique dual perspective. "It is clear that we need an organisation that is going to seek to raise standards throughout the banking profession," he told us.

"High standards and excellence must be an essential aspect of the leadership and management of banks. We also need to ensure that the right training and incentives are in place."

Six key professional bodies are involved in the review (see page 5 for the CISI's initial reaction). They broadly welcome the higher standards, but there is confusion over why Lambert hasn't mandated membership of the existing bodies. CISI Chief Executive Simon Culhane, Chartered FCSI says: "It is a shame that Lambert has stopped halfway when he could so easily have mandated membership of a relevant professional body, which means there is competition, and so very quickly achieved a demonstrable step change. As it is, I'm still unsure whether this new body is a cheerleader for higher standards or a potential competitor."

The professions broadly welcome the concept that the new body might provide a "canopy" under which existing bodies would continue to flourish, but are concerned to avoid duplication.

Simon Thompson, Chief Executive of the Chartered Banker Institute, while welcoming the paper, warned against reinventing the wheel: "A new body is most likely to succeed, in my view, if it builds on, challenges and supports the activities of the many professional bodies, including our Institute and the CISI, already working to raise



"A new body is most likely to succeed, in my view, if it builds on, challenges and supports the activities of the many professional bodies, including our Institute and the CISI"

Simon Thompson, Chief Executive, Chartered Banker Institute

standards across the banking industry in the UK and internationally."

Ruth Martin, CISI Managing Director and Chair of the professionalism stream at Professions for Good, a collaboration of the bodies responsible for entry policy, professional standards and qualifications across many of the UK's largest professions, said: "Public perceptions of the banking industry seem stuck at an historic low. Sir Richard Lambert's recommendations are an important step in the process of restoring trust by raising professional standards across all British banks and building societies, together with foreign banks doing business in the UK.

"We agree with him that good behaviour should at all times be defined from the customers' perspective. So it will be critical to the credibility of the new standard-setting body that its governance structure guarantees its independence and integrity, especially as, initially at least, it is anticipated that key deliverables will be through the banks themselves. Professionalism must be about demonstrable, transparent standards – and applying ethical principles in the public interest can never be a box-ticking exercise."

"Disorderly" pensions advice

Pensions are the biggest financial investment for the great majority of savers. But the FCA damningly reported two days after Lambert



"I'm still unsure whether this new body is a cheerleader for higher standards or a potential competitor"

Simon Culhane, Chartered FCSI, CISI Chief Executive

that four out of five customers who had bought an annuity from the company where they had saved for their pension, or a related third party, could have done better elsewhere (see page 15 for more on pensions). This is big business – it is worth £14bn a year and generates two-thirds of the new business profits of big listed life insurers. The FCA described the UK annuity industry as "disorderly" and will be pushing its investigation into the advice given on this one-off, life-changing decision much further.

Andrew Tyrie MP, Chairman of the Parliamentary Commission on Banking Standards, had recommended a new industry organisation "to promote high professional standards" in his report last year. But he was lukewarm on the Lambert proposals, saying that any new body would not be a "substitute" for regulation. His commission

had little stomach for a body parallel with the General Medical Council.

There remains broad industry support for the new organisation, though independence from the funders – particularly in the selection of a chairman and chief executive – is key. The BBC's Business Editor Robert Peston wrote: "Lambert is so persuaded that banks can't be trusted to rise from the savage bonfire of their finances that he argues there should be no bankers involved in choosing the board of the new body."

The big banks and bonuses

Bankers' remuneration, "incentives" in Lord Burns' remark above, could be the chief stumbling block for any major shifts in behaviour; it remains a toxic issue in public and political opinion. Lambert acknowledges this early on in his paper when he says: "Incentives shape behaviour. In too many cases, industry norms have incentivised short-term revenue generation as opposed to the duty of care to customers. So long as this is allowed to continue, banking will fail in its efforts to raise standards of conduct."

As Lambert published, Barclays announced a 10% increase in its bonus pool despite a 32% drop in annual pre-tax profit. Antony Jenkins, who had ushered in a new era at Barclays when he took over from Bob Diamond as Chief Executive, was struggling with the news that while Barclays' investment bank profits had fallen by 37%, bonuses were up 13%. Revenue per investment-banking employee, at \$674,000, was down 12% on 2013.

Jenkins' stock was high when he took the reins. A year ago, after he set out his strategy to make Barclays the "go to" bank by chucking out the bad apples, Barclays' share price ended the day 9% higher. By New Year's Eve 2013, he was guest editor of BBC Radio 4's *Today* programme, rubbing haloes with the Archbishop of Canterbury. How moods change.

His shelter from the overall bonus rise – he waived his own, potentially as much as £2.7m – was that the bank had to "compete in the global market for talent". In the fourth quarter, Barclays had scraped a £191m profit while rival Deutsche Bank made a thumping €1.2bn loss. This performance shows up in its return on equity, the crunch measure of profitability, which, in common with most of its European counterparts, is noticeably lower than that of its American cousins. The Europeans hope to improve this by cutting costs – Barclays to £16.8bn in 2015 from £18.7bn last year, including the loss of 12,000 staff. Deutsche has been making similar savage cuts in staffing. But institutional investor eyes may focus on the bonuses in the coming months. Meanwhile, Jenkins, Lambert and the rest of us must consider how to meld the professional requirements of the Barclays man at the till in Newcastle with his fellow employee, the swaps trader in New York. ■

EMIR reporting



THE GIFT THAT KEEPS ON GIVING?

George Littlejohn surveys the acronym alphabet around OTC markets regulation

THE PACE OF financial regulation is quickening and a new colossus, in the form of the G20, is pushing for more. The onslaught of new rules, covering everything from capital requirements to trade reporting and operations – via Basel III, Dodd-Frank, AIFMD (see ‘Acronyms Alphabet App’, right) and others – is already hitting the industry. The over-the-counter (OTC) trade reporting rules under EMIR went live on 12 February 2014, creating a deluge of new information for regulators and a huge workload for practitioners in firms big and small. That rule on its own has led to a gold rush for consultants – the “gift that just keeps on giving,” quips Dr Andrew Hilton of the

Centre for the Study of Financial Innovation, which has made a special examination of the post-trade landscape.

G20 and global policy

Now, G20, the rich countries’ club, plans to use its prime ministerial and presidential muscle to wade into the melee. Tony Abbott, Prime Minister of Australia, which holds the presidency of G20 this year, says: “G20 members have made considerable headway in global financial reforms aimed at preventing a repeat of the global financial crisis. But this work remains unfinished. To promote a more resilient financial system, as G20 President, Australia will make it a priority to complete

financial reforms in four core areas directly related to the causes of the crisis: building the resilience of banks; helping to prevent and manage the failure of globally important financial institutions; making derivatives markets safer; and improving oversight of the shadow banking sector.”

At its 2013 summit in St Petersburg, G20 made almost as many financial regulation recommendations as it had done in the previous five years – and there is much more in the pipeline from the Australians and next year’s President, Turkey. Despite lacking any formal ability to enforce rules, the G20’s prominent membership gives it a strong influence on global policy.

The 2008 financial crisis highlighted shortcomings, such as a dearth of counterparty risk management and a lack of transparency in the OTC derivatives market – particularly in the default of Lehman Brothers and the near-collapse of Bear Stearns in 2008. At their meeting in Pittsburgh the year after the crisis, the G20 countries passed a resolution stating: “All OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.”

EMIR, the European Commission’s flagship derivatives project, was designed to reduce counterparty risk in OTC markets and to increase transparency. While a



Live webcast now online

On 19 February, a week after the EMIR reporting rules began, the CISI ran its biggest ever live webcast, featuring Danny Corrigan, Executive Director and CEO of European trade repository, CME Group; Peter Norman, authority on post-trade processes and author of *The Risk Controllers*; and Richard Young, Head of Regulatory Affairs at Swift. It is available to members on CISI TV.

From left, Danny Corrigan, Peter Norman, Richard Young and George Littlejohn MCSI at the webcast

sound idea in principle, many think that the regulation is ill thought through, and the deadlines ferocious. Old hands knew well before the launch that midweek – yes, a Wednesday – was no time to switch on a major financial IT project.

EMIR covers three areas in this field: clearing, reporting, and margin and capital. The clearing requirement applies to financial counterparties (including banks, insurers and asset managers) and to non-financial counterparties. Intra-group transactions are exempt, and pension funds have a three-year grace period. The counterparty has to be a clearing member, a client of a clearing member (direct client) or a client of a client, with indirect clearing arrangements. This choice for most firms has rested on the best balance between the protection of a full omnibus-account model or individual segregation, and operational efficiency. Daily reporting to the competent authority – ESMA in Europe and then to national regulators – is now required for all OTC trades to identify potential systemic risks. But can ESMA, with fewer than 200 staff, make sense of the frightening amount of data now pouring into its systems every day, from the market players and the new European trade repositories set up to handle the work?

“Try taking a sip from a fire hydrant,” warns one insider.

The US position

Over the pond, the Federal Reserve Board and other financial regulators issued a final rule on 10 December 2013 implementing section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act – the ‘Volcker Rule’. This prohibits insured depository institutions and their affiliates from proprietary trading and from owning and sponsoring hedge funds or private equity funds. Certain activities such as market-making, risk-mitigating hedging, and trading in some government securities are excluded from the rule, and banks can still act as agents, brokers or custodians.

Volcker requires banks to establish internal compliance programmes, the detail depending on the firm’s size and scope. Banks with larger trading operations will face the most detailed requirements, including a written statement from their

Acronyms Alphabet App: the field of regulation abounds in acronyms. This special cut-out-and-keep table is a guide to some of the main ones.

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
Basel III	A global, voluntary regulatory standard on capital adequacy, stress testing and market liquidity risk
CCP	Central Counterparty
CSD	Central Securities Depository
CICI	CFTC (US Commodity Futures Trading Commission) Interim Compliant Identifier
CSFI	Centre for the Study of Financial Innovation
CT	Clearing Threshold
Dodd-Frank	The Wall Street Reform and Consumer Protection Act
DTCC	Depository Trust & Clearing Corporation
EMIR	European Market Infrastructures Regulation – covers OTC derivatives, central counterparties and trade repositories
ESMA	European Securities and Markets Authority
ETD	Exchange-Traded Derivatives
FC	Financial Counterparty
ITS	Implementing Technical Standards
ITS on reporting to TR	Commission Implementing Regulation (EU) No 1247/2012
Mifid	Markets in Financial Instruments Directive
MTF	Multilateral Trading Facility
NCA	National Competent Authority
NFC	Non-Financial Counterparty
NFC+	Non-Financial Counterparty above the clearing threshold
NFC-	Non-financial Counterparty below the clearing threshold
OTC	Over-the-counter
RTS	Regulatory Technical Standards
RTS on OTC Derivatives	Commission Delegated Regulation (EU) No 149/2013
RTS on CCP	Commission Delegated Regulation (EU) No 153/2013
SPV	Special Purpose Vehicle
TR	Trade Repositories
UTI	Unique Transaction Identifier

so inheres in the fact that a specific trade may be either permissible or impermissible depending on the context and circumstances within which that trade is made,” he explains. The Fed requires banks to be fully compliant with the Volcker Rule by July next year.

Brussels’ role

At the end of January 2014, the European Commission unveiled its own version of Volcker. The reforms affect about 30 huge firms – globally systemic banks, and institutions where total assets for three consecutive years exceed €30bn and whose trading book is more than €70bn or 10% of its total assets. Though a step back from the 2012 Liikanen Report, which would have split lending operations from trading in the big universal banks, Michel Barnier, nearing the end of his rule as EU commissioner in charge of financial services, views them as the climax of his reforms since taking the reins in 2010. But like their American

cousins, the new rules won’t hit the street until December 2015 at the earliest – giving worried observers (say, G20) time to put their oars into these already turbulent waters.

Under this final Barnier edict, supervisors would be empowered to force activities such as market-making and trading derivatives into separately capitalised entities. The potential inclusion of market-making is a rich source of argument between European capitals; it goes far beyond what the French and Germans, for instance, have in mind – and Brussels. And the consultants can barely contain themselves. ■

Can ESMA, with fewer than 200 staff, make sense of the frightening amount of data?

CEOs attesting that the programme is “reasonably designed to achieve compliance with the final rule”.

Fed Governor Daniel Tarullo, head of the Board’s bank supervision and regulation committee, sees a key challenge in defining the line between proprietary trading and market-making and hedging. “The difficulty in doing

George Littlejohn MCSI,
Senior Adviser at the CISI

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Image: iStock

Question time

Gathering personal information can benefit customers and companies alike. But how far should one firm go when justifying its pursuit of client data?

YOU HAVE RECENTLY moved to the marketing department for the retail division of a large bank. As part of your familiarisation, you are invited by your manager to accompany her to a meeting of the division's product review committee, which convenes quarterly to consider all aspects of new products before they are released into the market. She tells you that she does not think that anything particularly contentious is likely to be discussed and asks you simply to take notes.

You attend the meeting, at which there are representatives from Marketing, Risk, Line Management and Compliance. All those present are senior to you and you feel pleased that you have been invited.

A number of relatively straightforward matters are discussed that generate very little comment and you simply take notes as requested by your boss. The meeting

comes to the last item on the agenda, which is described simply as a fixed income fund-product replacement.

The new product team sponsor introduces the product and stresses that one of the principal attractions is that it is really only a modification of a previous product, which

No customers will be disadvantaged by the proposed questionnaire

was withdrawn a short while ago so as not to confuse customers. Although the products are broadly similar, the new product does have a number of features that are different, but nothing that should alarm the bank's mainstream customers.

The line manager says that he is very keen to have the new product to sell if his team is to meet its sales target. He says that the fact that it is evolutionary rather than revolutionary will be helpful since it is always a challenge to convince customers to buy something new, particularly if it contains anything that is not very obvious.

Notes on a scandal

You listen to the discussion and make notes that stress the replacement nature of the product and the fact that the Risk department considers that it is no riskier than the product it replaces and can therefore be sold to customers with a similar risk appetite.

Your boss then says that she has been considering how the bank can most effectively identify those customers to whom the product would be attractive, in order to improve the

prospect of successful sales – the mass mailing of customers is rather unscientific and historically has a poor success rate. Accordingly, she suggests that the bank should take advantage of the widespread publicity within financial services about the need to ‘know your customer’ and introduce a ‘pop-up’ questionnaire into the online banking screen, asking customers to provide information about their finances.

She says that this will enable the bank to identify more easily customers who are more likely to buy the product and will immediately enable the bank to dismiss the great bulk of these, for whom the product will be unsuitable.

One of the other attendees, who you were told subsequently was from Risk, asks how branches, in particular, may react if customers ring up and complain about this ‘pop-up’ questionnaire. In response, your boss suggests that a simple question-and-answer sheet should be drawn up and circulated to accompany the branch marketing pack. This would stress the regulatory requirement of ‘knowing your customer’ and can be supported by quoting customers’ financial protection, as well as being part of ongoing anti-money laundering requirements.

The representative from Compliance says that this is something of an exaggeration but, since it is not false, he would not object to it. No customer will be disadvantaged by this proposal and it could be argued as being within the parameters of Treating Customers Fairly.

You return to your office and your manager asks you what you thought of the meeting. Not wishing to bring your career to an immediate halt, you hesitate before replying and various thoughts run through your head:

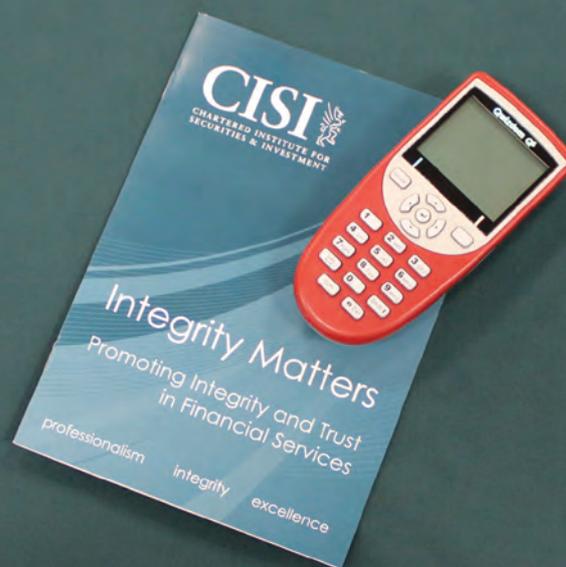
- You are reassured that these sorts of things are discussed these days, as the last thing that banks can afford is another scandal of the payment protection insurance type.
- You are a bit concerned that the justification for asking customers questions that they may regard as an intrusion is not really valid.
- You feel that, as a newcomer to the team, you are not in a position to comment (subtext: you are appalled at what you regard as rather cavalier behaviour towards the bank’s customers).
- You feel strongly that the proposed justification for the questionnaire is entirely bogus and that if the team cannot come up with a good reason, it should approach customers in another way.

What would you do?

Visit cisi.org/fairly and let us know your favoured option. The results of the survey and the opinion of the CISI will be published in a future edition of the S&IR. ■

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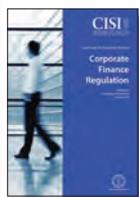
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Need to read

The latest publications and study aids supporting CISI qualifications

NEW WORKBOOKS AND EARNING EDITIONS



Certificate in Corporate Finance

The Certificate in Corporate Finance is aimed at individuals working in corporate finance and related areas who need to demonstrate a sound understanding of both regulatory and technical aspects of the subject. To achieve the certificate, candidates must pass two exams: Corporate Finance Regulation, and Corporate Finance Technical Foundations. New editions of the *Corporate Finance Regulation* and *Corporate Finance Technical Foundations* workbooks and corresponding elearning products (covering exams from 11 April 2014) are out now.



Price: £100 per subject for combined workbook and elearning product

NEW WORKBOOK AND EARNING EDITIONS



International Certificate in Wealth and Investment Management

The objective of the International Certificate in Wealth and Investment Management (ICWIM, formerly the International Certificate in Wealth Management) is to provide a test of competence for individuals

engaged in private client asset management (discretionary portfolio management) and fund management. New editions of the ICWIM workbook and elearning product (covering exams from 21 January 2014) are out now, covering:

- industry regulation
- financial assets and markets
- investment analysis
- lifetime financial provision.

Price: £100 for combined workbook and elearning product

NEW WORKBOOK AND EARNING EDITION



Managing Operational Risk in Financial Institutions

The object of this exam is to ensure that candidates can apply the knowledge, theory and

practical techniques required in order to: investigate an operational risk incident; manage operational risk in the long term; model appropriate behaviours to support operational risk management in the workplace; and effectively recommend, and contribute to, measures to enhance the operational risk culture and operational risk management in the workplace. A workbook and elearning product are due out (for exams from 11 May 2014) and cover:

- fundamentals of financial risk
- operational risk within financial institutions
- application of the risk management process
- operational risk incidents: an investigation
- regulation of operational risk.

Price: £100 for combined workbook and elearning product

NEW WORKBOOK EDITION



Regulation & Compliance

The aim of the Regulation & Compliance exam is to test candidates' knowledge and understanding of the legal, regulatory and ethical framework of the UK financial services

industry and their ability to apply such knowledge and understanding in a practical manner. Candidates are also required to display an awareness of current topics of interest in the field and be able to debate the major principles of such topics. A new edition of the accompanying workbook is due out (covering exams from 24 June 2014) and includes:

- the regulatory framework
- PRA/FCA Handbook of rules and guidance
- other regulatory provisions
- the regulation of markets and exchanges
- current regulatory developments
- risk in financial services.

Price: £150

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Masters in Wealth Management

Applied Wealth Management: This exam requires candidates

to identify a client's requirements, and structure and manage a suitable portfolio of financial assets.

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Portfolio Construction Theory: Candidates must think critically in the context of the theory of investment as applied to the management of private client funds and more.

New editions of the corresponding workbooks (covering the June 2014 exams) are due out.

Price: £150 per subject

Visit cisi.org/bookshop to purchase workbooks, publications and elearning products quickly and efficiently

ONLINE TOOL

Professional Refresher

Professional Refresher helps you stay up-to-date with regulatory developments, maintain regulatory compliance and demonstrate continued learning. This online learning tool, now enhanced and updated, allows self-administered refresher testing on many topics, including regulatory changes.

New modules are added to the suite regularly and existing ones are reviewed frequently by practitioners.

Price: Free for all CISI members, otherwise it costs £150 per user. There are also tailored module packages and a reporting management site available for individual firms. Visit cisi.org/refresher for further information.

All modules are in line with the new UK regulatory environment. At the end of each module, there is a test that will help you to determine how much knowledge you have gained.

The product currently consists of more than 50 modules, including:

- anti-money laundering
- behavioural finance
- taxation.

Passing a Professional Refresher module is logged under the CISI CPD scheme.



External specialists

The CISI relies on industry practitioners to offer their knowledge and expertise to help create and maintain its exams, workbooks and elearning products. There are several types of specialists: authors and reviewers for workbooks and elearning products, item (question) writers, item editors and exam panel members. All of them receive a number of benefits to thank them for their involvement. Around 300 external specialists have volunteered to assist the Institute's qualifications team, but more are required.

The CISI would particularly welcome applications from specialists to assist with developing exams for Advanced Global Securities Operations, Operations, Commodity Derivatives, Corporate Finance Regulation, Derivatives, Life Insurance & Pensions Administration, Regulation & Compliance, and Securities.

To register your interest, contact Iain Worman on +44 20 7645 0609 or download the application form available at cisi.org/externalspecialists

Diary

Events to attend over the coming months



Conferences

17 JUNE CISI Annual Conference 2014†

Grange St Paul's Hotel, 10 Godliman Street, London, EC4

9 JULY The Financial Regulation Summit†

America Square Conference Centre, 1 America Square, 17 Crosswall, London, EC3

CISI members can attend each conference for just £200 (non-members £400).

For further details, visit cisi.org/conferences or call +44 20 7645 0777.



CONFERENCE SPONSORSHIP

To consider taking up one of the sponsorship or exhibition opportunities at this conference, please contact Victoria Caine on +44 20 7645 0655 or victoria.caine@cisi.org

CPD training courses

Venue: London, unless otherwise stated

18 MARCH Conduct Risk: What Might We Expect in the FCA Environment? Practical Issues† £500

25 MARCH The Use of Structured Products in Wealth Management† £500

26 MARCH Cybercrime Risks Demystified† £500

2 APRIL Suitability & Appropriateness: Avoid Misselling†† £500

3 APRIL Behavioural Economics – the FCA and You and Your Clients† £500

8 APRIL Retail Derivatives Update (half day, morning)† £300

8 APRIL Retail Securities Update (half day, afternoon)† £300

9 APRIL Essentials of Financial Crime – Attestations, Anti-Bribery & Corruption, Anti-Money Laundering, Sanctions and Fraud† £500

16 APRIL FATCA and Global Tax Disclosure – its Impact on Your Firm and Your Clients (half day, morning)† £300

24 APRIL Significant Influence Functions – What You need to Know† £500

25 APRIL Client Assets and Client Money (CASS)† £500

30 APRIL Mifid II and the New Regulatory Structure† £500

1 MAY Introduction to Financial Markets £500

6 MAY Introduction to Risk – for Non-Risk Professionals £500

7 MAY Getting to Grips with Operational Risk – For Non-Operational Risk Professionals £500

Member and Fellow discounts

Professional courses discount: Fellows 35%; Members 30%; Associates 20%.

The following discounts are applicable only to one course per year: Affiliates 30%; Students 20%.

To book: cisi.org/events customersupport@cisi.org
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London CPD events

26 MARCH The Long Finance Spring Conference: Long-Term Performance Measurement in Finance†

Bank of America Merrill Lynch Financial Centre, 2 King Edward Street, EC1

1 APRIL The Changing Landscape of State-sponsored Cyber Attacks†

America Square Conference Centre, 1 America Square, 17 Crosswall, EC3

2 APRIL Corporate Social Responsibility†

Webcast

8 APRIL Behavioural Skills for Wealth Management†

Swift, The Corn Exchange, 55 Mark Lane, EC3R

28 APRIL ETF Essentials

BlackRock, Drapers' Gardens, Throgmorton Avenue, EC2

8 MAY Big Data, Big Opportunity?†

Fleming Room, IBM South Bank, 76/78 Upper Ground, SE1

21 MAY Stock Lending – Key Global Developments†

Swift, The Corn Exchange, 55 Mark Lane, EC3

27 MAY Financial Services & Social Media Don't Mix (and Other Myths)

America Square Conference Centre, 1 America Square, 17 Crosswall, EC3

29 MAY Competing on Behaviour

King's College London, Nash Lecture Theatre (K2.31), Strand, WC2

For further information about London CPD events, visit cisi.org/events

To book: cisi.org/events +44 20 7645 0777

Branch events

18 MARCH Social Evening

Manchester & District: Manchester Tennis & Racquet Club, 33 Blackfriars Road, Salford, M3

26 MARCH Student Event: Bonds for Beginners

Liverpool & North Wales: Investec offices, 100 Old Hall Street, Liverpool, L3

28 MARCH Bank of England†

Liverpool & North Wales: Pershing, Royal Liver Building, Pier Head, Liverpool, L3

4 APRIL End of Year Tax Drinks

Birmingham & West Midlands: Fleet Street Kitchen, Fleet Street, Islington Gates, Summer Row, Birmingham, B3

8 APRIL Update on Recent Trustee Cases and How These Impact the Private Client Area (held jointly with STEP)†

Manchester & District: 3 Hardman Street, Spinningfields, Manchester, M3

1 MAY International Tax Transparency Initiatives – Update on the Legal and Practical Considerations†

Yorkshire: DLA Piper, Princes Exchange, Princes Square, Leeds, LS1

8 MAY Financial Crime†

Southern: The Guildhall, 131 High Street, Guildford, GU1

14 MAY Industry Update Conference (half day)†

South East: The Spa Hotel Mount Ephraim, Royal Tunbridge Wells, Kent, TN4

15 MAY Annual Dinner

Bristol & Bath: Bristol Zoo, College Road, Clifton, Bristol, BS8

22 MAY Annual Dinner

Liverpool & North Wales: Crowne Plaza, St Nicholas Place, Princes Dock, Pier Head, Liverpool, L3

To book: cisi.org/events region@cisi.org +44 20 7645 0652

RDR ANNUAL CPD

† This event meets annual CPD requirements for members affected by the Retail Distribution Review. Please note, all RDR CPD must be relevant to your role.

SOCIAL MEDIA

Online connections growing



As a global network of more than 40,000 members, the CISI provides expansive opportunities for developing connections and enhancing working relationships. Social media networks have enabled this to go to the next level, as members from across the world can share insights.

Now with more than 6,000 members, the CISI's members-only LinkedIn network is a prime example of this benefit.

Daniel O'Hara, who leads on social media at the CISI, said: "Initial hesitance towards social media among financial services professionals is understandable. Stories of social media disasters abound, exemplified by a recent 'tweetchat' hosted by J.P. Morgan that had to be abandoned after generating a slew of negative comments. However, professionals should

not allow this fear to prevent them from exploiting the numerous opportunities on offer. As Dr Laura Toogood, Private Client Director at Digitalis Reputation, points out, professionals should simply approach social media with the same care they do other enterprises."

He added: "The growth that the CISI's social media networks have seen emphasises that members are finding value in the offerings.

"The Institute is seeing more debate and discussion being generated by members' posts. Members are asking for advice and sharing study pathways and career experiences with each other. The more members who get involved, the greater the opportunities become."

 CISI members can join the LinkedIn group at cisi.org/linkedingroup or follow the CISI on Twitter at twitter.com/cisi.

 For information on the latest developments in social media, and how it can support career development, view the CISI seminar 'To Tweet or Not to Tweet'. It is available on the CISI YouTube channel at cisi.org/youtube.

FUNDRAISING

Don't miss the curry lunch

Spice up 2014 by enjoying a mouth-watering event in the City calendar - the Lord Mayor's Big Curry Lunch. The lunch will be held at the Guildhall on 10 April in aid of ABF The Soldier's Charity.

In the past six years, the event has raised more than £1m in aid of current and former service personnel, regulars and reservists, and their families, who have been affected by conflicts in Iraq and Afghanistan. The theme for the 2014 lunch is '100 Years of

Duty' to commemorate the century that has passed since the beginning of World War I.

Tickets cost £95 and include a choice of curries, wine, beer and mineral water.

 For further information visit bigcurry.org/lordmayor



BRANCH DINNER

Guernsey raises £4,100 for charity

More than £4,100 was raised at the annual dinner of the CISI's Guernsey Branch to fund specialist lifesaving care for premature babies and support for their families.

The money, raised from a raffle, will go to the Priaulx Premature Baby Foundation, set up by triple World Touring Car Champion Andy Priaulx MBE and his wife Jo, who live in Guernsey.

In an speech to the 320 guests, the couple explained that they established the foundation following the premature births of both of their children.

The event, held at Beau Sejour Leisure Centre, St Peter Port, featured as guest speaker Monty Halls, TV broadcaster, explorer and marine biologist. Halls gave an interactive motivational presentation on stress and teamwork.

Guernsey Branch President Julian de G Parker, Chartered FCSI and CISI Managing Director Ruth Martin provided



Andy and Jo Priaulx speak about their charitable foundation

updates on CISI activities at a local and organisation-wide level. BNP Paribas Security Services was gold sponsor at the dinner. Silver sponsor was E.I. Sturdza, and ETF Securities and M&G were bronze.



CISI Annual Conference 2014
Bookings now open at
cisi.org/ac2014

Membership admissions and upgrades

MCSI

AFH
Leo Hathaway
Andrew Knighton
Amlin
Claire Boiget
Ashcourt Rowan
Michael Johnstone
Bank of New York Mellon
Narcissa Morton
Barclays
Nicholas Chuter
Nicholas Gordon
Joel Graves
Thomas Hobbs
Andrew Lewin
Jeremy Marchant
Ananda Raja

BNP Paribas

Zach Matai
Brewin Dolphin
Daniel Curtis
Charles Stanley
Jane Bransgrove
Michael Gifford
Andrew Marshall
John Redwood
Cheviot
Andrew Barham
Citi UK
James Dubignon
Prem Sidhpura
Citiban
Swastika Verma
Close Brothers
Penny Lovell
Commerzbank
Gillian Corbett

Corporate Elevation

Ahmed Alrahma
Coutts
Claire Foy
Lindsay Holmes
Andrew Keywood
Mark Pannell
Credit Suisse
Stuart Simpson
Crouch Chapman
Sakib Mohammad
Deloitte
Alastair Morley
Deutsche Bank
Ross Young
DIAM International
Anna Writer
Fidelity
Paul Harris

Financial Ombudsman

Service
Daryl Turner
Fitch
Harsh Bagla
Generali
Praveen Daswani
GlenQ Wealth
Iain Quenault
Hargreave Hale
Jean Roche
HSBC
Paul Galloway
Christopher Johnson
Ifamax
Bogdan Oleinik
International Money Matters
Nithin Sasikumar

Investec

Jimmy Muचेcheter
IPS Capital
Jonathan Fennell
JM Finn
Fenella Agar
Julius Baer
Stewart Edgington
Charles-Francois Falck
Fei Yu
Kleinwort Benson
Neil Joy
Londis
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Mattioli Woods
Richard Allen
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Mark Narinesingh
Redmayne-Bentley
Michael Coppeard

Rothschild

David Jessel
SDB Strategic Planners
Joanne Watt
SG Hambros Bank
Ian Walker
Smith & Williamson
Joseph Bond
St. Vincent Electricity Services
Gary Matthias
Standard Chartered Bank
Shahnawaz Malik
James White
Thesis
Steven Richards
UBS
Tom Dowling
Evgeny Gokhberg

Membership admissions and upgrades

Marcia Sato	Citibank	Midas	WH Ireland	Deutsche Bank	Bestinvest
Wealth Financial Planning	Kristal Garcia Caro	Adam Hollins	Luke Harris	Martin Roberts	Sara Allan
Nicholas Carter	Bautista	Mondial Academy	World First	EFG Harris Allday	Andrew Rees
Whitefoord	Michail Kouroupakis	Sean Abreu	Benjamin Mitchell	Neal Stevens	BNP Paribas
Anna Jewell	Yulia Mitryaeva	Nadia Chanandin	Zenith Bank	European Investment Management	Perry De La Hays
Others	Gokhan Oruk	William Davey	Solomon Adebayo Abe	Paul Wort	Brewin Dolphin
Titilope Abatan	Vlada Philippides	Jason David Diab	Others	Guy Webb	Toby Sellers
Saheed Alamutu	Svetlana Smirnova	Samuel Highfield	Abayomi Ajenifuja	Guy Webb	Geraint Hampson-Jones
Shoaib Ali	Lukasz Stepien	Ronan Lynch	Lukmon Akanni	Kevin Miskin	Adrian Watson
Joseph Ameyaw	Orit Usharovsky	Brendan Moloney	Olufolake Alao	Hottinger & Co	Canaccord
Anne Brawley	Olena Winter	Richard Munro	Emirul Bahar	James Surcouf	Benjamin Bavin
Tracey Bromley	Demet Wright	Robert Kenneth Palmer	Christopher Beecroft	Hugo Worth	Charles Stanley
Jason D'mello	Collins Sarri Statham	Kevin Alexander	David Berney	Investec	Camilla Brierley
Louisa France	Robert Barron	Stapleton	Deborah Bryce	Jon Walker	Matthew Guy
Desmond Fullam	Cornelian	Bincy Thomas	Moonga Chinika	James Brearley	Bruce Hendry
Nathan Harris	Stephen Ritchie	Rebecca Ward	Roksana Ciurysek-Gedir	Christian Gawne	Citibank
Anil Komban	Coutts	Moore Stephens	Tim Crannigan	JM Finn	Jahanmehr Javaheri
Alastair MacDougall	Paul Smith	Maxim de Carteret	Rupert Crook	Antonia Consett	Coutts
Ahsan Mehanti	Credit Suisse	Morgan Stanley	Jeremy Cusack	Michael Holder	Ashkan Anbari
Francis Oputeh	Aditya Mishra	Martyn Nott	Yewande Dada	LJ Athene	Diyan Atmadjov
Simon Prestcote	EFG Private Bank	Nutmeg	Will Dartnell	Charles Hamilton	Richard Bamber
Kamal Punchihewa	Sharon Grob	Nicholas Mckinley	Indra Falatehan	MarkitSERV	Nicholas Barton
Jonathan Rimmer	Emirates NBD Asset Management	Odey	Meidy Ferdiansyah	Thomas Kneafsey	Maura Dunling
Andrew Rodger	Lovesh Gheraiya	James Wheeler	Jason Hinds	Millen Capital	Rebecca Frowde
Jonathan Seymour-Williams	First Bank of Nigeria	Paul E Schweder Miller	Richard Hodgetts	Gareth Lyttle	Anthony Gibbens
William	Emmanuel Adepoju	Robert Appleby	Anistus Ihenacho	Rathbones	James Hill
Alexandru Sirghi	Fleet Street Publications	Pershing	Colin Iles	David Kness	Charles Jarvis
Zdravko Slavov	Simon Popple	Kelly Adams	Sinan Kahya	Michael Wright	Gary Jasper
Thomas Smith	GH Financials	RBC	Pinayur Krishna Murthy	Raymond James	John Mcgrath
Geoffrey Tuluhungwa	Simon Mathisen	Scott Goodrum	Indah Kurniati	Pieter Burger	Richard Neville
Shayaque Uddin	Halifax	Hugo Le Poidevin	Elizabeth Levine	Gareth McCaughey	Omar Omari
Mary Young	Helen Gibson	Gillian Schweppe	Stephen McAllister-Pell	Redmayne-Bentley	Eleftherios Sachanidis
	James Wood	Redmayne-Bentley	Wayne Mollet	Nigel Bottomley	James Sayers
ACSI	Hargreave Hale	Kieran Follis	Rita Ogor	Andrew Magill	David Stangroom
Adam & Co	Alex Sumner	Callum Wells	Emmanuel Okongwu	Richard Norman	Nicola Stephens
Ben Griffiths	Hatton National Bank	Royal Bank of Canada	Sikiru Olalekan	Royal Bank of Canada	Warren Thompson
Arena	Varuna Ratnasabapathy	Marie Braun	Hafeez Olanrowaju	Charles Hobbs	Nicholas Toubkin
Paul De La Salle	HiFX	Kerrie Rogan	Hafeez Olanrowaju	Royal Bank of Scotland	Credit Suisse
Arjent	Andrew Scott	Joanna Stachowska	Michael Olayinka	Catherine Levy	Owain Alderman
Andrew Waggett	HSBC	S&T Asset Management	James Oni	Sanne Trust	De Voil Consulting
Bank of New York	Jefferson Banga	Joshua Hewitt	Chukwuma Onwuka	Paul Clohesy	Nicholas De Voil
James Kearslake	Insurance PHB	Securities & Commodities Authority	Antonios Papadimitriou	Seven	Enhance Group
Barclays	John Chibuzor Osuagwu	Sean Kelleher	Andrei Paskhin	Howard Hardy-King	Michael Moretta
Matthew Breedon	International Alliance	Richard Mahony	Louis Powell-Voegt	Smith & Williamson	HSBC
Mariama Diaraye Diallo	Alan Gray	Lourens Oberholzer	Faraz Rahman	Matthew Kirkbride	Ben Alexander Hanney
Tania Jivrajani	Investec	Arvin Ramtuhul	Philippe Rouault	Thesis	Investec
Beaufort Securities	David Gregson	Securities & Exchange Commission Nigeria	Craig Schott	Sean O'Brien	Susan Fleming
Steven Brazil	Dawn Kendall	Edward Okolo	Alfred Showunmi	Thomson Reuters	IOMA
BNP Paribas	Bridget Trevor-Jones	Seven	Matthew Spehr	Sarah Jane Walshe	Mark Edge
Bianca Griffiths	JN Financial	Ahmer Tirmizi	Nagaraju Tallapelly	Vestra Wealth	JM Finn
Alison McMahan	Simon Garbutt	SFC Securities	Sunday Williams	Francoise Marcus	Sheba Hussain
Anna Robinson	Johngift Consulting	Adamu Yusuf		West Yorkshire Pension Fund	Killik
Brewin Dolphin	Abdul Abdulsalam	SG Hambros Bank		James Andrews	James Webber
Alan Baillie	Ganiyat Akanni	Kelly Baxter		WH Ireland	Lloyds
Natalie Johnstone	Oyenuga Alao	Helen Green		Terence Lewis	Christopher Payne
Lynne Lamont	Nkemakolam	SSA Realities		Zubin Kazak	Millen Capital
Adam Martell	Amamchukwu	Aliu Adebare		Harry Pickard	Angus Millen
Louise Summerfield	Kingsley Odiana	Standard Chartered Bank			Morgan Stanley
Brooks Macdonald	Olubunmi Ogunrinde	Nigel Scowen			Marlina Espinheiro
Lloyd Bannocks	Olabode Omiyale	Stanhope Capital			Maria Ruiz De Velasco
Brown Brothers	J.P. Morgan	Julien Sevaux			Panmure Gordon
Harriman Investor Services	Guilherme Pires	Sterling Bank			David Langshaw
Manenga Mwense	Julius Baer	Adewale Oshinowo			Royal Bank of Canada
Mark Savvas	Mazyar Moghadam	Stonehage Investment Partners			Nicholas Reid
Canaccord	Alejandro Velez Estrada	Ronald Armist			Seven
Robert Llewellyn	Jessica Young	John Veale			Stewart Sanderson
Capital International	Kames Capital	Strategic Outsourcing			Shelton Trust
Caroline Fischer	Marc Schroeder	Whenayon James Alfred			Peter Shelton
Captiva	Darren Kelly	TD Direct			Thesis
Sarah Rhodes	L&G	Brian Page			Giles Hedley-Dent
Castlefield	Angus Goldfinch	Thesis			UBS
David Elton	Lloyds	Andrew Jayne			Michael Pacione
Charles Stanley	Wilfred Rockcliffe Fianko	Anna Skrivanou			Others
Douglas McNeill	Lloyd's of London	Alisa Lature			Glen Arnett
CheckRisk	Tracy Nocerino	UBS			Walter Yaolong Guan
Ross Pepperell	Merrill Lynch	Mehmet Yeldan			
Citco	Tania Schueller				
Teodora Dimova					

This list includes admissions and upgrades from 12 December 2013 to 26 January 2014

The umpire

STRIKES BACK

Jeremy Beckwith MCSI puts his decision-making skills to good use in cricket, as well as in the investment arena. **Lora Benson** reports



Jeremy Beckwith
MCSI

AS A REGULAR TV commentator on Bloomberg, Reuters, CNBC and Sky's *Jeff Randall Live*, Jeremy Beckwith MCSI is never stumped for an opinion on finance issues.

Outside his job as Chief Investment Officer for London Wall Partners in the City, Jeremy has a growing reputation as an umpire on the professional cricket circuit.

He has risen through the ranks as a cricket official since deciding to concentrate on umpiring in 2003 after a 30-year career in club cricket. (Jeremy decided it was time to go out on a high as a player after scoring 146, including 15 sixes.)

"As I was usually the oldest player in my team by some margin, I was often asked to take on the role of umpire when my team were batting and I found that I really enjoyed it,"

says Jeremy. "The next winter I went on an umpires' training course, passed the exam and started umpiring instead of playing."

Decisions, decisions

In the following season, Jeremy was appointed as a panel umpire for the Surrey Championship. He then progressed through the divisions of the League and in 2008 was made a Premier League umpire, to cover matches between the best teams in Surrey. In 2013, he was appointed to the England & Wales Cricket Board's D list, which appoints umpires to stand alongside one of the 34 professionally contracted umpires in the County 2nd XI competitions.

Jeremy mostly umpires in Surrey and on occasions officiates at matches in Kent, Sussex, Middlesex, Hampshire, Berkshire, Hertfordshire, Buckinghamshire, Suffolk and Essex. He has also umpired at the National Cricket Academy at Loughborough.

So what are the qualities that make for a good umpire?

"You need to have the attitude that it is the umpire's job to give the players the best chance to make full use of their abilities in playing the game. This is key. The umpire should never seek to be the centre of attention," says Jeremy.

An essential attribute is the ability to concentrate for long periods of time – matches can last for seven hours.

"In some matches you might not have an appeal to make a decision on for six and a half hours but then one comes along that could determine the outcome of the match. You need to be alert and ready to give a decision," says Jeremy.

Man-management skills also come into play to ensure the umpire remains in firm control of the match and has the respect of the players.

Jeremy says: "Dealing with very experienced cricketers who

want to get inside your head in order to possibly influence your decisions is the main challenge I face when umpiring in the professional game."

For Jeremy, one of the most rewarding aspects of his umpiring career has been observing the development of young players.

He says: "I get to be a central part of cricket matches of a quality that I could never dream of playing in, which allows me to get a wonderful close-up view of the skills of very talented cricketers. I have watched the development of many youngsters

Umpiring a match at Lord's was one of Jeremy's most memorable experiences

who have gone on to play professional and international cricket."

Out of all the cricket matches Jeremy has umpired, one in particular stays in his mind. It took place at Lord's – the ground in London revered throughout the world as the home of cricket – and saw Jeremy umpire a match between the renowned Marylebone Cricket Club (MCC) and the CCC (Club Cricket Conference).

"That day was one of the most memorable of my life," recalls Jeremy.

"The grass on the playing area felt like walking on a giant cushion and is so beautifully maintained; the umpires' changing room has its own dressing-room steward, who took my order for preferred drink and snack for after the match and found towels for me; the food in the player's dining room is legendary within cricket and I now understand why; and it was my first time inside the Lord's Pavilion.

"The game itself was very close and dramatically exciting. In the end, the MCC won by one run, with one ball left, and the match was ended by me giving the last batsman out LBW." ■

Have an interesting hobby? Contact Lora Benson at lora.benson@cisi.org. If your story is published, you will receive £25 of shopping vouchers.



Jeremy has been concentrating on his umpiring skills since 2003

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