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"I needed a bit more guidance and structure on the financial planning side. I needed to test my own perceived knowledge of cashflow modelling and financial planning. I wanted an independent accreditation that showed I could combine the technical with the financial planning. The exam tested my technical knowledge – I thought the exam was great."

John Reynolds, Chartered FCSI, Expert Pensions, who successfully passed the new level 6 exam, on the new qualification

thereview

thereview

PROVIDING INSIGHT AND ANALYSIS FOR FINANCIAL SERVICES PROFESSIONALS

CISI.ORG/REVIEW

OCTOBER 2019

LIFETIME MORTGAGES CAN BE A VITAL VEHICLE FOR CERTAIN CLIENTS

US BANKS SOAR, WHILE THEIR EUROPEAN RIVALS STUTTER

NEW PROD RULES ARE SET TO IMPROVE SERVICES FOR CLIENTS



CAN INNOVATIONS OF THE FOURTH INDUSTRIAL REVOLUTION HELP TACKLE THE SECTOR'S DIGITAL SKILLS CRISIS?



OCTOBER 2019

welcome

“Our own research into digital skills in the financial services sector reveals that just 51% of respondents feel they are given adequate training in this area”



RUDQ? Lord Mayor of London Peter Estlin asked this of his audience at a speech at Gresham College in January, meaning “are you digitally intelligent?” or “what is your digital intelligence quotient?” He spoke of a “digital skills crisis”, citing statistics that include an estimated cost to the UK economy of £63bn per year.

Our own research into digital skills in the financial services sector reveals that just 51% of respondents feel they are given adequate training in this area, despite separate UK government research that says 90% of jobs will require digital skills within the next 20 years. These statistics, and others included in our special report, punch home the importance of lifelong learning to future-proof careers in financial services.

This message was reiterated at fringe events at the two main UK party conferences in September 2019, organised by the Chartered Body Alliance (Chartered Banker Institute, Chartered Institute for Securities & Investment, and Chartered Insurance Institute). The theme, reflected in our cover, was ‘Upskill, Reskill, Future Skill: The next generation challenge for financial services’. Turn to pages 17–25 for the full report.

Alderman Michael Mainelli, Chartered FCSI(Hon), recently appointed Sheriff of the City of London, needs no reminding of the importance of digital skills, having created the world’s first digital map in 1983 and co-founded City think tank Z/Yen to “promote societal advance through better finance and technology”. But his talents don’t end there. We chat to ‘the polymath’ on pages 30–33 for his take on financial inclusion, green finance, purpose and more.

Other highlights include a questioning look at the details of the FSCS levy and how the charges are computed (pp.36–38), an ethical dilemma about a chatbot (pp.48–49), and an entertaining look at Sir Thomas Gresham’s life as “Tudor, trader, shipper, spy” (pp.67–69).

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

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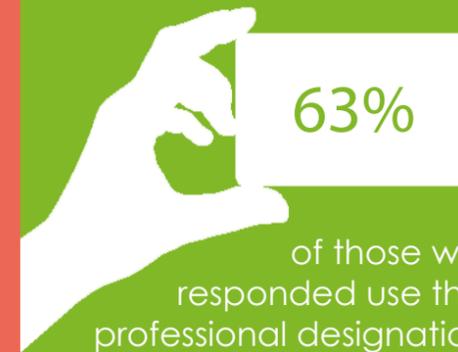
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66% 64% 59%

WhatsApp, LinkedIn and Facebook are the most regularly used social media channels



11% have downloaded the new CISI digital badges

of those who responded use their professional designations



of you rated us reasonable, good or excellent value for money



99%

of our Chartered members value their Chartered status



Top ten standout findings from our



suggestions of new event topics for the next 18 months. Thank you!



55%

of respondents feel confident talking about stress, anxiety, or depression to their manager

This is a rise from last year’s score of 46%

Membership Survey 2019



36%

of you want to be more involved in your local network

Contact crm@cisi.org



22.5%

of respondents say they offer work experience to 14 to 18-year-olds

Contact education@cisi.org to find out how we can help

3,298

Total respondents

22%

increase on 2018



550

suggestions of other benefits members would like

We’ve read and noted all suggestions

membership

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CISI.ORG/REVIEW

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

100110
011001

Watch



Winners of our 2018 Global Educational Trust awards visited our London head office recently to chat about what the awards mean to them and for their future.

View at cisi.org/etrust

MOST COMMENTED ON

Grey matters ethical dilemma: Continuing professional dishonesty
cisi.org/greymatterscpd



Learn



ETHICAL SUSTAINABLE INVESTMENT
CPD gained: 1.5 hours
Distinct pass numbers: 248

MOST READ

The end of the paper trail
cisi.org/papertrail

Investors' cannabis conundrum
cisi.org/cannabis

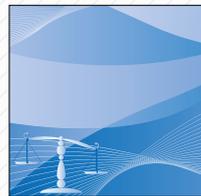
A healthy approach
cisi.org/healthyapproach

Goodbye LIBOR, hello SONIA
cisi.org/libor-sonia

To read more, visit
cisi.org/review



Read



SPIRIT OR LETTER?
The Woodford Equity Income Fund saga highlights the need for ethics and integrity in financial services. What lessons can be learnt about following the letter or spirit of the law?
cisi.org/spirit-or-letter

EVENTS

ACCREDITED FINANCIAL PLANNING FIRMS™ CONFERENCE AND DINNER
3 March 2020
Schroders, 1 London Wall Place
Save the date.
More details to follow.
cisi.org/events

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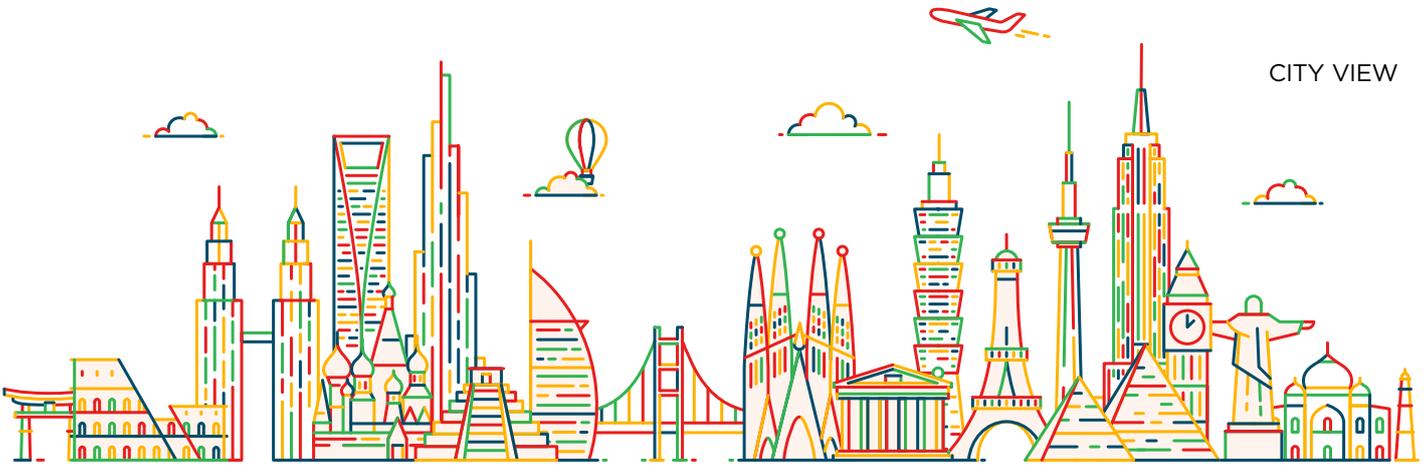
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30% off designer frames with Glasses Direct



Climate emergency and the new eco-warriors – in responsible investment

FOR ALL THE BARK, THE CLIMATE LOBBY STILL LACKS BITE. FINANCE CAN CLAIM A PROUD ROLE IN CHANGING THE WORLD

London's Mansion House – home to the Lord Mayor – saw one of its most dramatic moments in June 2019 when climate emergency protesters disrupted the then UK Chancellor Philip Hammond's annual speech to the City of London. What has stuck in most guests' minds was what Hammond and Bank of England governor Mark Carney had to say on the protesters' theme. Both recognise the existential nature of the climate threat. There is an urgent need, they know, to allocate resources to counter alarming trends. Time is short. The climate lobby is failing: oil and gas consumption is still growing, our world is burning more coal than ever. Action, not words, is now vital.

The UN has regained some clout with its Sustainable Development Goals, now part of the growth strategy of most serious institutions. Its Principles for Responsible Banking, launched in New York at the end of September 2019, pack more backbone.

Finance has a defining role in creating a sustainable future. The CISI has for some years kept members alert to the issues through events, live and on CISI TV, and articles in this *Review* on issues around 'responsible investing', thanks in large part to input from our forward-thinking members. Our community provides growing, well-informed support for action, and reports strong demand from clients.

The CISI supports the work of the Green Finance Institute, launched shortly before the Mansion House drama. Its founder and chairman, banker (and former Lord Mayor) Sir Roger Gifford, emphasises the financial consequences of climate change, and the opportunities and challenges for our sector: "Extreme weather is already causing billions of pounds of damages, not in the future, not tomorrow, but now. The numbers are increasing but they still mask the trillions at risk if the low-carbon transition occurs abruptly." The transition, he says, will be "a monumental undertaking – the single greatest economic transformation in human history".

Finance is being called to serve, and the CISI's

global membership is already playing a powerful role in helping put the brakes on the emergency. Green finance is part of the broader picture of responsible investment, which is contributing greatly to the global necessity of managing the carbon transition. Together, they bring our sector broader opportunities for meeting emerging client needs – in both wholesale and retail markets – and making sound and sustainable profits to boot.

Globally there are now some US\$30tn of assets under management (AUM) that are aligned with environmental, social, and governance (ESG) strategies. There has been 14% compound annual growth in this over the past decade. Some US\$87tn of AUM is held by signatories of the UN Principles for Responsible Investment, suggesting that this trend will continue.

// FINANCE HAS A DEFINING ROLE IN CREATING A SUSTAINABLE FUTURE //

London Stock Exchange was the first exchange to launch a dedicated green bond segment. It now has 118 active green and sustainability bonds, raising over US\$36bn for major businesses and countries. It has 22 green funds, worth more than US\$9bn, covering renewable energy (about half of them), energy storage, energy efficiency and other clean technologies.

At its index subsidiary FTSE Russell, the majority of mandates for index development by investors now incorporate ESG and, in particular, climate change components. HSBC's pension fund, for instance, has put £4bn into the Future World Fund, a 'climate smart' index developed by FTSE Russell. The Japanese Government Pension Investment Fund has used a similar approach and now has ¥1tn (nearly US\$10bn) tracking ESG indexes, including those from FTSE Russell.

The future has to be greener – a desideratum we must all work towards. ●

AROUND THE GLOBE

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

86%

of members rate us as excellent, according to our 2019 membership survey

UNITED KINGDOM

Chief executive officer: Simon Culhane, Chartered FCSI

We've launched an enhanced CERTIFIED FINANCIAL PLANNER™ certification. At level 7 on the UK National Qualifications Framework, it is the UK's highest level qualification for financial planners.

The CFP certification is an internationally recognised licence overseen by the Financial Planning Standards Board (FPSB) in Denver, US. The credential qualifies professionals to work with both individuals and families to help review all aspects of their financial affairs.

Jacqueline Lockie CFP™ Chartered FCSI, CISI head of financial planning, said: "As a global certification there is nothing which matches the CFP designation for the breadth and depth of financial planning knowledge, putting the consumer experience and wellbeing at the heart of this process. The new certification meets the FPSB requirements



on four key levels: exam, ethics, education and experience. It is also now on a par with the CISI's other high-level qualification, the level 7 Chartered Wealth Manager." cisi.org/cfplaunch

NIGERIA

Senior international manager: Praneet Shivaprasad

In July we confirmed a cooperation agreement with the Chartered Institute of Stockbrokers of Nigeria (CIS) that will enable its 15,000-strong membership to become CISI members, provided they achieve the required qualification and annual CPD thresholds.



Chukwudi Nga, CIS head of education and training, at the signing ceremony with CISI CEO, Simon Culhane, Chartered FCSI

CIS Nigeria members will be offered access to seven professional CISI qualifications, all of which will be examined by computer-based testing in Lagos: Securities (Capital Markets Programme); Derivatives (Capital Markets Programme);

Certificate in Corporate Finance; Risk in Financial Services; Global Financial Compliance; Combating Financial Crime; and Managing Cyber Security.

Mr Tunde Amolegbe, first vice president, CIS Nigeria said that the CIS will also be introducing the CISI IntegrityMatters test, "making it mandatory and renewable for members".

KENYA

International manager: Lisa Elo



In August we agreed a partnership with the Institute of Certified Investment and Financial Analysts (ICIFA) in Kenya to support the enhancement of professionalism in the country's capital markets.

ICIFA has been accredited as a CISI training provider with the mandate to offer training for our qualifications in Kenya. Those holding our qualifications in Kenya can apply for ICIFA exemptions. The partnership will offer practitioners joint membership with the two institutes. Full and Associate members of ICIFA can join the CISI as Full and Associate members, and use the designatory letters MCSI or ACSI, respectively.

Kevin Moore, Chartered FCSI, CISI director of global business development (front row, left), said: "This reciprocity deal will offer membership, professional qualifications and CPD benefits to both parties, sharing skills and competencies to meet and exceed the challenges of working in globally competitive capital markets."

BELGIUM

Senior international manager: Karolina Pajor

The CISI has achieved Triple E accreditation for two of its qualifications from the not-for-profit European Banking & Financial Services Training Association (EBTN). The EBTN, of which the CISI is an Associate member, includes institutes, associations and other organisations that provide banking and financial services education and training from any of the 47 Council of Europe member states and beyond.

The two CISI qualifications which have achieved Triple E accreditation are the International Introduction to Securities and Investment (IISI) and the International Certificate in Wealth and Investment Management (ICWIM), both at level 4 on the European Qualifications Framework.

Colin Morrison (pictured with Karolina Pajor, CISI senior international manager), EBTN president and interim chair of EBTN's Triple E Committee, said: "IISI and ICWIM both meet the ten values of Triple E to a great extent, and the pillars of the Triple E standard are well represented in these qualifications."



99%
of Chartered members who
answered our survey highly
value their Chartered status

SAUDI ARABIA

Regional director Middle East:
Matthew Cowan, Chartered MCSI



In September, we signed an agreement with the Financial Academy (FA) in Riyadh, which will be the exclusive exam venue provider throughout Saudi Arabia for all our professional examinations. This comes as one of the Capital Market Authority's (CMA) initiatives, to develop qualification examinations for registered persons, is included in the Financial Leadership 2020 programme.

CISI CEO Simon Culhane, Chartered FCSI (pictured fourth from left above), said that the agreement will help ensure that those working in the capital markets in Saudi Arabia are qualified to international standards.

Mana Al-Khamsan, director general of the FA (pictured to Simon's right), said that the agreement will help to achieve the CMA's vision to improve efficiency in the capital market sector.

UNITED ARAB EMIRATES

Regional director Middle East:
Matthew Cowan, Chartered MCSI



In August we signed an MoU with the Abu Dhabi Global Market (ADGM) Academy. We will be working together to identify training needs and will be providing learning opportunities with the support of other institutions and consultancy firms in the region.

Matthew Cowan (pictured far left above), said: "We are proud to collaborate with ADGM Academy as its strategic partner by providing international qualifications to UAE professionals, raising standards across the profession in investment, wealth, risk management, capital markets and Islamic finance."

Hamad Sayah Al Mazrouei, managing director at ADGM Academy (pictured above right), said: "We have been actively engaging the MENA community to develop purposeful and bespoke training and education programmes that address the dynamic needs of the sector. ADGM Academy is set to expand financial literacy and expertise in the region with an aim to become a centre of excellence in financial services."

LONDON CALLING

Graham Bishop’s monthly *Brussels for Brunch* webcast on CISI TV has proved popular with members since its launch four years ago, through the EU referendum and subsequent chaos. As Britain’s negotiations with Europe reach another new phase, the programme has changed gear, focusing on three or four major issues which will carry on – at least for a while – whatever happens with Brexit.

These webcasts follow intensive and well-informed discussions organised by the Centre for the Study of Financial Innovation (CSFI), and hosted at CISI, immediately beforehand. Sir John Redwood MP, Chartered FCSI, speaking at the September 2019 event about Brexit and its impact on financial services, complimented both CSFI and CISI for bringing intelligent discussion to bear on matters of European finance.

Facebook’s Libra proposals, for instance, have triggered much thinking about the real consequences of cryptocurrencies. Should central banks issue their own ‘public money’ digital currency? A European Central Bank paper considers the implications if citizens choose to hold this digital public money rather than private, bank money.

If Libra is backed by real assets such as currencies, would it become a currency board? Or an asset-backed security, so subject to securities laws? If the controllers changed the basket of assets, could they benefit from a devaluation? What about money laundering on the dark web? “Cryptocurrencies have a long way to go before rivalling ‘legal tender,’” Graham concludes.

For more details on Graham Bishop’s work, and suggestions on future coverage in *Brussels for Brunch*, please contact graham@grahambishop.com



NEW CISI MANCHESTER BRANCH PRESIDENT ANNOUNCED



Becky Jones, 29, is the youngest person to be appointed president in the CISI Manchester branch’s 21-year history. She replaces David Gorman, Chartered MCSI, of Castlefield Partners, who held the position for the previous three years.

Becky has over five years’ experience in the financial services sector, beginning her career at BNY Mellon in

operations before moving to compliance in 2016, where she now works as a compliance officer.

Becky is responsible for UK compliance monitoring reviews. She holds an LLB (Hons) law degree (First Class Honours), a Legal Practice Course Postgraduate Diploma, and the level 3 CISI Investment Operations Certificate. She is also currently completing the level 6 CISI Diploma in Investment Compliance.

Becky said: “I am thrilled to be taking on the role of president of the Manchester branch and would like to thank the outgoing president, David, for his leadership over the previous years and for his continued support. I am extremely excited to drive forward the excellent work our Committee does and I look forward to the various CPD, social, educational and Young Professionals Network events ahead.”

The power of personal storytelling

David Swanwick, head of client services at Dimensional Fund Advisors, presented a soft skills session to about 60 CISI Young Professionals Network (YPN) members on 16 September, on the impact of personal storytelling on client engagement. The session included practical tips and diagrams on how to tell a story to achieve a connection with clients.

The event, held at Dimensional’s offices in London, marked a year since the YPN was launched. Since then we’ve held 20 YPN events around the UK, covering topics of interest to those wanting to progress in their careers and helping them develop their competitive edge through professional development in leadership, communication, teamwork, problem solving and adaptability.

CISI YPN member Stephen Harris MCSI, client relationship manager at Sandaire, said that the “session with David Swanwick was excellent”, and that for him, being part of the YPN means “the chance to learn, meet and develop alongside future business leaders”.

Events preview

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

LONDON CPD

- 11 NOV** What is the future of digital investing?
- 29 NOV** Sector investing with ETFs
- 2 DEC** Your life, your journey, your future

REGIONAL CPD

- 6 NOV** Bristol and Bath branch CPD session: CASS (Bristol)
- 7 NOV** Integrity at Work; Networking skills for confidence and success (Gloucestershire)
- 7 NOV** Supporting sustainable businesses in Scotland (Edinburgh)
- 11 NOV** Paraplanner Interest Group: Birmingham half-day seminar (Birmingham)
- 13 NOV** The internet of things, 5G, digital warfare and the case for investing in cyber security (Oxfordshire)
- 26 NOV** Mind matters: agile mindset and stress reduction (Liverpool)
- 10 DEC** Cybernomics and the common mistakes organisations make (Guernsey)

ANNUAL DINNERS

- 14 NOV** East Anglia branch annual dinner (Norwich)
- 21 NOV** South Coast branch annual dinner (Bournemouth)
- 28 NOV** Cotswolds branch annual dinner (Gloucestershire)

SOCIAL EVENTS

- 6 NOV** Young Professionals Network: Quiz night social (London)
- 11 DEC** Young Professionals Network: Banter; barrier breaker or barrier maker? (London)

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

QUICK QUIZ

The Review's quick quiz features questions from CISI Professional Refresher, an online learning tool. This popular product consists of more than 150 modules covering topics including anti-money laundering, the UK Bribery Act, information security and data protection. The answers are on page 51.

Which statement best characterises the term 'big data'?

- A** Data that, due to several varying characteristics, is difficult to analyse using traditional data analysis methods
- B** Data that can only be analysed by way of machine-learning techniques
- C** Data that can only be analysed by way of deep-learning techniques
- D** Data that is best analysed using robotic process automation

What is the primary purpose of anti-trust regulation?

- A** To promote fair competition in the marketplace
- B** To encourage industry consolidation
- C** To regulate share issuances and associated disclosures
- D** To protect shareholder rights

What type of companies will a venture capital firm look to invest in?

- A** Blue chip FTSE 100 companies
- B** Financial services firms only
- C** Small unquoted companies
- D** Well-established and profitable companies which have cornered the market with innovative products

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

Disciplinary sanction: Nicholas Lanzl MCSI

Following notification that Mr Lanzl had been subject to disciplinary action by his employer, he was invited to appear before the Disciplinary Panel. The Panel, having considered the matter and the member's submissions, determined that Mr Lanzl was in breach of the CISI Membership Regulations and CISI Code of Conduct, and that he should receive a reprimand and be required to complete an additional

three hours of CPD focused on data protection within a 12-month period.

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





Financial planning news

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

DISCOUNT AVAILABLE ON CFP ACCREDITATION

The CERTIFIED FINANCIAL PLANNER™ designation is the only global mark that recognises financial planning skills and that all-important application of knowledge across the world. There are now over 180,000 CFP professionals in 27 countries all playing their part to provide better-quality advice to the public.

We have re-engineered the UK qualification pathway to CFP certification. It is now a tested and robust process with two new component parts: one level 6 exam plus one level 7 financial plan assessment. I hope you feel that this is a significant step forward for the financial planning profession in the UK and that you will encourage your professional friends and

colleagues to embark on the new CFP certification pathway.

The next exam is in March 2020. In a world where many investment and adviser professionals are describing themselves as financial planners, more and more people are now looking at ways to differentiate themselves. Becoming a CFP professional is a great way to do that.

Have you been through the old CFP certification process and struggled? Many have struggled with the old CFP certification case study assessment. We are now offering a substantial discount to those who feel ready to take on the new CFP certification pathway. The cost of the new

level 6 exam component has been cut from £482 to £100 for those who are already in the middle of the process, in recognition of the struggles some have had while we've been re-engineering the new pathway. We have records showing who can obtain this discount and we have emailed you all. If you'd like to talk through your options, please contact either me (jacqueline.lockie@cisi.org) or Christopher Morris, Chartered MCSI, CISI deputy head of financial planning (christopher.morris@cisi.org) and we will support you.



GET INVOLVED

Financial Planning Forum Committee help

We are looking for new forum members to join the committee to help us push forward our efforts to build a bigger, better financial planning profession. The committee has several members who have completed their three-year tenures and are stepping down, so if you'd like to be part of a diverse group dedicated to financial planning, please email christian.scott@cisi.org or pf@cisi.org to put your name forward.

Branch committee help

We are always looking for enthusiastic individuals to help develop financial planning subjects for new and existing planners in the regions. With many wealth managers starting to add in

financial planning services to their business models, now is an important time to welcome and support them in their endeavours. If you can spare a few hours to help your local regional branch committee, please contact christopher.morris@cisi.org and we will put you in touch with the right people.

Speakers for branch meetings and conferences

If you have an interesting financial planning related topic that could be useful to our community of financial planners and would be interested in talking at a branch meeting or conference, please do contact me. We'd love to hear your stories about financial planning and how you have helped clients, so don't be shy. Let us know if you can get involved.

REVIEW MAGAZINE SUBJECTS

We are always looking for great subjects for *The Review* online and print articles. If you have any ideas or thoughts on new topics or areas of financial planning that you would like to see included in future editions of the magazine, please contact jane.playdon@cisi.org.

WORLD FINANCIAL PLANNING DAY AND UK FINANCIAL PLANNING WEEK 2019

My thanks to all those who got involved in helping the public understand what financial planning is and how it can benefit them. You have been fantastic in supporting the education of the public by offering practical help. Same time next year?



SCHRODERS GLOBAL INVESTOR STUDY 2019

Schroders is delighted to be a Gold Financial Planning Corporate Supporter of the CISI in 2019. We believe the CISI plays an instrumental role in the professional development and education of the UK financial planning community, and are pleased to support this community through the key learning initiatives driven by the CISI.

Schroders

The highlights from our partnership this year include the Paraplanner Conference in June and hosting the CISI Young Professionals Network event at our offices in July. We also enjoyed the Annual Conference from 30 September to 1 October. Through these events we continue to support the CISI's efforts to set high standards of conduct within the financial planning profession.

Schroders has also been involved in the CISI's Financial Planning Mentoring Scheme, offering support to financial planners. Our business has a wide-ranging set of skills and knowledge which we can share through the mentoring programme.

As a global asset and wealth manager, Schroders delivers a broad range of investments designed to meet the diverse needs of financial

advisers and planners. We believe that we have an important role to play in driving better outcomes for our clients and society.

Recently we published the initial report of our *Global Investor Study 2019*, focusing on investor behaviour. We spoke to over 25,000 people from 32 countries around the world, to explore their behaviours around investing. Understanding personal behaviours and motivations when investing is important to help make the right decisions. Overall, the results show that, against a backdrop of market turbulence, people's expectations for income and returns are continuing to rise. Despite recognising that investment plans should be long term, the majority of investors alter their investments according to short-term market movements.

To see the results of the Global Investor Study 2019 visit bit.ly/schroders2019

To find out more about Schroders, visit www.schroders.co.uk/adviser

CISI FINANCIAL PLANNING CORPORATE SUPPORTERS Q3 2019

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www.bmogam.com

Financial Express

www.financialexpress.net

First Trust Global Portfolios

www.ftglobalportfolios.com

HANetf

www.hanetf.com

Heartstone Investments

www.homeinvestor.fund

Independent Health Care Solutions

www.iwcs.co.uk

James Hay Partnership

www.jameshay.co.uk

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NS&I

www.nsandi.com

Orbis Investments

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Royal London

www.adviser.royallondon.com

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Vanguard

www.vanguard.co.uk

Affiliate

Blackfinch Investments

www.blackfinch.com

Selectapension

www.selectapension.com

CRP – IS IT JUST ABOUT INVESTMENT?

Just is pleased to be a CISI Gold Financial Planning Corporate Supporter in 2019 and to help promote continuing professional development in the financial services sector.

JUST.

Financial planners know the fundamental importance of establishing a client's

'life plan', considering their individual objectives and aspirations before they can create a financial plan to meet them.

A needs- and goals-based approach is the starting point. There are, perhaps, some behavioural biases to overcome so that priorities are set in the right order, starting with covering the non-negotiable income needs.

Thereafter, helping the client to understand if their life goals are realistic and ensuring they are prioritised is key. Understanding how much income will be needed, and when, will inform

the financial plan. It will help to determine where to invest over what period to make retirement dreams a reality, or whether an element of guarantee is needed.

When the concept of a centralised retirement proposition (CRP – a sustainable decumulation strategy for those in retirement) is mentioned, the focus is often on the investment. But that is just part of the story.

The shift between accumulation and decumulation brings additional risks. The retirement choices available to clients bring several complexities, and a robust process needs to be in place to account for things like longevity and sequence risks. The entire process needs to be documented. This can

be complex, so selecting the right tools to demonstrate this is key.

The CRP should also account for stress-testing and 'what if' scenarios, with a plan of action for if things go off track.

Finally, a detailed review process is needed. As well as adjusting to any new income goals, financial planners will need to consider other potential future situations, such as a need for care funding.

To find out more about developing a CRP that covers all the bases, please contact Just, visit JustAdviser.com, or view CISI TV at cisi.org/crptv.

*Martin Lines
Business development director
Just Retirement*



Financial freedom

PETER MONTAGUE, CHARTERED FCSI, CEO AT MONTAGE WEALTH MANAGEMENT, SET UP THE FIRM WITH THE GOAL OF HELPING CLIENTS ACHIEVE THE FREEDOM OF FINANCIAL INDEPENDENCE

CONGRATULATIONS ON YOUR RECENTLY ACQUIRED ACCREDITED STATUS. WHY DID YOU DECIDE TO BECOME ACCREDITED AND WHY SHOULD OTHERS SEEK TO DO SO?

Scott [Scott Mordrick CFA CFP™ Chartered FCSI, director and CIO at Montage] and I, who have both been CISI members for some time, looked at the benefits of becoming an Accredited Financial Planning Firm™ and felt it was an excellent way to evidence our commitment to setting the highest standards within the firm and demonstrate our desire to give our clients the highest possible level of service. As part of this, all our team are CISI members and are aiming to be Chartered members shortly.

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

We had a terrific start to the year, picking up three awards at the Professional Adviser Awards 2019, which included the Adviser Firm of the Year (UK); Best Adviser Website; and Adviser Firm of the Year – Midlands & East Anglia. We were astonished, but also certain that having two of our advisers complete the CFP™ certification contributed to that success.

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

We believe that we offer the depth of a family office, with a comprehensive approach that impacts all areas of our

// OUR MOTTO IS 'WE BELIEVE IN FREEDOM' AND WE THINK THIS IS REFLECTED IN EVERYTHING WE DO //



clients' personal affairs. We look at lifestyle decisions and cashflow modelling and build plans for clients based on those findings, spending time educating clients about how to make their money work for them. Our motto is 'We Believe in Freedom' and we think this is reflected in everything we do.

HOW DID YOU GET INTO FINANCIAL PLANNING?

When I was about 17 I chatted to a family friend about his role as a financial planner in a big city firm. I became intrigued by the profession's ability to change people's lives and was drawn to the financial services sector. I secured an interview with a financial planning firm during the early part of my engineering degree course, and straight after university I began working for the firm as a financial adviser under supervision. After five years I left to set up my own firm, which is Montage Wealth today.

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

Making a significant positive impact on our clients' lives is a powerful motivator for everyone here. We don't want to

just go in and look at a client's pensions or investments in isolation. Financial planning is so much more than that, and if a client doesn't feel they want the full service then we will shake hands and part ways. The clients who are engaged with what we do for them see real benefits in our service. We are the link that holds everything together for many clients. We maintain regular dialogue with accountants and solicitors, we keep them in check and expect them to do the same as we all work in the interests of the client.

WHAT DO YOU LIKE ABOUT THE CISI?

It is very pleasing to see that the CISI, rather than resting on its laurels, is making a conscious effort to drive a new wave of financial planners into the marketplace, both by teaching new entrants to the sector good practice from day one and by providing continuing professional development opportunities to enable firms to evolve as the demands on the profession change.

WHAT DOES A TYPICAL DAY LOOK LIKE?

Every day tends to be different. The core of what we do revolves around our client service proposition, and that takes priority. After a review meeting, we come back and digest the information the

client has given us and see what impact that has on their overall financial plan. This is a key part of every day. We also have other big projects going, such as delivering seminars to both clients and professional connections. We also deal with new client enquiries, and you can almost always guarantee that at least one of us is studying for an exam of some sort. We are used to squeezing as much out of each day as possible by being as organised as possible.

WHAT ARE YOUR KEY TIPS FOR OTHER FINANCIAL PLANNERS?

Find and articulate your core values. Make sure your team knows what those values are and that they all share them. It is important that you are all pushing in the same direction. Once you know what sort of practice you want to run/be a part of, stay true to yourself and don't be afraid to speak up if you think something could be better. Always keep developing yourself. Qualifications are not the be all and end all, but similarly there is no reason not to push yourself to be the best you can be. It can only benefit you, your colleagues and your clients. ●



PETER MONTAGUE, CHARTERED FCSI

Peter founded Montage Wealth Management in 1998 as a sole trader, converted to a limited company in 2001, and in 2014,

aided by Mark Polson at the Lang Cat, the business took on the current Montage brand with the launch of its discretionary managed portfolios. Peter is now completing the Society of Later Life Advisers qualification and studying for the Society of Trust and Estate Practitioners exams because of the work Montage is doing with solicitor firms.

Peter is a strong advocate of the value of financial planning and has invested heavily in the next generation. Three of the team are in their early 30s, have recently featured in a Citywire *NMA* next generation article and are all going for the Top 35 under 35 accolades with Citywire this year. They are Scott Mordrick CFA CFP™ Chartered FCSI, director and CIO at Montage; David Rule MCSI, one of the firm's wealth managers; and Christopher Thompson CFP™ Chartered MCSI.

Outside the office Peter is passionate about motorsport and competing in GT racing, and keeps fit with boxing training.

AMARJIT SINGH BANSAL, CHARTERED FCSI, RISKS HIS OWN SAFETY TO HELP PERSECUTED WOMEN AND GIRLS IN DISASTER-STRICKEN TERRITORIES. **LORA BENSON** MCIPR, CISI HEAD OF MEDIA, REPORTS

Selfless service

Amarjit is in the business of helping people, whether that be through his day job as a personal injury and court of protection independent financial adviser with the Leeds office of Chase de Vere, or through his voluntary work with charity Khalsa Aid International (KAI).

His day job involves “delivery of financial security” to clients who have sustained serious personal injury, who may be in the pre- or post-settlement phase. “It is not only about the investment or planning. What you do for the client and how you do it can impact on their wellbeing,” he says.

His voluntary work with KAI is based on its key Sikh principle to ‘Recognise the whole of the human race as one’. KAI is a UK-based humanitarian disaster relief charity providing support globally to victims of natural and man-made disasters such as floods, earthquakes, famine and war. The team is often first on the scene to help distribute food, water, clothing,

medical and sanitation supplies. They also fund and build semi-permanent shelters.

Amarjit first volunteered with KAI in 2011, going on a humanitarian aid mission to Kenya. “At the time there was a major drought in Somalia, with refugees crossing the border, entering camps around Dadaab in Kenya. Our initial aim was to assist refugees crossing into Kenya, but we discovered that much aid was already entering the region to support this group; it was the locals in the region who were being neglected. We delivered over 100 tonnes of aid to schools, orphanages and camps.”

As well as supporting projects in Africa, India, Turkey, Lebanon, Haiti, Bangladesh and Yemen, KAI is involved in support closer to home: “Our team has helped UK residents cope with devastating floods, and was there to support the families who escaped the horrific fire at Grenfell Tower in London.”

Amarjit has made several trips to northern Iraq (Kurdistan) to assist women and children from the Yezidi community “during the height of the offensive in Kurdistan by coalition forces against Daesh/ISIS”. Amarjit helps establish a team, source materials and food, and arrange delivery logistics. “I’ve assessed the security risks for our volunteers, local staff and those we work with, and established contacts at a local and regional level with the authorities. It is truly a team effort.”

Amarjit and the team have supported Yezidi girls and women who have been subjected to forced marriage and sexual slavery by Daesh and who have since escaped and returned to their communities: “At one point we were supporting about 650 girls and their families with monthly food supplies. Many had been wearing the same clothes since capture, or clothes given to them by their kidnappers. So we started Project Dignity, whereby KAI volunteers take girls who have just returned from capture/slavery to local clothes stores, with a budget of US\$50 each, so they can buy clothes of their choice.

“We’ve also helped women support their families by setting up micro-businesses. One girl who escaped capture had an

interest in photography; KAI purchased a camera and helped her sell photos locally.”

Amarjit and the team face personal safety dangers and health issues in some of these territories, but one of the biggest challenges is the transfer of funds to aid centres. “Understandably, governments and financial institutions are very cautious about where, how and to whom they allow charities to transfer money.”

// IF WE TRULY BELIEVED IN HUMANITY, WE WOULD RECOGNISE THE WHOLE HUMAN RACE AS ONE //

Amarjit has seen the best and worst of human behaviour in his time with the charity. Humour can be a superb coping mechanism, he says. “Once I was in a situation where a desperate crowd surrounded myself and the team, asking for food. I shouted for our driver in Kurdish, wanting some reinforcements, and couldn’t understand why everyone laughed. It turns out that I had mispronounced the driver’s name and referred to him as a donkey!”

While KAI’s key principle is part of Sikh ideology, the charity’s work is not restricted to the Sikh community. “Donations and volunteers come globally from all communities and faiths,” says Amarjit. He believes that it is everyone’s responsibility to do what they can to improve humanity and the environment, and gets satisfaction from knowing he’s helped a mother feed her child or helped restore a young girl’s self-esteem.

“If we truly believed in humanity, we really would recognise the whole human race as one,” he says. ●



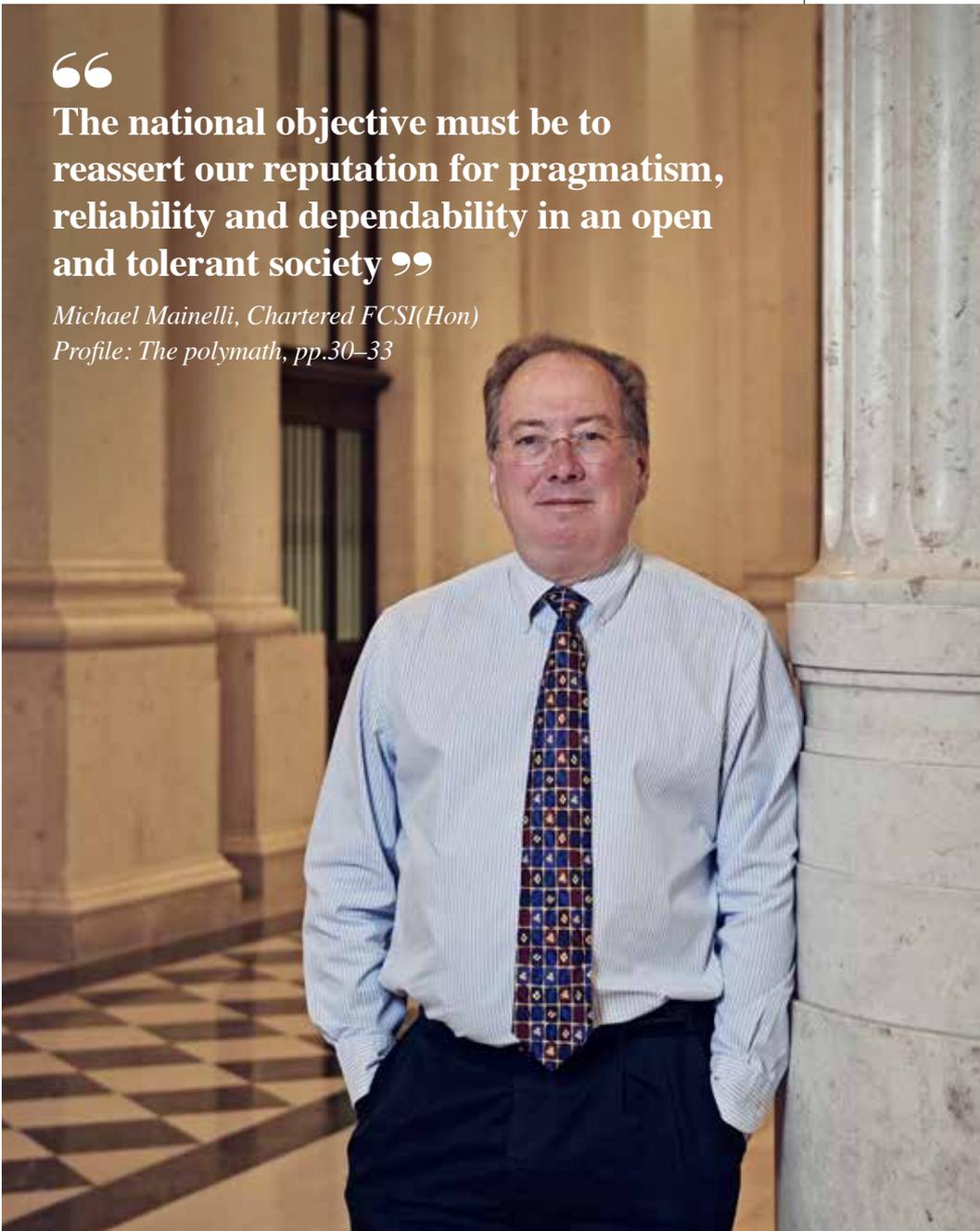
Contact jane.playdon@cisi.org if you have a hobby you think will interest other CISI members. You will receive a £25 voucher if we publish your story.



“

The national objective must be to reassert our reputation for pragmatism, reliability and dependability in an open and tolerant society”

Michael Mainelli, Chartered FCSI(Hon)
Profile: The polymath, pp.30–33



PHOTOGRAPH: CHARLIE SURBEY

“Europe has privacy laws that will make it much harder to use machine learning and AI”

Anthony Hilton
FCSI(Hon), p.16

“

It will be interesting to see whether the advancement of challenger banks plateaus”

”

Dan Jones, head of digital at Capco Hong Kong
Threat or fad? pp.34–35



pp.17–25
Special report:
Digital skills

pp.26–29
Lifetime mortgages

pp.36–38
The FSCS levy

pp.39–41
PROD rules

pp.42–44
US banks



Anthony Hilton
FCSI(Hon)

FIRST
PERSON

China's tech edge

WHICHEVER MEASURE YOU LOOK AT, CHINA IS WAY OUT IN FRONT WHEN IT COMES TO THE TECHNOLOGICAL REVOLUTION

“ According to Huawei's 2018 annual report, 58% of people will have access to a 5G telecoms network by 2025. Content and service will travel as one, and experiences will flow seamlessly. Or so they say.

But this requires a twentyfold increase in data by 2025. And artificial intelligence (AI), which supports it, will need to grow tenfold every year. By that time, the global AI market will be worth US\$380bn, according to Huawei.

All this sounds good for Britain because it is good at AI and tech in general. Research by Tech Nation shows that it is third in the world for producing unicorns – new, unquoted companies with a value of US\$1bn – after the US and China.

And, as I wrote in the *Evening Standard* in May 2019 (slightly paraphrased below), technology has the edge in terms of growth in London:

London & Partners, Mayor of London Sadiq Khan's publicity vehicle, says that tech is fast becoming the dominant force in the capital. It listed Google at King's Cross, employing 4,500; Apple at Battersea Power Station, which should have 1,400 employees by 2021; and Facebook, which has plans to double its capacity in London with up to 6,000 jobs. LinkedIn, Amazon and Spotify also have a major presence in the capital. It used to be that financial firms were where the growth was and, indeed, in ten years, 740 financial firms created 25,000 jobs in London. But in that time 822 tech companies, creating 27,000 jobs, also set up in the capital. Technology has the edge.

Douglas McWilliams, founder of the Centre for Economics and Business Research, talked about this in *The flat white economy*, a book he published in 2016.

It was called *The flat white economy* because employees who worked in these tech companies seemed to live off that particular type of coffee. But that aside, it celebrated the fact that not only were scores of tech businesses start-ups, but they had a vibrancy and a diversity which left most other sectors gasping.

In April this year, McWilliams revealed that this economy had become the UK's largest industrial sector. In 2013, it was estimated to be 8.7% of gross value added (GVA). By 2016, it had risen to 13.3% of GVA and the latest data suggests that in 2018 it had reached 14.4%.

But the UK's tech sector is still tiny in global terms. Huawei, for example, has 80,000 technologists in a workforce of 180,000, and that is just one company. The Alan Turing Institute, which is the UK's national institute for data science and AI and a model of its kind, has 3,000 technologists.

According to Howard Covington, chair of the Board of Trustees of the Alan Turing Institute, America may not be where it is at, either. PayPal, the payment platform, handles 250 cash transactions a second. Visa and Mastercard handle 2,000 cash transactions a second.

But Ant Financial and Alipay, which are part of Alibaba, the technology group created by Chinese entrepreneur Jack Ma, puts these western organisations to shame. Ant Financial handles an astonishing 250,000 transactions a second and it is already upgrading. The plan is that it will handle one million financial transactions per second at some point in 2020.

Trump's motivation

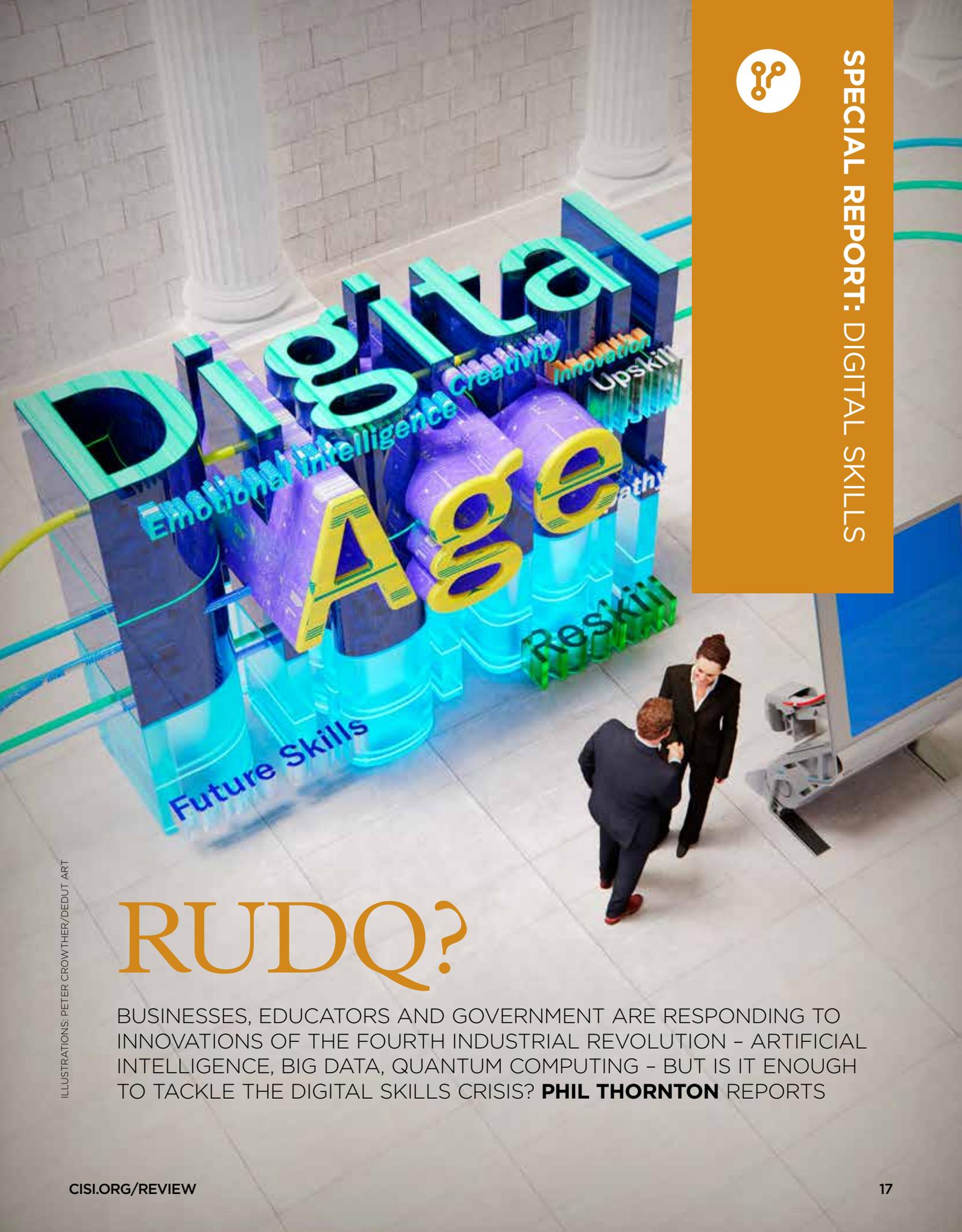
Trump may say he is targeting China because of its unfair trade practices. But China seems likely to overtake America in AI in the next ten years, so his real motivation could be to disrupt and put them off course for as long as he can. According to the Financial Stability Board, established by the G20, Alipay is reported to have 870 million users, which already makes it the world's number one payment platform. And other Chinese providers are doing almost as much.

The US tech giants are also following the market, which they hope will lead to profit, rather than doing so much blue-sky research. The Chinese take a longer-term view, with the Chinese state, rather than the market, the dominant factor. That is one reason why Huawei is doing so well; it spent much of its life getting up to speed, but then had products that rivalled the west in ten years. Now, Made in China 2025 – the overriding government-inspired initiative – threatens to do the same for AI.

The second thing to note is the data. Every transaction from every phone in China is collected, processed and used to refine the product and to develop new features – lifestyle, where to shop, financial planning and so on. The Chinese are much less bothered by this harvesting of data, whereas Europe has privacy laws that will make it much harder to use machine learning and AI. This gives a massive advantage to the Chinese authorities in bringing things to market.

Parker Fitzgerald, the London consultancy, has recently produced a report that also shows how much British banks are falling behind in technology. Since the financial crisis, the banks have been making their systems more resilient, shrinking their balance sheets, meeting litigation costs, and coping with regulation. But this has meant they have been focused on operational efficiency, not transformation. They have not focused, as the Chinese technology companies have, on getting rid of banks altogether and doing things differently.

Britain will certainly have a niche, but it will be the Americans and the Chinese who do the big stuff – and it is the Chinese who seem to have the edge. ●



RUDQ?

BUSINESSES, EDUCATORS AND GOVERNMENT ARE RESPONDING TO INNOVATIONS OF THE FOURTH INDUSTRIAL REVOLUTION – ARTIFICIAL INTELLIGENCE, BIG DATA, QUANTUM COMPUTING – BUT IS IT ENOUGH TO TACKLE THE DIGITAL SKILLS CRISIS? **PHIL THORNTON** REPORTS

ILLUSTRATIONS: PETER CROWTHER/DEDUT ART

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In June 2019, Facebook unveiled its plans for a global digital currency, called Libra, that would allow its billions of users to make financial transactions, a move that had the potential to shake up the global banking system. Since then, however, PayPal has withdrawn its support and other payment providers are reported to be considering doing so. Regulators, notably in the US, France and Germany, have also expressed reservations.

Even if Libra never makes it to market, however, it is evidence of the digital disruption that has been sweeping through finance for some time. Electronic trading, for example, became mainstream in the 1990s, which, as explained in a previous *Review* article (see cisi.org/lifelonglearning), required formalising of processes through compliance, codes and reporting requirements, which in turn created a “need for training and education about these new ways of working”.

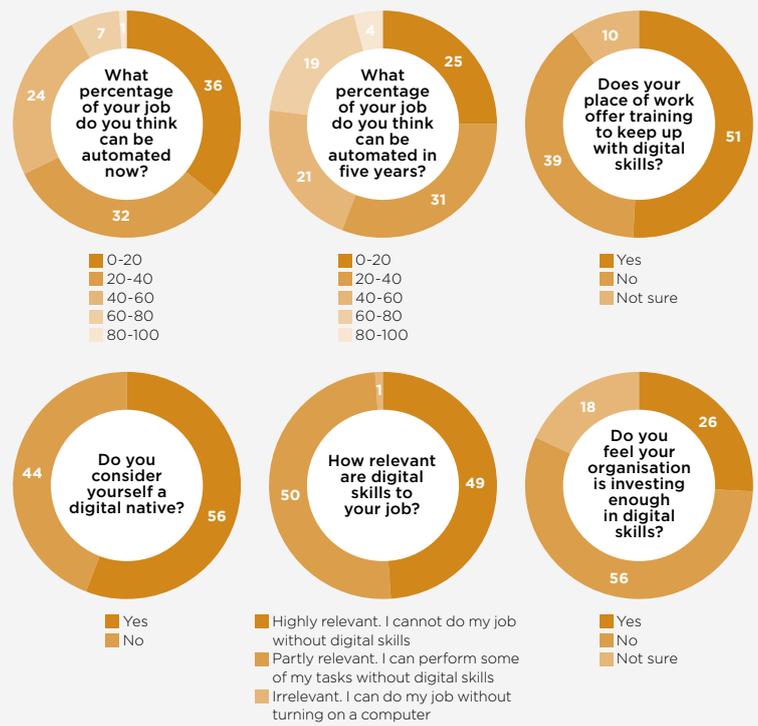
More recently, the likes of Google, Apple and Samsung have gained a foothold in the sector with their mobile payment solutions. Driven by technological, cultural and regulatory change, this disruption requires financial services professionals to acquire a range of new skills and talents that are second nature to employees of digitally native companies such as Facebook.

But what are these ‘new’ digital skills, and how can employees ensure they future-proof their careers? Twenty years ago, Microsoft PowerPoint was seen as a cutting-edge skill, but nowadays year 7 pupils in school will use it to present their homework. Charlotte Crosswell, CEO of Innovate Finance, which represents the fintech sector, says it is growing at a rapid pace and the supply of talent to support it in the long run is fast being overtaken by demand. “New businesses which rely on highly skilled talent are emerging every day, and we must act now to future-proof the sector and fuel the talent pipeline,” she says.

Digital skills shortage

While many workers have the basic digital skills required to do their job, the more complex skills remain sought after. An online *Review* article published in June (see cisi.org/digitalskills) looks at the lack of digital skills in the financial services sector and the necessity for

FIGURE 1: THE *REVIEW* POLLED CISI MEMBERS ON DIGITAL SKILLS - HERE’S WHAT YOU TOLD US



Source: cisi.org/digitalskills

(All figures are in percentages)

action. It says that, according to the Digital Marketing Institute, skills needed to help future-proof workers include expert data analysis, such as extracting, analysing and translating useful information in a dataset, and network and information security to ensure watertight cyber security.

The article highlights some key figures, including the UK government’s Education and Skills Funding Agency prediction that within the next 20 years, 90% of jobs will require some level of digital skills. And by 2022, more than 130 million new roles could emerge as a result of the new division of labour between humans, machines and algorithms, according to the World Economic Forum’s (WEF) *Future of jobs report 2018*.

Only 56% of respondents to the poll questions included in the *Review* article, answered mostly by those who work in wealth management, operations, or compliance, risk and regulation, consider themselves to be a digital native, and just 51% feel their place of work offers the required training to keep up with digital

// THERE ARE BRIGHT SPOTS, BUT THE BRIGHT SPOTS COME AGAINST A GLOOMY PICTURE. THERE IS CLEARLY MORE TO DO //

MARK HOBAN, CHAIR, FINANCIAL SERVICES SKILLS TASKFORCE

// WE WANT
OUR FUTURE
TALENT TO BE
COMFORTABLE
DEPLOYING THEIR
DIGITAL SKILLS TO
BETTER SERVE
THE NEEDS OF
CUSTOMERS //

**WEIYEN HUNG,
CHARTERED FCSI,
CHAIR, T LEVEL
FINANCIAL PANEL**

skills, despite nearly 99% maintaining that digital skills are either highly or partly relevant to their job.

Separate research by the consulting firm McKinsey indicates that between 25% and 34% of financial jobs in areas such as procurement and payroll will be lost in the US and Germany by 2030, while the number of financial and business specialists will rise by between 5% and 24%. And a recent report by Parker Fitzgerald, the London consultancy, entitled *Banking in 2019: a year of transition*, finds that British banks are falling behind in their use of technology.

While the Fourth Industrial Revolution offers huge opportunities, the extent and speed of change risk creating a significant mismatch between the tech skills required by financial services firms and those acquired by people leaving academia at all levels, according to Marcus Scott, chief operating officer of TheCityUK, the sector-led body representing UK-based financial and related professional services. He describes the risk of a fintech skills shortage as “very serious”. He adds, “We start with one arm tied behind our back because the reputation of the sector is such that it is not seen as a dynamic, forward-thinking tech-advanced sector, even though inside it is.”

The crisis

The Lord Mayor of London, Alderman Peter Estlin, gave a speech on digital skills at Gresham College in London in January 2019. He referred to statistics from several reports that highlight the scale of the crisis, including that 12.6 million people lack basic digital skills, that 5.8 million adults in the UK (9% of the population)



By 2040
90% of jobs will require
some digital skills

have never even used the internet, and that the estimated cost to the British economy per year in lost GDP is £63bn.

“On the face of it, then, we really are experiencing a digital skills crisis,” said Alderman Estlin, who pointedly asked his audience: “RUDQ?” – referring to the newly minted concept of digital quotient or DQ, an education framework and assessment that involves eight skills we all need to be familiar with as digital citizens or workers. He went on to draw on an ancient Chinese proverb. “It is often said that every crisis presents an opportunity. In this case, we are presented with an opportunity for the UK to do what the UK does best – innovate.”

But is it happening fast enough? Around 40% of 500 UK chief technology officers, HR directors and HR managers surveyed by the Open University in its 2019 report, *Bridging the digital divide*, say their profitability, competitiveness and agility have been impacted by digital skills shortages, with 50% saying they expect to suffer in the future (see figure 2 on page 20). And in a 2018 Accenture Research survey of more than 1,200 CEOs and top executives who use artificial intelligence (AI) as part of the business function of their companies – called *Reworking the revolution* – respondents describe only about a quarter (26%) of their workforce as ready for AI adoption.

Research by Accenture in 2016 into the digital readiness of the financial sector found that just 53% of firms were training employees in digital skills. Our 2019 *Review* poll results reflect this, with 56% of respondents saying they do not feel their organisation is investing enough in digital skills training, and 39% saying their place of work does not offer training in this area. >>



IMAGE: ISTOCK

>>

“That points to a sector that has yet to fully embrace the need to reskill its workforce to deal with these trends,” Marcus says. “There are bright spots, but the bright spots come against a gloomy picture. There is clearly more to do.”

The response

Whitehall, financial services firms, think tanks and academia have responded to the crisis. The UK government launched its digital strategy in 2017, setting out how the UK can build a “world-leading digital economy that works for everyone”. The GDS Academy, formerly known as the Digital Academy, offers a range of introductory sessions, specialised courses and training for people in digital roles and digital services leaders, with the aim of teaching public servants about the essential digital skills that are needed to transform public services.

And in 2018, then-Chancellor of the Exchequer Philip Hammond unveiled the Financial Services Skills Taskforce (FSST), which he said would “harness emerging technologies” and “ensure a wealth of talent for the financial sector, securing its future post-Brexit”.

The taskforce, convened by TheCityUK, was asked to help the sector access a better long-term pipeline of specialist skills and support efforts to retrain or refresh employees’ skills over their working lives.



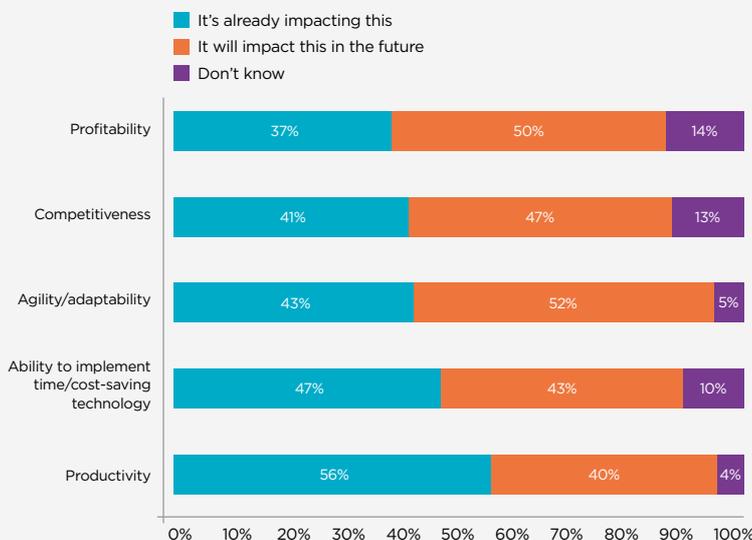
It produced an interim report in June 2019 and will produce full recommendations in November 2019. The June report sets out ways in which firms and employees can future-proof themselves amid the rapid pace of technological changes. For example, leaders will need to develop high-level competencies in digital intelligence and improve their social intelligence and intellectual integrity. Skills required across firms will include effective communication and empathy, as well as digital literacy and critical thinking.

Its chair, Mark Hoban, a former MP and chair of reinsurance firm Flood Re, says skills required by financial services firms are changing significantly. Skills such as coding and software development, user experience, product design, data science and cyber are on the increase at all levels.

“We need to have a response that is strategic and system-wide, reflecting the nature of the tech change that we are facing,” Mark says.

In recognition of the need for action, the Chartered Body Alliance – Chartered Banker Institute, Chartered Institute for Securities & Investment, and Chartered Insurance Institute – held fringe events at the two main UK political party conferences in September 2019. The events, titled ‘Upskill, Reskill, Future Skill: The next generation challenge for financial services’, included panellists from TheCityUK and MPs discussing potential solutions to the mismatch between supply and demand, and the need to remain competitive with

FIGURE 2: BUSINESS IMPACT OF THE DIGITAL SKILLS SHORTAGE



Source: Open University

// IN FIVE YEARS' TIME THE MOST VALUABLE EMPLOYEE MAY BE A PART-QUALIFIED ACCOUNTANT, PART-QUALIFIED DATA SCIENTIST AND PART-QUALIFIED LAWYER //

**MARCUS SCOTT,
CHIEF OPERATING
OFFICER, THECITYUK**

other sectors in the economy. TheCityUK said: “As the digitalisation of the economy matures, many of the required [digital] skills are common across all sectors. We are competing with the rest of the economy for skills such as data science, machine learning, user experience and cyber. These skills are in short supply versus the increasing demand. It is often those skills seen as ‘soft skills’ which are the differentiators for successful challengers: adaptability, resilience, disruptive thinking, curiosity, customer rapport. We need to develop those behaviours quickly.”

There is evidence that companies, educators and other organisations are also responding. Employers are starting to realise that they need to invest in upskilling and reskilling – teaching additional and new skills to their current workforce. Mark highlights Fidelity International, HSBC and Barclays as examples of financial institutions that are providing opportunities for self-guided learning to their employees. For example, Barclays has partnered up those of its employees it says are digitally empowered with less confident colleagues. It has some 16,000 ‘digital eagles’ who help colleagues to become more proficient with digital techniques.

Fidelity’s chief people officer, Sally Nelson, explains that the company has recently introduced LinkedIn Learning,

“which offers on-demand, experiential learning delivered in a multitude of formats to suit our varied learning approaches. It’s really interesting to see what employees are selecting: recently the most popular included courses on speed-reading tips, learning to code with Python, and ‘disrupting yourself’.” Sally explains that Fidelity has also embraced opportunities to ‘gamify’ learning.



**of 225 retail banks,
102 had business
applications that
will be impacted by
artificial intelligence**

A Fidelity Cryptoleague, which was recently started by employees in Gurgaon, India, has proved to be a big hit with the global workforce, with over 1,200 people participating out of a total employee base of just under 8,000. “The purpose of this game was to have fun and learn about crypto tokens trading in a market-like environment without exposing any real money,” Sally explains.

In 2018, HSBC launched a recruitment drive for more than 1,000 digital roles, including user interface designers, digital product managers, software engineers, solution architects, exploratory testers and delivery managers. Marcus says: “Fundamentally, this is our problem to solve. We have to own this and solve it and we can’t rely on someone waving a magic wand and transforming the situation for us.”

However, it can also be argued that technologists in the sector need to bear some responsibility, in terms of better understanding the workings of finance, in order to aid the drive for digital skills in the fintech era. Michael Mainelli, Chartered FCSI (read his profile on pp.30–33) co-founder and director of City-based commercial think tank Z/Yen, believes that both sides must shoulder the burden of accountability in order to achieve a “proper understanding of the biggest revolution going”.

Nathalie Bourquenoud, head of human development of the Mobilière Group, the Swiss insurance firm, says: “We currently have several projects for the digitisation of the training of our employees. The goal is

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for them to be able to learn anywhere, anytime, but also according to their needs and at their own pace. The meaning of the word ‘learning’ is changing. Knowledge is available everywhere and we want to have fun in order to stimulate our curiosity.” She says they need to be open to innovation, and to be able to adapt easily to change. This involves encouraging them to develop what distinguishes them from a machine, “in other words, their creativity and social skills”.

Soft skills crucial

In a detailed report by the financial giant Citi, *Technology at work v4.0*, Ronit Ghose, Citi’s global head of banks research, says that generic roles such as administrative assistant, salesperson, banker and manager are declining and specialist roles such as data analyst, finance analyst and software engineer are rising.

“In retail and commercial banking, under influence from rising competition from new entrants from the fintech and big tech [technology giants such as Amazon and Google] worlds, there is an increasing demand for employees that have advanced skills in design thinking, data forensics and behavioural science,” he says. However, he also points out that while a large swath of jobs will be transformed, jobs which will not be substituted using data analytics and automation will converge into new roles that require more judgement and creativity.

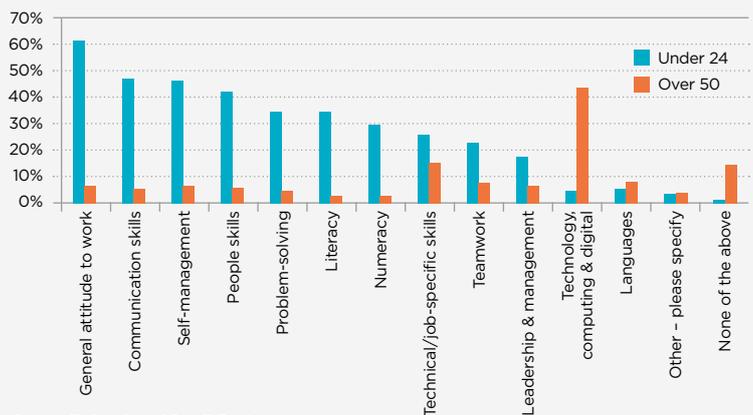


Only 53%
of financial services firms are training employees in digital skills

Many will find they need soft skills to work alongside fintech and AI. These include adaptability, empathy, resilience, constructive thinking, curiosity, customer focus and rapport, and an ability to manage a diverse team, including specialists, generalists, contractors and homeworkers. In its interim report, the FSST says that managers will need to cultivate virtual teams, and place greater emphasis on soft skills. In recognition of this need, the CISI’s Professional Refresher online

FIGURE 3: YOUNGER GENERATIONS LACK SOFT SKILLS

Respondents were asked: when recruiting, which skills, in your view, are most commonly lacking in candidates?



Source: Federation of Small Businesses

training solution offers plenty of scope when it comes to boosting soft skills, with modules including Influencing Teams and Problem Solving focusing on things such as creative thinking and emotional intelligence.

According to research by Capgemini and LinkedIn in 2017, more employers globally (59%) say that their organisation lacks employees who possess soft digital skills than hard digital skills (51%). The two soft digital skills in most demand are customer-centricity and passion for learning. An earlier report by the Federation of Small Businesses – *Reassured, optimised, transformed* – finds that while those under 24 have good digital skills, they lack soft skills such as communication, problem-solving and teamwork (see figure 3, above).

Successfully merging digital and soft skills will often come down to identifying tasks that AI can do and humans cannot, and vice versa, Marcus says. He gives an anecdotal example of a global US-headquartered bank where, several years ago, about 4,000 people were investigating false positives – potential frauds identified by computers that turned out not to be fraud – at any one time.

“The algorithms were unsophisticated and could not tell what genuine fraud was. Imagine if you redeploy those people to investigate genuine fraud and provide evidence to prosecute in a court of law. The challenge is to take people off what they are doing now and retask them on other things that are more important to the business. There is only so much you

// BY ASSESSING NOW WHAT SKILLS ARE NEEDED FOR THE FUTURE, WE CAN PUT IN PLACE THE RIGHT MEASURES TODAY TO MAKE SURE OUR EDUCATION SYSTEM CAN DELIVER THE SKILLS WE NEED TOMORROW //

ALDERMAN PETER ESTLIN, LORD MAYOR OF LONDON

can automate, and the rest has to come from human skills.”

Marcus says in five years’ time the most valuable employee may be a part-qualified accountant, part-qualified data scientist and part-qualified lawyer. “A combination of those things will give them everything in one person.

“Soft skills are misnamed because they are fundamental now,” Marcus says. “We used to think they were acquired by osmosis, but a lot of those things can, should and must be taught.”

Sector solutions

The City of London is looking to create a British version of the Coalition for Digital Intelligence (CDI) – an alliance of the DQ Institute, Organisation for Economic Cooperation and Development (OECD) and the Institute of Electrical and Electronics Engineers – hosted by the WEF.

The CDI is coordinating the implementation of a ‘DQ framework’ across the technology and education sectors. DQ is also the abbreviation for digital intelligence that advocates believe should rank alongside IQ (intelligence quotient) and EQ (emotional intelligence).

Alderman Estlin is using his mayoral programme to solicit interest in a UK CDI to help organisations advance their digital intelligence and promote a common understanding of digital literacy and skills. The Mayor is engaging with private sector firms ahead of an update expected this autumn. His ‘Shaping tomorrow’s City today’ mayoral agenda centres on promoting innovation and technology, championing digital skills and addressing digital and social inclusion.

“Businesses and civil society organisations spend huge amounts of resource towards developing digital skills, but these efforts are often poorly aligned,” he says. “That’s why I am supporting work undertaken by the WEF and OECD to form a UK branch of a Coalition for Digital Intelligence, which will look to promote a common international framework for digital skills, helping the world to move collectively towards universal digital intelligence.”

Focus on high-tech

Within financial services, areas where demand for skills are expected to be strong will be those driven by technology such as AI, augmented reality (AR) and blockchain, according to TheCityUK.

// NEW BUSINESSES WHICH RELY ON HIGHLY SKILLED TALENT ARE EMERGING EVERY DAY, AND WE MUST ACT NOW TO FUTURE-PROOF THE SECTOR AND FUEL THE TALENT PIPELINE //

CHARLOTTE CROSSWELL, CEO, INNOVATE FINANCE

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CASE STUDY HELPING COLLEAGUES TO FUTURE-PROOF THEIR CAREERS



RBS International, the Jersey-headquartered banking arm of the Royal Bank of Scotland Group, has embarked on a digital transformation journey focusing

on its overall customer experience.

While the bank can leverage some digital functionality offered by its parent, it also needs people on the ground, fully focused on developing products and experiences that are unique to the places it operates in.

“Many customers are expecting immediacy of fulfilment through their mobile or online and as a bank we need to create products and processes that cater for customers,” says Richard Bolingbroke, RBS

International managing director of customer experience.

He admits it is hard for Jersey to attract top graduates in computer science and technical degrees in the face of competition from big tech firms such as Google and Amazon, but says the bank has found other ways to develop the technology it needs.

“The days of banks just doing everything themselves – building, designing and offering the full IT suite – are long gone,” he says. “By collaborating with fintechs, both locally and internationally, we are able to develop the tech side so we can provide those services to our customers.”

For its in-house team, Richard looks for colleagues with a broader capability skill-set to build a team with the skills needed to exploit

the new technology and augment it. “You find you are building teams of people who can understand and almost forward plan careers and who are agile and can anticipate change before it happens.

“Over the past three months I have been recruiting customer journey managers and agile change experts – jobs that six, 12 or 18 months ago did not exist. We are seeing a fundamental shift in the sort of people we need and the roles they will play in the bank.”

It also works with Digital Jersey, the government-backed agency, via their digital skills partnership to provide sector placements for aspirant students. “As a bank we recognise the role we have to play for everyone who works here to help them future-proof their own capability,” Richard says.



AI will have a huge impact on financial services by redefining how people work by changing the processes behind financial transactions, what sort of products and services they sell and how firms interact with their customers and employees. In 2017, Deloitte looked at 225 retail banks globally and identified 102 business applications that would be impacted by AI.

AR allows financial services providers to overlay digital layers onto a real-world environment, most commonly by using the cameras built into a mobile device. For example, the National Bank of Oman has an AR app that enables customers to locate their nearest branch or ATM. BBVA of Spain has unveiled Valora View, the first app in the European banking sector using AR to help prospective buyers or renters find a home.

Education, education, education

Educators are beginning to realise that they need to start laying the groundwork to ensure people leaving school, college and university are well prepared.

As Alderman Estlin said in his Mansion House speech in January 2019, “By assessing now what skills are needed for the future, we can put in place the right measures today to make sure our education system can deliver the skills we need tomorrow.”

Greg Wade, policy manager for skills at Universities UK, which represents the university sector, says that at a time when Britain must ensure it has the skills it needs to deal with new economic conditions, universities are aware of the rising demand for digital skills among employers and students.



analytics and AI, to enable easier incorporation in other courses. Meanwhile, Manchester University is one of the few in the country that has a full AI degree.

However, our online report highlights research by Jisc, a national research and education network, which finds that only half of further and higher education students believe their courses have prepared them sufficiently for the digital workplace, while almost a third say they have not been informed which digital skills they need to improve. This is despite more than four out of five (82%) saying that digital skills are important in their chosen career.

Many initiatives that have emerged from the UK government’s digital strategy have focused on education. It has invested £20m to launch the Institute of Coding and, in 2017, it helped launch the Institute of Apprenticeships, which became the Institute for Apprenticeships and Technical Education when it took on responsibility for the new T level

// FIRMS AND EMPLOYEES MUST ENSURE THEY HAVE THE SOFT SKILLS - COMMUNICATION, EMPATHY AND LEADERSHIP - THAT WILL ENSURE THEY CAN WORK ALONGSIDE AND FULLY EXPLOIT THE ADVANTAGES THAT INNOVATIONS SUCH AS AI AND AR CAN BRING //



5.8m

adults in the UK have never used the internet

“There are good examples across many universities of taking strides to meet that demand, both by offering innovative courses and by ensuring that digital skills are increasingly embedded into courses,” he says.

A leading example is Imperial College London, which has modularised significant amounts of undergraduate content, including on coding, data



IMAGE: ISTOCK

programme in January 2019. T levels, which the UK will introduce in September 2020, are two-year courses that follow GCSEs and are equivalent to three A levels. Developed in collaboration with employers, the new qualifications are designed to meet the needs of businesses and prepare students for work.

There are 18 apprenticeships that have been approved for use in the digital sector. They range from cyber intrusion analyst, which involves detecting breaches in network security, to data analyst, software developer and network engineer. There were 7,550 enrolments onto apprenticeships in the digital sector in 2017/18 – up from 800 in 2015/16.

The digital T levels are in the development phase and scheduled to be rolled out from 2020. The first digital T levels – digital production, design and development – will be available then, with digital support services and digital business services available from September 2021.

Weiyen Hung, Chartered FCSI, chair of the T Level Financial Panel in the legal, financial and accounting pathway, says that when the panel was designing the financial T level content, ensuring students had the digital skills that will make them ready for the future was critical. “This includes awareness of digital technology and its associated risks, and latest advances in fintech,” he says. “We want our future talent to be comfortable deploying their digital skills to better serve the needs of customers.”

Action is also being taken at secondary school level. The City of London Academy school in Islington, UK, is running a pilot programme with 165 year 7 pupils of formal and informal learning activities to develop their digital skills. If successful, this pilot will be rolled out to the nearby City of London Academy Highbury Grove in 2020. The drive to improve digital skills in schools has also been fronted by the ECDL Foundation, an international organisation that seeks to raise digital competence standards in education, the workforce and society. In Austria, the Ministry of Education has implemented the ECDL programme – the world’s leading computer skills certification – in 800 schools, while in Romania ECDL forms part of final school exams. Such measures are vital to improving digital literacy.

After all, even if young people don’t need digital skills currently, they will need them in the digital age that the world stands on the cusp of.

In March 2019, Innovate Finance, which represents the fintech sector, launched its FinTech for Schools Initiative, designed to inspire the next generation of fintech leaders and raise young people’s ambitions for innovation in financial services. Its CEO, Charlotte Crosswell, said, “We are committed to working with schools, universities and our larger financial institutions on their school engagement programmes to ensure a bright future for all.”



“A fundamentally different skill set is needed for us to cope with, and thrive in, today’s digital landscape”

Local social enterprises are also seeking to fill the gap. The London-based National College for Digital Skills is a specialist institution set up by former teachers. The college seeks to enable its students to progress into highly skilled, computing-related roles. It aims to use digital skills to drive social mobility and promote diversity, with a target of 2,000 students by 2021, of which half will be women and half from low-income households. Partners include Bank of America Merrill Lynch, Deloitte Digital, Gamesys and IBM.

Given the advent of innovations such as Libra from digitally native companies, financial services employers, educators and workers will need to ensure they can answer Alderman Estlin’s question “RUDQ?” in the affirmative. In order to future-proof themselves against constant technological change, firms and their current and prospective employees must ensure they have not only the latest digital skills but also the soft skills – communication, empathy and leadership – that will ensure they can both work alongside but also fully exploit the advantages that innovations such as AI and AR can bring. As Estlin concluded: “A fundamentally different skill set is needed for us to cope with, and thrive in, today’s digital landscape.” ●



Home is where the heart is

LIFETIME MORTGAGES ARE AN OPTION FOR ASSET-RICH, CASH-POOR CLIENTS WHO MIGHT BE STRUGGLING TO FUND LATER LIFE OBJECTIVES. WHERE DOES CONSIDERATION FOR THEM FIT INTO A FINANCIAL PLANNER'S RELATIONSHIP WITH CLIENTS? **GILL WADSWORTH** REPORTS

IMAGE: SALLY ELFORD / IKON

The UK has an ageing population. According to charity Age UK, by 2030 more than 20% of the population will be aged over 65 and represent a significant market segment for financial planners. Growing old can present the idea of downsizing, due to many reasons, such as the cost of running a property, appropriate access, and simply not needing as much space. Some living in large homes may not want or need to downsize, but for some it could mean that there is a large amount of illiquid capital in their portfolio if the property is included, which could cause cashflow problems later. How should clients be advised on this, and how can innovative products help achieve a client's objectives?

The financial planning demands of this client base are varied and complex, and are not confined to pensions. Financial planners do not expect to simply recommend downsizing as a solution to freeing up cash. Some elderly occupants may require wheelchair access, or proximity to facilities, which makes it more challenging to find a suitable alternative to their current home. The ageing population has – according to research by the London-based Centre for the Study of Financial Innovation – exposed a shortage of suitable housing for over-55s.

Financial planners are reviewing the newer equity release products as a source of possible solutions. Lifetime mortgages fall under this equity release umbrella.

Aimed at the over-55s and regulated by the FCA, a lifetime mortgage is a debt secured against a percentage of the home that is repaid along with any interest on the death of the borrower (or last borrower if a joint mortgage). The house will usually need to be sold, but surviving family can repay the debt without a sale if they have the available funds. Borrowers can choose to ring-fence a portion of the property's value to pass to loved ones.

Typically, lenders require that borrowers stay in the home and maintain the property. If they choose to move out, the home is sold and normally the debt is repaid at that point, but lenders may also allow the debt to transfer to a new property.

Such products are proving increasingly popular. Figures published in April 2019 by the Equity Release Council, which registers reputable providers, show that the sector enjoyed the biggest annual increase in customer numbers during 2018, compared to other equity release products. According to the Equity Release Council, there were 46,379 new lifetime mortgages taken out in 2018 compared to 37,014 the previous year – an increase of 25%.

Lifetime mortgage options

There are different kinds of lifetime mortgages, but they usually fall into two distinct types. One is an interest roll-up mortgage, where a lump sum or regular amount is paid, against which interest is charged and added to the loan. The amount borrowed, including the rolled-up interest, is repaid only when the home is sold. The second type is an interest-paying mortgage, which provides a lump sum and borrowers make monthly or ad hoc payments. Some plans also allow borrowers to pay off capital as well as interest.

Simon Chalk, founder of equity release specialist Laterliving now! and member of the advisory board of the Society of Later Life Advisers (SOLLA), says: “There are lots of providers and products. Clients can pay some of the interest, all of the interest and some of the capital back. In a way, clients can create or design their own mortgage to shape their needs and budget.”

Other equity release options that differ from lifetime mortgages include home reversion products, where the homeowner sells all or a share of their home – rather than borrows – in exchange for a lump sum of money or a lifetime of regular income, while retaining ownership of the remaining share. This differs from

a lifetime mortgage in that the owner has relinquished ownership of all or a share of their home. However, no interest is charged under this option, and when the homeowner dies or requires long-term care due to ill health and goes into a residential or nursing home, the property is sold and the provider receives their share of the sale proceeds, based on the share that has been sold to them.

With a home reversion plan, the client knows precisely what they have parted with and, equally, what has been ring-fenced for later use, possibly to leave in a will to specific family members.

However, home reversion means selling either all or part of the value of the home to someone else, usually at a discounted price. It is not possible to benefit from appreciation in house prices for the part that has been sold, once the deal is done, and should the homeowner die early, their estate has effectively lost out on escalation in value of that proportion of that asset. Consequently, these types of options are largely seen as less favourable than a lifetime mortgage, which provides more flexibility (see Table 1).

While enjoying a renaissance, it has been a long journey for equity release products, which suffered a collapse in reputation towards the end of the 1980s. According to a 2001 report commissioned by the Council of Mortgage Lenders, the early equity release days of the 1980s and very early 1990s saw some borrowers use their loans to invest in stock market-related investment bonds, which were supposed to pay enough income to cover the mortgage and provide an additional payment for investors.

// IT HAS BEEN A LONG JOURNEY FOR EQUITY RELEASE PRODUCTS //

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TABLE 1: LIFETIME MORTGAGES: PROS AND CONS

Pros	Cons
No negative equity guarantee	Compounding interest rates mean the debt will grow substantially
No need to move	No other debts can be secured against the property
Able to sell house and transfer debt	It may be expensive to repay the debt if borrowers want to exit the contract
Flexible borrowing	Increasing income through borrowing may affect benefits
Current low interest rates	Borrowers usually must be over the age of 55, but some lenders will demand that borrowers are over 60 years old
No need to make repayments if rolled-up mortgage taken	
Can be used to manage inheritance tax bill	
No maximum age limit	

Source: *Just Retirement*

LIFETIME MORTGAGE CASE STUDY

Cedar House Financial Services recently recommended a lifetime mortgage for a 73-year-old widowed client with a terminal illness. The client had an interest-only mortgage that had matured, along with £200,000 of additional secured and unsecured borrowing.

She was not in a position to downsize and could no longer afford to meet her monthly commitments. Her creditors began threatening legal action to retrieve their debts. We were able to arrange a lifetime

mortgage for our client, using her current medical condition to obtain an enhanced facility on the new lifetime mortgage. The funds raised paid off all creditors, with an excess lump sum going towards care fees at home. Most importantly, the client’s mental wellbeing significantly improved, with the pressure from her creditors removed instantly.

Richard Kafton CFP™ Chartered MCSI is managing director of Cedar House Financial Services and an accredited member of SOLLA.

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However, subsequent work by MPs and the insurance ombudsman revealed that such loans were taken unadvised and borrowers were encouraged by salespeople to enter the deals. These bonds failed to deliver following the stock market crash of 1988, just at the point at which house prices fell and interest rates rose on mortgages, leaving people saddled with debt. This resulted in some homeowners being effectively trapped in their homes as it was financially unviable to sell up and move. This caused many homeowners a great deal of distress at a time when they would have reasonably been expecting to be enjoying their retirement.

That all changed in 1991 with the formation of trade body Safe Home Income Plans – now the Equity Release Council – which imposed standards to protect borrowers (see box on page 29).

Roger Jackson CFP™ Chartered MCSI, director of financial planning at Financial Management Bureau, says that, as a result of these changes, lifetime mortgages are much more weighted in favour of the borrower than the equity release products pre-1991.

Suitable borrowers

However, that does not mean lifetime mortgages are considered suitable for everyone. Roger says the products are typically limited to clients in need of extra income and the only asset against which they can raise cash is their home.

“The types of people opting for lifetime mortgages are those who are asset rich and cash poor. They have lots of equity in their

home but not much in the bank. People usually only borrow against their homes as a last resort,” he adds.

Consequently, it is unusual for a financial planner to work with clients solely in need of a lifetime mortgage. These products are usually part of a specialist equity release adviser’s remit.

Craig Palfrey CFP™ Chartered MCSI, managing partner at Penguin Wealth, explains that there is “only so much financial planning one can do” in a situation where a client only has a house and a limited income.

Keeping it in the family

In cases where people want to borrow together, joint lifetime mortgages work in the same way as they do for individuals. Certain criteria must be met, notably that both applicants are of eligible age. The amount available to borrow may be limited to the youngest person on the deeds, both applicants must be the homeowners, and they should be married, civil partners or living as partners.

Joint lifetime mortgages do not have to be repaid until the second person on the mortgage either dies or moves into long-term care. However, there are issues to be considered, specifically covering the costs of long-term care of both borrowers. Local authorities do means testing to check eligibility for help towards long-term care costs, and homes are an eligible asset.

However, if one of the homeowners still resides in the property, the local authority will not take the house into consideration as part of funding for long-term care. Cash is taken into consideration, however, which means any equity released from the home would be taken into account in local authority assessments and might need to be used by borrowers to pay the care costs.

Financial planners need to do thorough analysis to understand how the lifetime mortgage might impact long-term care funding, for example by ensuring clients only draw the cash they need and not large amounts of excess cash. They should also help clients separate cash assets according to who owns what, and make sure the local authority only takes into account each individual’s assets.

Lifetime mortgages can pay for long-term care, so long as the client stays in their home. The flexibility of taking an income as and when it is needed, or in lump sums, makes lifetime mortgages a practical way of meeting the costs of

// PEOPLE USUALLY ONLY BORROW AGAINST THEIR HOMES AS A LAST RESORT //

home care. However, it is important that clients are sure they can cover the cost of care using the lifetime mortgage and, crucially, that they know that the cost of care can increase unexpectedly.

If the borrowing requirements have changed significantly as a result of funding long-term care, the client may need support, since lifetime mortgages are not typically renegotiated. A drawdown mortgage adds flexibility and could be considered at the outset to allow borrowers to control the sums taken.

Roger says that in this kind of situation the client can only borrow a certain percentage of the equity content of the home depending on their age. Financial planners must remember that this percentage varies from provider to provider and product to product.

There are also issues with attempting to take a second lifetime mortgage. Roger says: “The mortgage provider would want a first charge on the property, rather than a second charge. Bringing another provider in may prove tricky. The client’s best option would be to return to their existing provider and see about increasing the cover level (if possible).”

Financial planners must also ensure any offspring, or those expecting to inherit the home, are made aware of the impact that a

THE EQUITY RELEASE COUNCIL'S STANDARDS TO PROTECT BORROWERS

- Interest rates should be fixed or, if they are variable, capped for the life of the loan
- Borrowers have the right to remain in their property for life or until they need to move into long-term care, provided the property is the main residence and the contract is kept
- Borrowers have the right to move to another property acceptable to the product provider as continuing security for their equity release loan
- The product must have a ‘no negative equity’ guarantee. When property is sold, and agents’ and solicitors’ fees have been paid, even if the amount left is not enough to repay the outstanding loan to the provider, neither the borrower nor their estate will be liable to pay any more.

TABLE 2: LIFETIME MORTGAGE VERSUS HOME REVERSION

Lifetime mortgage	Home reversion
It's a mortgage, but you don't usually have to make any repayments during the lifetime of the mortgage unless you choose to do so.	The provider buys a share (or all) of your property in exchange for a lump sum or regular income. Unlike a lifetime mortgage where you retain 100% ownership of the home, with home reversion you sell the property but retain the right to live there rent free, until you die or move into long-term care.
The interest on the mortgage is usually 'rolled-up' and added to the mortgage, although with some products you can choose to pay the interest if you wish.	When the property is sold, the provider receives their share of the sale proceeds, based on the share that you have sold to them.
The mortgage is usually paid back when you die or move into long-term care.	If you choose to buy back the share of the property you sold to the provider, you'd have to do so at the full market value.
Early repayment charges could apply if you choose to pay back the mortgage early.	

Source: *Just Retirement*

lifetime mortgage might have on the value of their inheritance. Unless the money released from a lifetime mortgage has been used as an early inheritance gift for children, who want to use the money to improve their financial situation, children will need their expectations managed in terms of how much must be repaid to the lender.

IHT solution

There are pitfalls to avoid when managing inheritance tax (IHT) if the lifetime mortgage is given as a gift. First, if the donor dies within seven years of the gift, it will be liable for tax, and any income from the gift may be subject to capital gains tax. Second, since the homeowners remain in the property, passing on the wealth to family may be considered a gift with reversion of benefit and liable to IHT.

The product can also be useful when financial planning for IHT mitigation. If clients choose to borrow against their property and pass the cash to loved ones before they die, this has the benefit of reducing the size of the estate and could reduce IHT, which is payable on estates worth £325,000 and above for individuals and £650,000 for couples. There is an additional ‘top-up’ IHT break of £125,000, known as the residence nil rate band, available on homes passed to direct descendants on deaths after 6 April 2017.

However, any such gifts are only exempt from IHT if the donor survives for a period of seven years from the date of the gift. In addition, as the debt increases thanks to rising interest, the estate reduces still further.

Craig says he has arranged lifetime mortgages as part of IHT planning to

help parents provide for their grown-up children, but says equity release is not a “go-to IHT planning solution”.

Last port of call

Simon agrees that lifetime mortgages are a rare occurrence in conversations with clients and recommends calling on other sources of capital before borrowing against a home.

“People should delay equity release as long as possible. If they have a decent amount in the bank, say a five-figure sum, that should be used as a priority. Even with low interest rates, a debt against the home is going to build up over time,” he says.

Craig says that he prefers to talk to clients about downsizing rather than borrowing against equity release, arguing that because of compounding interest, the debt grows quickly.

However, Roger notes that there are occasions when individuals are so emotionally invested in their homes, or there are practical reasons why moving is undesirable, that lifetime mortgages are a viable option.

He says: “You can recommend downsizing, but clients may have spent 30 or 40 years creating their perfect home and it can be incredibly important to them to stay. Lifetime mortgages might be a solution here.”

Lifetime mortgages are another tool in the kit for financial planners helping those in later life, but they are limited. They may yet become more sophisticated and appeal to a wider section of clients as the population ages and more solutions come to market, but, at present, these planning options are a somewhat niche solution. ●



PHOTOGRAPHY: CHARLIE SURBEY

AS ALDERMAN PROFESSOR MICHAEL MAINELLI, CHARTERED FCSI(HON) STARTS HIS TERM AS SHERIFF OF THE CITY OF LONDON, HE REFLECTS ON HIS ACHIEVEMENTS AND THE CHALLENGES FACING FINANCIAL SERVICES. **EILA MADDEN** REPORTS

The polymath

The appointment of Michael Mainelli as Sheriff of the City of London could not be better timed. As the UK government prepares to leave the European Union and venture forth on a world tour of trade negotiations, the City needs an ambassador like Michael – a multi-linguist with four passports and a natural talent for innovation at the intersection of technology and finance. This is the man who created the world’s first complete commercial digital map in 1983 at the age of 24. Google co-founders Sergey Brin and Larry Page had just turned ten and Google Maps was still a distant dream.

The financial services world best knows Michael as co-founder and director of Z/Yen, a City-based commercial think tank that he set up in partnership with Ian Harris in 1994 to “promote societal advance through better finance and technology”.

But that is just the day job. Among his many other roles, Michael has, for the past six years, been Alderman of Broad Street Ward for the City of London Corporation. In June 2019, he was elected Aldermanic Sheriff of the City of London – a position he took up on 27 September.

City sheriff

For the year-long term, he and his wife Elisabeth will live in apartments at the Old Bailey and he will be one of two sheriffs who work closely with the Central Criminal Court to promote the rule of law and England’s court and legal services, defend the City of London and oversee its taxation. Michael and his fellow Sheriff, Chris Hayward CC, have chosen ‘Primacy of the rule of law’ as their theme for 2019–2020. Michael points out that defence and taxation are vestigial duties, describing the sheriffs’ core responsibility as one of using ‘soft power’ to promote their theme, hosting numerous events at the Old Bailey, dining with judges, making speeches and chairing discussions on a

range of topics from UK urban knife crime to the business of trust.

Michael is less familiar with the world of violent crime that the Old Bailey deals in, but he does know something of anti-money laundering (AML) and ‘know your customer’ (KYC) regulations. During his time as Aldermanic Sheriff, he is hoping to explore and perhaps tackle the blockages to a stronger and simpler AML and KYC system.

Beyond this, he will support the Lord Mayor’s events in London and some around the world – Lord Mayors spend about 100 days in over 25 countries – promoting the UK in all aspects (professional, business, legal, technical and financial) as an open, tolerant and connected place to do business.

Early years

‘Open, tolerant and connected’ is how you might describe Michael’s own background, coming as he does from an ‘international’ family. He was born to an Italian American father and an Irish American mother, and his paternal grandmother was German. His family moved to Italy from the US when he was a toddler and back again when he was five years old.

He describes his childhood as “not unusual”. He liked gadgets and science. Both of his grandfathers were engineers and his father instilled in him his own love for technology, whether that was repairing cars or recording on Super 8 film. It was also the era of the moon landing and Michael was a self-confessed “space kid”, memorising the amount of thrust Apollo had in each stage, the points at which the boosters decoupled, and the timing of re-entries.

In his mid-teens, he won a scholarship to work in a defence factory with top secret clearance to install computer guidance systems in missiles. By his own admission, it sounds fanciful. “Nobody will ever believe these stories,” he jokes. Watching footage from a camera flying over the missile testing model, it occurred to him that that process could be digitised. He had already used a

// THIS IS THE MAN WHO CREATED THE WORLD’S FIRST COMPLETE COMMERCIAL DIGITAL MAP IN 1983 AT THE AGE OF 24 //

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>> digital computer in high school and put that experience to good use moving analogue missile guidance systems into digital circuitry.

Harvard University

The next stop was Harvard University, where he applied for a part-time job at the Harvard Laboratory for Computer Graphics and Spatial Analysis. The lab was in search of computer programmers who understood graphics. Michael got the job even though it was advertised as a postgraduate research position and he was in the first month of his first year at university.

Although he didn't know it at the time, Michael was building himself a reputation as one of the world's top computer cartography experts. In the summer of 1979, contemplating how he was going to fund his third year at Harvard, he was invited to work at Petroconsultants in Geneva, Switzerland, now part of IHS Markit. It was at Petroconsultants that he finally realised his vision of creating the world's first commercial global digital map via Geodat – a project that he initiated and became director of. This post, based in the group's London office, was Michael's first job in the UK.

Getting technical

Digital cartography devastated draughting and cartography posts in the oil industry. "We were sort of single-handedly responsible for thousands of job losses," Michael says. That side effect of his vision taught him a valuable lesson: get technical fast.

True to this lesson, Michael insists that every professional who joins Z/Yen but hasn't programmed must complete the freely available Harvard Introduction to Computer Science course. "That's my point about getting technical," he says. "I don't want you to be familiar with computers; I want you to actually have studied them to the depth that you could, in theory, program them. Computing is a thinking discipline essential to modern business, just as finance, law, or management is."

He believes that society needs to take a similar approach to understanding finance. "While we talk a lot about financial inclusion and lecture citizens on how to balance their chequebooks, we don't teach them about how finance works," he argues. On financial inclusion courses, for example, he wants to see students, at least once, calculating an option value. They wouldn't have to get to grips with the maths behind it, but they could begin to understand how price volatility in the future compared with price changes today begin to influence behaviour. "This is how you learn about the

// WITH A LOT OF FORTITUDE AND A BIT OF LUCK, A PERIOD OF CHANGE WILL OPEN UP SIGNIFICANT OPPORTUNITIES //

origins of financial instability and why you need to balance that chequebook," Michael says, adding, "We're struggling to come up with something that gets people 'beneath the bonnet' of money."

For those in the financial services sector, his expectations are even higher. To survive the fintech revolution, technologists in the sector need to understand the workings of finance and vice versa.

High achiever

For most people, creating the world's first complete digital mapping source might be enough achievement. But not for Michael. He went on to launch start-ups specialising in seismology, digital cartography, and energy information, before a spell in management consultancy, first with Arthur Andersen and then as a partner in BDO Binder Hamlyn. Next came the UK Civil Service, where he served as a director of Europe's largest research and development organisation – the Ministry of Defence's (MoD) Defence Evaluation and Research Agency (DERA). Michael helped to transform DERA's external sales into a £100m business that was eventually privatised.

Michael has been involved in many more privatisations of public services, including North West Electricity Board, South West Water, MoD spin offs, British Telecom spin offs and Nuclear Electric, as well as overseas privatisations in Hong Kong, Eastern Europe and Australia. How did he feel, then, to watch some of Britain's banking giants move into public hands during the financial crisis?

CV

- 2019** Aldermanic Sheriff of the City of London
- 2018** Honorary Fellow of the Chartered Institute for Securities & Investment
- 2013** Alderman of the City of London
- 2008** Visiting professor, London School of Economics
- 2006** Commissioner, London Waterways Commission of the Greater London Authority
- 2005** Mercers' Memorial School Professor of Commerce, Gresham College; non-executive director of the UK Accreditation Service
- 2004** Graduates from the London School of Economics with a PhD in Mathematics, Statistics, and Information Systems
- 1995** Co-founder Z/Yen Group; corporate development director, Defence Evaluation and Research Agency
- 1988** Partner and main board member, BDO Binder Hamlyn
- 1985** Senior manager, Accenture
- 1984** Graduates from Harvard University with a BA in Government with Physics, Mathematics and Economics
- 1979** Geodat project director and Petroconsultants general manager

Although he is a great advocate of privatisation, he believes it only works when there is adequate competition. He attributes many of the problems in British retail banking to the “oligopoly” of five banks that control 85% of the market. There is, he says, just not enough competition in the retail banking sector: “We don’t like to talk about it but 75% of the banking sector in Britain was on life support.”

Michael points out that the three countries that suffered systemic retail banking crises – Ireland, Iceland and the UK – had banking markets dominated by less than a handful of banks. America’s retail banking system, with nearly 8,000 banks at the time, did not have a systemic crisis, nor did Germany, with its 1,800 banks. “Both of them could handle banks failing,” says Michael. “In fact, it happened every year. It wasn’t an unusual thing.”

Co-founding Z/Yen

At the time that Michael joined the MoD, he also co-founded Z/Yen as a vehicle to explore something he was passionate about and went on to tackle as a PhD student, studying mathematics, statistics and information systems at the London School of Economics – the application of risk/reward methodologies as an analytical tool. Z/Yen aims to help clients to enhance reward, reduce risk and increase certainty through better decision-making.

More interesting, however, is Long Finance – Z/Yen’s research and events initiative that seeks to improve society’s understanding and use of finance over the long term, the ‘long term’ being a timeframe of 100 years. Long Finance has created a number of flagship research projects that are gaining traction with the financial services sector, including the Global Financial Centres Index.

In 2005, it launched the London Accord, designed to introduce policymakers and non-governmental organisations (NGOs) to financial services sector thinking on how to tackle climate change. The aim was to improve the alignment and effectiveness of public and private sector thinking and action in this area. Today, the London Accord is an open source library of 600 pieces of research, donated by more than 60 institutions, all aimed at helping policymakers understand how the financial services sector can help society to become more sustainable.

Green finance

Sustainability is an issue close to Michael’s heart and one that he has been an early advocate of – he participated in his first



climate change debate in the City in 1984. In 2017, Long Finance launched the Global Green Finance Index (GGFI), which assesses the quality and depth of green finance offerings across 110 international finance centres.

Interestingly, while Michael welcomes sponsorship of the GGFI from NGO MAVA, he is disappointed that it has struggled to attract a private sector sponsor. Does that tell him something about how ready the financial services sector is to embrace green finance?

He says the sector can be selfish in terms of avoiding self-regulation. “The LIBOR scandal took at least seven years to wake up to and people were talking about it openly, but nobody did anything,” he points out. “We have a lot of scandals because we are unclear about finance’s social purpose.”

For Michael, this really hit home soon after the 2008 financial crisis. In an interview with *Prospect* magazine, Lord Adair Turner, then head of the Financial Services Authority, had described much of the City’s activities as “socially useless” and questioned whether the City had grown too large. In the wake of the interview, an unsuspecting young banker was accosted by a TV news team in London’s Finsbury Square and asked whether banking had, in fact, become socially useless. The man had no answer.

“To be in a sector where you don’t understand your purpose is depressing,” says Michael. “I feel we need to rediscover our sense of purpose. Knowing our social

purpose gives us direction when we start talking about how finance could help to save the planet, or help to address inequality.”

Reform from within

Long Finance has sought to learn from what other sectors have done at times of loss of trust and credibility. The biggest lesson coming out of sectors such as mining and chemicals is that true reform starts from within. While the financial services sector has tried to change, Michael argues that existing initiatives have been ineffective because they have been apologist or reactive. He believes finance needs to produce and promote positive reform by starting with discussions about the very nature of financial services and what it is trying to do. He suggests the discussion might begin by focusing on the role of credit in modern society.

It is a huge and time-consuming task. Will the looming prospect of Brexit force the sector into taking its eye off the ball? Z/Yen’s Global Financial Centres Index suggests that London is taking some small Brexit-related knocks, but it is not yet a crisis.

“With a lot of fortitude and a bit of luck, a period of change will open up significant opportunities,” says Michael. “Then we must have the courage to take them. The national objective must be to reassert our reputation for pragmatism, reliability and dependability in an open and tolerant society.” Luckily for the City, as Aldermanic Sheriff, Michael will be in the front line of achieving that objective. ●

APP-BASED CHALLENGER BANKS HAVE BEEN ATTRACTING A LOT OF ATTENTION, BUT HOW MUCH OF A THREAT DO THEY REALLY POSE TO TRADITIONAL PLAYERS? **PHIL THORNTON** REPORTS

Threat or fad?

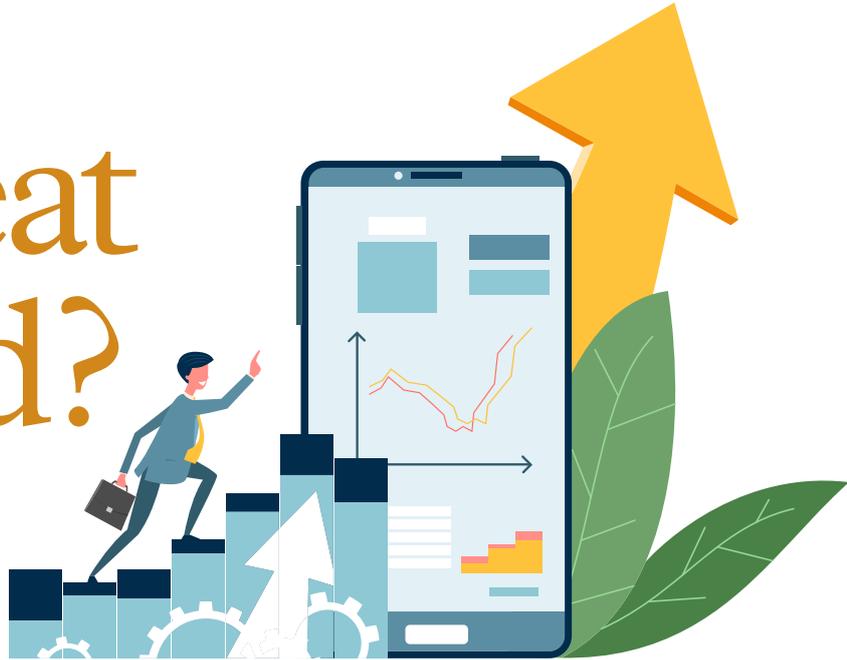


IMAGE: ISTOCK

Before the 2008 global financial crisis, most people opening a current account were likely to choose a bank familiar not just to their mum and dad, but possibly also to their great-great-great-great-grandparents.

Barclays Bank, for example, was founded in 1736, while in the US the Bank of New York (now BNY Mellon) started in 1784 and the Hongkong and Shanghai Banking Corporation (HSBC) was established in Asia in 1865. A few large banks held the lion's share of the personal current account (PCA) market in those economies.

In the wake of near-failures of several leading banks such as Lloyds Banking Group and Royal Bank of Scotland – both were bailed out by government rescue deals in the wake of the 2008 crisis – smaller players such as Metro Bank (the first institution in over a century to gain a full banking licence) and Aldermore emerged, offering customers similar retail banking services to the established banks, but with a greater focus on customer service and brand loyalty.

For example, Metro Bank branches are open until 8pm on weekdays with a

customer service agent to direct clients to the right person, and added extras such as free pens and colouring-in sets for kids, while Aldermore has an online Help Centre featuring a large number of FAQs and a wealth of personal and business savings literature and documents. Because they were seen as a challenge to the status quo, they were dubbed 'challenger banks'.

While there were a handful of these banks in 2010, FinTech Futures, a digital publishing platform for the worldwide fintech community, today identifies no fewer than 108 in the UK. Including the US, Canada, South Africa and Europe, the total rises to 245.

One reason for their emergence was a fall in customers' trust in the big banks. Back in 2013, a survey of 11,089 UK adults by YouGov and the University of Cambridge, called *Public trust in banking*, found almost three-quarters (73%) of respondents describe the reputation of banking as bad. This is the highest figure of the 26 sectors the researchers tested.

New technology

Richard Little, head of challenger banking at KPMG UK, says the public has had an appetite for a different type of bank since

// 44% OF 18- TO 65-YEAR-OLD BRITONS HAD OPENED AT LEAST ONE NEW CHALLENGER BANK ACCOUNT IN THE PAST FIVE YEARS //

the crisis. However, he highlights another driving factor behind the new banks: the emergence of financial technology or fintech. Applications developed and finessed over the past decade have enabled challenger banks to provide customers with a different offer. At its heart is mobile banking that enables customers to carry out all their transactions on their phone, which was made possible by the development of 3G, 4G and now 5G technology. One recent innovation is the ability to pay in a cheque by photographing it on your phone. Contactless payments have enabled tech companies such as Google and Apple to offer virtual wallets.

While the first wave of challenger banks, such as the aforementioned Metro Bank and Virgin Money, which was created out of the ashes of Northern Rock, used the bricks and mortar branch network of their larger rivals, more recently, banks have emerged with a digital-only platform such as Monzo (2015), Starling (2014) and Revolut (2015) in the UK and N26 (2016) in Germany.

These now well-established challengers offer a range of user-friendly innovations. Monzo, for example, recently launched a feature giving account holders the ability to gain access to their monthly salary a day early, while Starling features include payment notifications, instant card blocking and a perk that allows users to round up transactions to the nearest pound and put the change into a savings account. Revolut features include a group 'vault', which enables friends or family to pool their savings, and auto-exchange, which allows customers to automatically exchange money from one currency to another based on a target rate set by the user.

The UK has been an important launching pad because of the deep financial services base in London, but the trend has caught on globally. Dan Jones, head of digital at management and technology consultancy firm Capco's Hong Kong office, points to Hong Kong, where the regulator recently issued eight new licences for 'virtual' digital banks. "A lot of the Asia Pacific countries are now looking at what's happened in Europe and what's happening currently in Hong Kong," he says. For example, Dan highlights that Singapore's central bank, the Monetary Authority of Singapore, has rubber-stamped five new digital banking licences, which will come into effect in mid-2021.

Another example can be found in China, where the app-based WeBank has been supported by technology firm

Tencent Holdings. Kakao Bank of South Korea is another notable player in the Asia Pacific markets. Elsewhere, DBS Bank has launched a mobile-only proposition in the growth markets of India and Indonesia, while Thailand-based CIMB has set up app-based digital banks in the Philippines and Malaysia.

Making inroads

While the major banks have maintained their dominant market share of PCAs at the pre-crisis share of 85% in the UK, the digital-only banks are gaining ground mainly, but not exclusively, among younger customers.

According to a survey in 2018 of 2,000 18- to 65-year-old Britons – commissioned by Crealogix, which provides technology to the fintech sector – 44% had opened at least one new challenger bank account in the past five years, increasing to almost 80% of Generation Z, those born since 1996.

Significantly, 14% of UK bank customers across all age groups have at least one mobile-only digital banking provider – with up to a third of under 37-year-olds having two or more accounts with these challenger banks.

As Richard Little points out, consumers of all ages are willing to have multiple banks rather than just relying on one, as most people would have historically done. Although he believes the challengers have made only a small dent in the big players' share, he says the trend for people to hold multiple accounts makes that impact hard to gauge.

Regulation has helped to underpin demand by giving customers the confidence to invest, including the UK's Financial Services Compensation Scheme protection of deposits up to £85,000 per UK-regulated financial institution. Following a 2013 review by the previous UK regulator, the Financial Services Authority, reforms have meant that start-ups no longer face additional capital requirements known as add-ons and scalars. These often resulted in higher initial capital requirements for start-ups than for established banks. Meanwhile, changes to the authorisation process have enabled a speedier application process for firms.

Challenger banks globally appear poised to launch fresh inroads. More than US\$2.8bn was raised by challengers between 2014 and early 2018, according to data provider FinTech Global. It says the average deal size grew from US\$7.2m in 2014 to US\$31.8m in 2018, as challenger banks require more capital to fund

customer acquisition costs and to pursue banking licences. And figures from CB Insights from August 2019 show that challengers worldwide raised US\$1.5bn in 44 deals in the first two quarters of 2019, with the year-end total set to easily surpass the previous record fundraising of US\$2.25bn in 90 deals in 2018.

The money is coming from a range of traditional and tech-specific investment houses. For example, Ualá, an Argentinian app that uses prepaid cards to bring banking to the unbanked, raised US\$44m in 2018 from investors such as Goldman Sachs Investment Partners and Tencent, and from Jefferies Financial Group, Monashees, Point72 Ventures, and Ribbit Capital.

Incumbents respond

Many banks in leading western economies have developed their own digital apps to allow for mobile banking. All of the Big Four in the UK have their own mobile banking app, whether it is Barclays, HSBC, Lloyds or NatWest.

Some incumbent banks have gone further by establishing digital-only banks. Banco Bradesco, for example, one of the largest banking and financial services companies in Brazil, launched a new digital banking platform called Next Bank in partnership with Capco in 2017. In the past two years Brazil has seen the emergence of several digital challenger banks including C6, Nubank and Neon. Citibank has set up Citi Mobile, a digital pure play option in the US, while Goldman Sachs has launched Marcus in both the UK and US.

Such responses from incumbent banks could act as a brake on the rise of digital challenger banks. While sector watchers don't doubt that new digital challenger banks will continue to come to the market, they are less willing to bet on their ability to significantly eat into the market share of the traditional players. "It will be an interesting time over the next few years to see how that pans out and whether the advancement of challenger banks continues at the pace it has done, or it plateaus," says Dan.

The developments of the past decade have shown that this sector is evolving at a rapid pace. One certainty is that it is the consumer who will be the winner, as each innovation and corporate launch comes with a new offering and a different financial experience. As the technology billionaire Bill Gates said way back in 1994: "Banking is necessary, banks are not." ●



ILLUSTRATION: JONATHAN MCHUGH/IKON

Will the levy break?

CAN RECENT CHANGES TO THE FSCS LIFEBOAT FUND, AND OTHER SECTOR INITIATIVES, HELP TO LESSEN THE STRAIN? **DOMINIC DUDLEY** REPORTS

The Financial Services Compensation Scheme (FSCS), which compensates customers of failed financial firms, announced in April this year that it would levy £532m from firms for 2019/20, an increase from £517m the previous year.

The levy is often the subject of criticism by firms that complain about the consistently high level of demands. Ian Cornwall, Chartered FCSI, director of regulation at the Personal Investment Management and Financial Advice Association (PIMFA), said: “The good firms have to pick up the tabs of the cowboys who aren’t running their business properly or of individuals who are basically ripping off clients. Whether I’m speaking to a large or a small firm, they’re all pretty gobsmacked about the cost year after year.”

Such attitudes are no surprise to FSCS, which knows its levy is often unpopular. “We recognise it can be a significant and unwelcome expense for many firms,” said recently appointed chief executive Caroline Rainbird when

announcing the 2019/20 levy distribution in early July.

The founder of a boutique financial planning firm, for example, said in mid-July that it faced a 30% increase in its levy bill for the year. “Investors need protection, but the system is broken,” tweeted Dominic Spalding, of Oxfordshire-based Expert Wealth Management.

Others have different complaints. “The bigger issue with FSCS, rather than whether the levies are the correct amount, is whether the process works quickly enough,” says Andrew Frost, director of global financial compliance firm Lawson Conner. “Perhaps the process needs to be streamlined and automated so it is more efficient.”

In response, FSCS points to the launch of its online claims service, which, according to FSCS, “now sees 95% of its claims made online, and significant reductions in claims processing times and costs”.

System tweaked

In 2017, the FCA ran a consultation exercise on the funding of FSCS, including the levy. In response to the feedback it received, the system for allocating the levies has been tweaked as of April this year.

Among the changes is a requirement for insurance and investment providers to contribute to the compensation costs that fall to intermediaries; and life, pensions and investment advisers are now grouped together as a single class. Under the current set-up, the limit for the investment intermediation class is set at £330m, including £90m from product providers; while the limit for the investment provision class is £200m.

Ian Cornwall says the way the system has been set up is broadly fair; the main problem is the amount firms are being asked to pay. “I think it’s not an unreasonable basis of allocating costs,” he says. “The issue is not how you cut the cake. It’s the size of the cake that is too large. The volume of claims hitting the fund is enormous and has been year after year.”

The FSCS outline for levy distribution for the financial year 2019/20 says some 46,000 firms will contribute to the lifeboat fund. Over half of those contributors, 59%, will pay less than £50 and around 4,500 firms will not make any contribution at all, instead receiving a rebate averaging £139. However, the bill for some is far more substantial, reaching into the millions of pounds.

This has been the case in past years, too. Hargreaves Lansdown, for example, reports a levy of £3.5m in its financial results for the year to 30 June 2018. Charles Stanley paid £1.2m in the year to March 2018 and just over £1m in the following 12-month period.

FSCS says the top 110 firms will cover 61% of that, paying an average of £3m each. These figures are estimates though, based on FSCS’s forecast of how much will be needed. FSCS chief corporate affairs officer, Alex Kuczynski, says: “It’s a bit of an art rather than a science. There’s an element of past experience, there are claims in the pipeline that we put a value to and we make an allowance for claims we think might be coming. There’s no magic formula, which is why we never come up with a perfect number. There’s always the possibility of a completely unforeseen failure.”

The levy includes management expenses of around £75m, slightly higher than the £73m in 2018. FSCS justifies the rise in its management expenses by saying it is processing more claims than before. In 2018/19, FSCS paid out £473m in compensation to 425,760 customers of failed firms. The previous year, it paid out £405m in compensation to 69,980 customers. Staff costs rose from £14.7m for the previous year to £15.6m in 2018/19, although staff numbers averaged 187 over the same period, a slight fall on the 191 average from the year before.

Other costs include FSCS press and communication expenses, which in 2018/19 were £3.5m, a slight increase on the £3.3m from the year before. Much of FSCS marketing is done by financial firms themselves, who often include information about FSCS protection in their own customer communications.

Alex says, “FSCS receives little criticism of its management costs, which reflect the levels of claims activity, and are the smaller part of the total FSCS levies. Each year we consult on the budget in January. We have had no responses in the past two years and few over previous years. FSCS’s annual Plan and Budget is reviewed by the FCA and the Prudential Regulation Authority (PRA) before publication.”

Dividing up the bill

Once the total has been calculated, FSCS applies rules set by the FCA and the PRA on how to divide the bill around the sector. This is done by activity and, with the exception of deposit-takers, there is no risk

// THE ISSUE IS NOT HOW YOU CUT THE CAKE. IT’S THE SIZE OF THE CAKE THAT IS TOO LARGE. THE VOLUME OF CLAIMS HITTING THE FUND IS ENORMOUS AND HAS BEEN YEAR AFTER YEAR //

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>> weighting within different sector classes – it is simply allocated on a flat distribution across each class. This is something FSCS has considered changing in the past.

“Whether it is possible to have a risk metric has been repeatedly looked at, but to date no solution has been identified,” says Alex. “Because the investment intermediation class is so diverse in terms of firms, it’s quite hard to come up with an easily applicable metric. So far, the FCA hasn’t been able to find a readily applicable risk-based levy approach. But it’s something that we come back to from time to time and will come back to again.”

Although there is no risk weighting, there is an upper limit for each group, which is designed to ensure the demands aren’t too onerous for any one class; any compensation requirements beyond that cap are shared around other groups.

If the amounts prove insufficient, FSCS is able to raise more through supplementary or interim levies, usually around the turn of the calendar year. On occasion, these interim charges have been substantial. Brewin Dolphin, for example, was levied an additional £6m in 2011, while Jupiter Fund Management reported a £5.2m supplementary demand the same year. More recently, Hargreaves Lansdown was charged an interim levy of £0.3m by FSCS in November 2018.

The levies have been consistently high in recent years, due to the need to compensate consumers for failing firms. Recent examples have included stockbroker Beaufort Securities, which collapsed in early 2018, leaving 17,500 clients at risk of losing their money.

However, not all failing firms are automatically covered by the scheme. FSCS only covers claims against FCA-authorized firms that have gone out of business and are unable to pay claims themselves. One recent case was London Capital & Finance (LCF), which entered administration in January 2019. FSCS initially said that it would not accept claims from LCF’s clients as the mini bonds it issued, which were used as the basis for making loans to corporate borrowers, were not an FCA-regulated activity. Then in late June it said some customers may be eligible for claims after all, as a firm linked to LCF had provided misleading advice – which is a regulated activity. FSCS revealed in early October that it has been progressing its investigation of the extent of potential claims, adding that “the LCF case is very complex [so] this may take some time [before] we can make an announcement regarding eligibility”.

Tighter regulation

One possible way to reduce the volume of claims hitting the fund could be tighter

regulation by the FCA, so that it acts before firms collapse. Some steps are being taken to improve oversight. In its strategy document published in November 2018, *FSCS into the 2020s: protecting the future*, FSCS sets out four priorities, one of which is collaborating with regulators and others in the sector to try to prevent future failures and to reduce compensation costs. “Although we have fed that back to the FCA over the years, we think we can do that more effectively,” says Alex.

In April this year, FSCS teamed up with the FCA, the Financial Ombudsman Service, the Insolvency Service and Scotland’s Accountant in Bankruptcy to set up a new mechanism to tackle firms or individuals who deliberately seek to avoid their liabilities or poor conduct history by closing down a business and then setting up again as a different legal entity – known as phoenixing. “The anti-phoenix work is already having an effect, providing a more up-to-date stream of intelligence,” says Alex, although he did not point to any specific examples. However, he says the other work to prevent future failures is likely to take longer to have an impact. “What we’re dealing with today is advice or arranging carried out over the past few years, not this year,” he explains. “So it may be a few years before you see the prevention strategy come to fruition.”

Further reforms

In the meantime, other figures in the sector continue to argue for further reforms. Some would like a more risk-based approach.

“Unregulated investments have been a key source of increases in compensation claims made on FSCS,” says Steven Cameron, pensions director at asset management firm Aegon. “We’ve previously called for those advisers recommending unregulated investments to pay higher FSCS levies. We continue to support a move to risk-based levies as a means of sharing costs more fairly across intermediaries.”

The FCA has clarified that it has no plans at the moment to reopen the levy since the changes introduced in April. “There is no fixed time for a further review,” says Alex. “We need to let this one bed down. From our point of view, it’s unhelpful to change it too often because it requires system changes and then the sector needs to become familiar with the changes.” ●



ILLUSTRATION: NEIL WEBB/IKON



PROD rules: everything in the right place

THE INTRODUCTION OF PROD RULES SHOULD IMPROVE DELIVERY OUTCOMES FOR CLIENTS, BUT TEETHING PROBLEMS STILL EXIST, AS **GILL WADSWORTH** REPORTS

The FCA's Product Intervention and Product Governance (PROD) rules came into force on 3 January 2018 and were born out of the European Markets in

Financial Instruments Directive (MiFID II). These important rules – they impose requirements rather than best practice – apply to all product providers and advisers regulating the “systems and controls that firms have in place to design, approve, market and manage products throughout the product’s lifecycle to ensure they meet the legal and regulatory requirements”.

In short, financial planners and advisers within wealth management must be sure that what they put in front of a client is genuinely going to deliver value for money.

PROD builds on MiFID II's suitability requirements for firms operating in the EU when they provide investment advice or discretionary portfolio management “to ensure that [when providing advice] any personal recommendations made or [when providing discretionary portfolio management services] any discretionary investment decisions taken on behalf of clients are suitable for each client”.

As noted, PROD applies to providers (manufacturers) and advisers (distributors), but in this article we are looking specifically at the demands on advisers/distributors. According to PROD (3.3.1), “The target market identified by distributors for each

financial instrument should be identified at a sufficiently granular level.”

The FCA does not give examples of what is meant by “sufficiently granular”, leaving it to each adviser to decide how to divide up their client base. How could advisers go about doing this?

In identifying the target market and creating a distribution strategy, PROD 3.3.11 says distributors should take into account:

- The nature of the financial instruments to be offered or recommended and how they fit with clients’ needs and risk appetite.
- The impact of charges on end clients.
- The financial strength of the manufacturer.
- Where information is available on the manufacturer’s processes, how efficiently and reliably the manufacturer will deal with the end client at the point of sale or subsequently, such as when complaints arise, claims are made, or the financial instrument reaches maturity.

Paul Resnik, co-founder of Australia-based risk tolerance house FinaMetrica, part of PlanPlus Global, says that the PROD rules demand nothing more from distributors than is expected of any business. “PROD is common sense,” he says. “The FCA is simply asking advisers and financial planners to have a clear, documented notion of who they are serving, what they are selling or advising, and why.”

// THE FCA DOES NOT GIVE EXAMPLES OF WHAT IS MEANT BY “SUFFICIENTLY GRANULAR”, LEAVING IT TO EACH ADVISER TO DECIDE HOW TO DIVIDE UP THEIR CLIENT BASE //

>>

>> **The issues with PROD**

However, research from The Lang Cat, a financial services consultancy, reveals low levels of compliance with PROD at the end of 2018, and high levels of uncertainty about compliance (see chart below). The firm published results of a question asked: Are you able to evidence (to the standard required by the new PROD rules) the suitability of products and investment services you have advised on by client segments?

In June 2018, 64 financial advisers responded, and the same questions were repeated as part of a larger survey of 223 financial advisers, with the results published in November 2018. Just 17% of respondents were able to say with certainty they were complying with PROD in June, rising to 39% in November. More than two-thirds (70%) were unsure if they were compliant when responding to the initial survey, dropping to just over half (55%) five months later.

Part of the issue may be the lack of direction from the FCA on how to segment, or indeed the need to segment at all, according to Mike Barrett, consulting director at The Lang Cat.

Mike says: “There is a misnomer about PROD where people jump to the conclusion that they have to automatically conduct a client segmentation exercise. The FCA doesn’t mention that at all. It puts distributors down that path, but the rules only require them to have conducted an analysis of target clients based on the knowledge they have of their own clients, and the material provided by manufacturers.”

Mike says this need not be a huge undertaking, since financial planners and advisers will already have clear, established relationships with their clients. Targeting will have happened organically and just needs to be documented, he explains.

However, Paul says advisers must be clear in why they are selecting – and indeed rejecting – products for their clients. He says advisers would be wise to target markets not solely based on quantitative measures, but also qualitative considerations.

Kusal Ariyawansa CFP™ Chartered MCSI, Chartered Wealth Manager and branch principal at Appleton Gerrard Private Wealth Management, says: “As an adviser and financial planner, granularity is achieved in establishing the purpose and outcome for each objective, based on the individual’s personal circumstances. Placing clients into boxes is something

I am not comfortable with, as every client is different. A meaningful financial plan is constructed in the skill and experience of the financial planner.”

For example, information on investible assets should be complemented by a clear understanding of the client’s objectives, since no two people will have identical target outcomes even if they have an identical sum to invest, says Philip Deeks, director of KPMG’s Risk & Regulatory Insight Centre.

“If one client has a windfall of £30,000 at the age of 30, they cannot be segmented in the same way as someone with a similar sum who is decumulating at retirement,” Philip says. Segmenting, then, requires both cold, hard number-crunching and a thorough understanding of individuals’ lifestyles, risk appetites and objectives, he explains.

// THE CONFUSION OVER PROD RULES BY SOME FIRMS MAY PROVE PROBLEMATIC //

Distributors may find segmentation challenging where they are working for a family that contains individual members with conflicting savings objectives.

Rory Percival, founder of Rory Percival Training and Consultancy and former technical specialist at the FCA, spoke on the topic at the CISI Financial Planning Conference in October 2019. He says PROD does not impose strict rules on segmentation. As noted, the rules only demand that segmenting be “sufficiently granular”. In other words, distributors provide enough detail as to why a product is suitable for the identified target market.

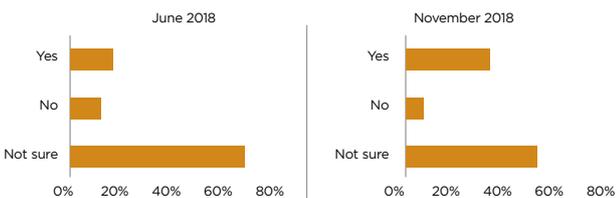
That does not mean that distributors are tied to those segments. If there are overlaps between family members, or indeed if products appear suitable to those outside the corresponding segment, distributors simply need to have a documented process to justify the advice and recommendations that they make.

Rory says, “Firms have to think about how to segment clients effectively to best group them into similar types of circumstances, so they offer similar services and platforms, but that doesn’t mean everyone in the segment is going to want or need the same things.” He believes that providing the right advice to individual clients based on their needs is more important than being restricted by segmentation. However, if done properly, “80 to 90% of clients will be suited to the products associated with their identified target market.”

This approach is reflected at Appleton Gerrard Private Wealth Management, Kusal explains: “Intergenerational planning sees a natural progression of the family’s values where a financial planner can address the three areas, starting with safety. This involves conversations around building an emergency fund or creating a savings mentality. At this stage we are often seen as a ‘coach’ because it is easy to spend more than you earn to satisfy impulse buys. Beyond savings, there needs to be a safety net via insurance that allows you to plan for the next stage, progression, which will involve sensible investing. Finally, the overall purpose of all of this is to enjoy what you have and,

A PROD IN THE RIGHT DIRECTION

Are you able to evidence (to the standard required by the new PROD rules) the suitability of products and investment services you have advised on by client segments?



Source: The Lang Cat

again, coaching becomes paramount as to how money can be best spent tax efficiently.”

Segmenting clients

As part of the initial segmenting process, Mike suggests assessing client knowledge and experience to establish whether they have managed money before and how much support they will need. Then comes investible assets, objectives and any other of the myriad criteria on which markets can be divided.

According to Nucleus Financial’s Census 2019 (p.19), of those distributors that are dividing up clients, there are on average three client segments. The most popular of the variables is the value of investments, followed by the frequency or depth of service required and then the client’s financial requirements (see chart to the right).

Nucleus Financial market insight manager Geoff Taylor describes this as sensible and manageable and says reasonable progress has been made by many distributors. However, he argues that there is still a long way to go before full compliance can be evidenced.

He adds: “Less than 20% of advisers [segment their customers based on retirement] and of those, there is no additional charge made for this proposition. This may be driven by a lack of understanding around how this sits within the PROD requirements.”

The confusion over the PROD rules by some firms may prove problematic when it comes to identifying those products deemed inappropriate. Unsuitable products are not referenced in the rules. Instead, the FCA says distributors must put forward a product “only when this is in the best interests of the client”. The interpretation of this could be that anything deemed not in a client’s best interests should be considered unsuitable.

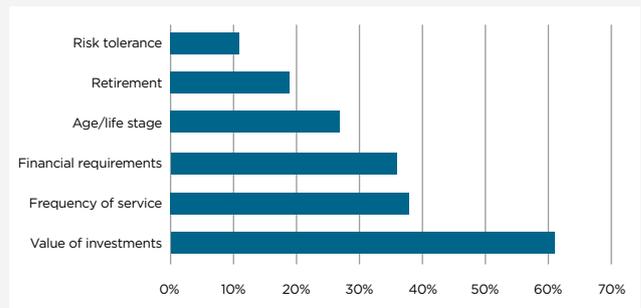
Paul Resnik says that there might be situations where products could, under certain circumstances, be sold that are not obviously in the best interests of the target market. For example, when clients do not easily fit into one segment, or if a financial planner is working with a family that has conflicting objectives and demands.

Mark de Ste Croix MCSI, head of compliance and legal at wealth management firm Raymond James, expands on this. “PROD rules provide a guide to what might be suitable but stop short of defining what is suitable. In practical terms, target market data informs an adviser on what type of client the product is likely to be suitable for, but suitability itself is defined by the circumstances of the particular client(s) and the adviser’s assessment of those circumstances. To that extent, suitability is the higher standard and, where appropriate, will override target market, though that should be rare.”

In a situation where there is a mix of complex and simplistic affairs within a family, Rory advises that PROD is about ensuring the right outcome for all clients. “When creating this structure, you always need to have in mind that there may be outlier clients, and good practice would entail explicitly highlighting certain circumstances when this could be the case and treating them appropriately.

Along with ensuring clients are presented with the right products based on a thorough understanding of their needs, PROD enables distributors to demonstrate to

WHICH VARIABLES DOES YOUR FIRM ASSESS WHEN SEGMENTING CLIENTS?



Source: Nucleus Financial Census 2019

clients, through documenting the level of ongoing service they provide, that they are delivering value for money.

Feeling the impact

Philip Deeks suggests that the impact of this on advisers’ and financial planners’ bottom lines may be twofold. First, improved efficiencies since firms will be clear in their processes, reducing the need for compliance that in turn allows people to get on with finding new business. Second, Philip says distributors may need to revisit their fee structures since they “see the service through the eyes of the client” and offer better value for money.

Rory says that, as advisers go through the PROD compliance process, it will encourage them to formalise their charging structure based on the work involved for certain client segments. Rather than simply charging a certain fee based on “what sounds about right”, advisers will be better able to assess both what it cost them to provide advice, and what the added value is to clients.

Rory says: “Some firms have selected a fee structure based on a hangover from the pre-retail distribution review days when they were paid commissions. Some advisers may have just charged what seemed a sensible figure. PROD is focusing distributors on what they do and why, which should make costing for services less arbitrary.”

Advisers and financial planners that don’t comply with the rules risk fines of up to £5m, or 10% of their annual turnover under MiFID II. There is a forthcoming review of the MiFID II rules by the FCA, but none scheduled for PROD specifically. However, this does not mean distributors are off the hook. The regulator says that the rules will only work if distributors “take them seriously” and – while it will not be drawn on how it is enforcing PROD – it expects firms to comply.

Rory explains that, if a client feels they have been short served and their adviser or financial planner cannot demonstrate compliance, that firm may find the watchdog is keen to demonstrate a bite every bit as bad as its bark. By way of example, in August 2019, the FCA issued a first supervisory notice on SVS Securities, which refers to clear breaches of PROD. According to Rory, with so few distributors complying, this is unlikely to be the last company to fall foul of these important regulations. ●



HAVING BOUNCED BACK FROM THE FINANCIAL CRISIS FASTER THAN THEIR EUROPEAN RIVALS, US INVESTMENT BANKS REMAIN WELL PLACED TO WIDEN THEIR LEAD. **PAUL GOLDEN** REPORTS

A US banking revival

The 1980s could be said to mark the starting point of the modern investment banking era in the US, with derivatives, high yield and structured products having been established and an increased emphasis placed on trading rather than deal-making.

Over the following decade, the market experienced an unprecedented initial public offering boom, while the 1999 Gramm-Leach-Bliley Act repealed the Glass-Steagall Act of 1933, which had separated investment banking from commercial banking.

The faster pace of reform in the US was welcomed by the country's investment banks, which had spent much of the previous two decades calling for deregulation and had earlier targeted Europe as a growth market at a time of US capital flow restrictions.

Europeans viewed this as an American banking invasion of Europe, explains

Professor Richard Sylla, Professor Emeritus of Economics and the former Henry Kaufman Professor of the History of Financial Institutions and Markets at New York University Stern School of Business.

"But the American banks didn't feel like invaders," he says, "more like they were escaping and had more freedom. The real story here is the weakness of the European banks. They came and operated in the US, but they never seemed to do as well as our bankers did."

The end of the party?

It seemed like the party might have ended in 2007 when the collapse of the US sub-prime mortgage market precipitated the most damaging financial crisis since the Great Depression of the 1930s. But the actions taken over the following months and years enabled the US investment banks to not only reassume their previous dominance,

IMAGE: ISTOCK

but also reinforce their global corporate financial services market primacy.

In *Searching for growth in an age of disruption*, an Oliver Wyman ‘blue paper’ published in 2019, data shows that in 2012, the market share of US banks in Europe and European banks in the US was roughly the same (31% and 29% respectively). However, by 2018 the US banks had increased their European market share to 40%, while European banks saw their US market share fall to 20% (see graph below).

// IT HAS BEEN ANOTHER TOUGH YEAR FOR INVESTMENT BANKING IN EUROPE //

The first – and most significant – difference between the US and European response to the crisis was the Troubled Asset Relief Program, which was part of the Emergency Economic Stabilization Act of 2008. Under this programme, the US government and Federal Reserve immediately and forcefully recapitalised the US banks, whereas capital issues continued to hamper European banks.

This coincided with the exposure of the European banks to the eurozone crisis that engulfed Portugal, Ireland, Greece and Spain, and further depleted the banks’ capital pools.

“We really bailed out our banks,” says Richard Sylla. “The Fed came in and bailed out AIG, which in turn bailed out Goldman Sachs and some of the others. We had major interventions under [Federal Reserve chairman Ben] Bernanke and got them back in shape as fast as we could. The Europeans had a crisis after the crisis.”

The European post-crisis regulatory backlash was also more severe. The revised Markets in Financial Instruments Directive (MiFID II) alone has a plethora of complex requirements that have improved transparency for investors, but added to the compliance burden on banks.

“Europe hasn’t slowed down in terms of regulatory implementation either, whereas the pace of reform in the US has slowed over the last couple of years,” says Virginie O’Shea, research director of Aite Group, a research and advisory firm focused on the financial services sector. (See our article and poll results regarding regulatory overstretch in Europe at cisi.org/reg-poll)

In addition, the European Central Bank (ECB) has historically been relatively restrictive on cross-border mergers and

acquisitions by European banks, which has further reinforced the scale advantage enjoyed by their counterparts in the US.

Another tough year

The bad news for European financial institutions is that it has been another tough year for investment banking in Europe. In March, the chief executive of UBS referred to “one of the worst first quarter environments in recent history” when revealing that the Swiss bank’s investment banking revenues had fallen by approximately one-third from the same period in 2018. Then in July, Deutsche Bank announced a major restructuring that will reduce headcount by around 20% and cost in excess of US\$8bn. While the move was broadly welcomed by analysts, it is expected to boost the earnings per share growth of its US-based rivals by as much as 10% next year.

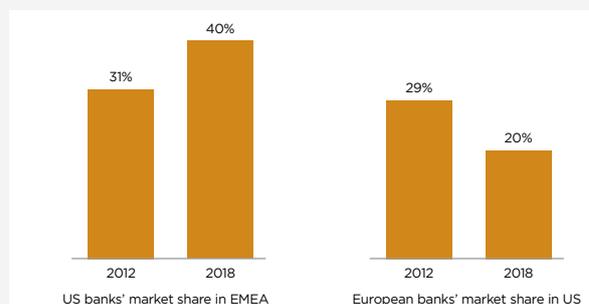
The interest rate environment also continues to favour US banks. Despite the Federal Reserve’s decision to reduce its benchmark interest rate by 0.25% in September, the US is still firmly in positive territory whereas European banks depositing with the ECB are earning a negative yield.

A research note published by Credit Suisse in early August states that, although the investment banking market share shifted slightly in favour of the European banks in Q2 2019, US investment banks still account for 62% of total trading revenue for the combined US and European share and 59% of fee income.

When lower GDP growth across many parts of Europe is added to the equation, it is easy to see why European banks are struggling to compete with their counterparts across the Atlantic, suggests Christian Edelmann, co-head of EMEA financial services at Oliver Wyman.

>>

US AND EUROPEAN BANKS’ MARKET SHARE¹ EVOLUTION, 2012–2018



Source: Oliver Wyman

US-LISTED EQUITIES VOLUMES BY BANK

Since 2007		2019*			
Rank	Lead bank (parent)	Rank	Deal value US\$ (m)	No. deals	% share
1	JPMorgan	4	14,875.17	168	9.55
2	Goldman Sachs	1	23,094.95	165	14.82
3	Bank of America Merrill Lynch	3	15,309.62	125	9.83
4	Morgan Stanley	2	17,905.04	143	11.49
5	Citi	5	12,025.68	121	7.72
6	Barclays	6	8,661.72	85	5.56
7	Credit Suisse	7	8,605.87	96	5.52
8	Deutsche Bank	10	4,746.22	48	3.05
9	Wells Fargo Securities	8	5,622.51	67	3.61
10	UBS	13	2,294.03	35	1.47
11	RBC Capital Markets	9	5,398.22	58	3.46
12	Jefferies LLC	11	4,539.07	75	2.91
13	Stifel	16	1,638.44	41	1.05
14	Cowen & Company LLC	12	2,788.36	57	1.79
15	Piper Jaffray & Co	20	1,271.28	27	0.82
16	BMO Capital Markets	22	1,132.56	24	0.73
17	Raymond James & Associates Inc	30	550.59	23	0.35
18	SVB Leerink	18	1,509.42	33	0.97
19	B Riley FBR Inc	34	461.45	6	0.30
20	HSBC	15	2,016.41	9	1.29
	Subtotal		134,446.59	486	86.29
	Total		155,813.55	664	100

*Year to date (7 August)

Source: Dealogic

// THE TOP FIVE RATED BANKS IN 2019 ARE ALL US-BASED //

>> “There are also structural considerations to take into account, such as market size and profitability,” he says. “Higher profitability also enables banks to better attract and retain talent.”

Topping the table

Data on US-listed equities volumes shows that the top five rated banks in 2019 are all US-based and that the deal value of the fifth largest US bank is 40% higher than that of the highest rated European bank (see above).

Christian notes that US banks have a dollar funding advantage because commercial, corporate and retail deposits are usually the cheapest form of funding, much of which comes through a branch network that European banks don't have on anything like the same scale in the US.

This is important because the greenback still dominates global finance. For example, most commodity contracts are settled in dollars and approximately 80% of trade finance transactions globally are financed in dollars.

The homogenous nature of the US also helps, despite the EU's best efforts to promote capital markets union – and with the UK having been the strongest supporter of capital markets union in the EU, the impetus behind this initiative may well be diluted in the event of Brexit.

“Europe doesn't really have a single banking market; it has a bunch of national banking markets,” says Richard. “They talk about it a lot, but there has not been a lot of action.”

All these factors make it hard to see how the balance of power in investment banking will shift any time soon. If the trade disputes between the US and China and the US and Europe were to escalate, Christian posits that it could become much harder for US banks to operate across Europe.

“When the current disparity in interest rates and GDP growth in favour of the US is added to the scale and profitability of the US, it is difficult to see how the competitive position of European banks will improve in the short to medium term,” he concludes. ●

“

Climate change presents an unprecedented challenge to the financial system. Financing the transition to sustainability is key to success. To tackle that, investors need transparency on what ‘sustainable’ finance frameworks mean and, in particular, on definitions ”

George Littlejohn MCSI

Not waving but drowning: navigating the oceans of ‘green finance’ speak, pp.50–51

pp.46–47

Intergenerational financial family planning

pp.48–49

The ethics of replacing an employee with a chatbot

p.52

Shedding light on the state of global stewardship

IMAGE: ISTOCK



DIANE WEITZ CFP™ CHARTERED MCSI, DIRECTOR AND FOUNDER OF ASHLEA FINANCIAL PLANNING, AND HER DAUGHTER ELEANOR CLARK, TRAINEE FINANCIAL PLANNER, EXPLAIN HOW THE FIRM IS HELPING A COUPLE AND THEIR SON ACHIEVE THEIR OBJECTIVES

Intergenerational financial planning for the family

THE BRIEF: MARY, DAVE, AND TOM

Mary (62), a retired teacher, and Dave (63), a retired town planner, are a couple who are long-standing friends of Diane. They had been her clients before, but had moved to another adviser who dealt with the teachers at Mary's school. Retirement, which represented a new phase of their lives, prompted them to approach Ashlea Financial Planning in 2013.

Mary's retirement had led to a reassessment of her investments, and a need to ensure that she and Dave would have sufficient funds to enable them to live the retirement that they had planned.

They had four objectives:

- To travel to various parts of the world.
- To maintain their lifestyle, which included living in their French house in the summer and in the family home in the UK in winter.
- To have sufficient funds to provide occasional gifts to their children to help them on their way and to mitigate inheritance tax.
- To have peace of mind that their financial affairs are in order.

Their son Tom was also a client. They had suggested he speak to Ashlea Financial Planning in 2006, after he received an inheritance from his great aunt. A portfolio of investments had been arranged for him, which was the start of his journey with the firm (see next page for his story).

Mary and Dave's financial plan, by Diane Weitz

The couple had a house in Cheltenham and a holiday home in France. Mary and her sister had two houses in Cornwall, given to them by their father. Dave's mother had died a few years previously and her estate had been distributed between her two sons. Mary's mother had also passed away, leaving some inheritance, including her house, which was eventually sold.

Their existing investments consisted of a variety of structured products with different end dates, one of which was paying them an income of 6.3%. There were some multi-asset portfolios with some ISAs held on the Skandia platform (now known as Old Mutual Wealth), and a Standard Life Insurance Bond. They both had self-invested personal pension (SIPP) investments to supplement their defined benefit pensions. These were held on different platforms.

We decided to consolidate the investments where possible onto the Transact platform. At that time Skandia did not facilitate in specie transfer, so cash was transferred. This enabled us to build an investment strategy in line with their attitude to risk.

The SIPPs both held Investec Kick-Out structured products which were due to pay out within a month. These were left in their existing platforms until the bonds paid out, when they were also transferred to the Transact platform.

The Investec structured product was left to run its

course, and when it matured, the proceeds were transferred to the Transact account, with income being generated from the ISA accounts to replace that from the structured product.

The Standard Life Insurance Bond, which was paying out 5% deferred tax income each year, was left in place.

The result

Mary and Dave now have a much clearer picture of their net worth, which has given them peace of mind that their funds will be available when they need them. They are not drawing down from their SIPP's at present. They both have good index-linked defined benefit schemes, and are now drawing their state pensions.

The financial plan has enabled them to plan to give £50,000 to each of their children over the next few years as they need it. Tom had already received his to help him renovate his first house.



DIANE WEITZ CFP™ CHARTERED MCSI

Diane started Ashlea Financial Planning in 2005, and the team now consists of eight people.

The company won the David Norton award in 2017 and achieved Chartered and Accredited status in the summer of 2018.

Diane spent many years as chair of the Cotswold branch of the Institute of Financial Planning and a year as president of the Cotswold branch of the CISI. She has resigned as president but still plays a role on the Committee.

Ashlea moved to a new office in central Cheltenham at the beginning of August.

Tom's financial plan, by Diane Weitz and Eleanor Clark

Tom met us for an initial meeting in 2006, to discuss how to deal with his inheritance money. He had decided to use the money to purchase a flat.

We invested the remaining funds using the Transact platform, with a strategy set for long-term investment.

Tom later studied to become a chef, landing a job on a private yacht. He had few expenses, a high net income, and another source of income from renting out his flat. He was in the fortunate position of being a 'Seafarer' in the eyes of HMRC, meaning he could claim for the Seafarers' Earnings Deduction (SED).

He kept his Transact account open with us and regularly deposited amounts of surplus income, utilising his ISA allowance. This was invested and as a result his Transact portfolio has seen healthy growth over time.

At one of our meetings, we discussed that he had not yet begun contributing to any pension. We put Tom onto

our cashflow software, Truth, to model the benefits of beginning pension contributions. The SED meant that he could contribute a maximum of £3,600 annually to a pension. We discussed the possibility of using a LISA as a retirement plan as well as a personal pension. Tom agreed, so we set this up and he began contributing.

Before one of his annual review meetings, we asked Tom to think about the three George Kinder questions (see cisi.org/georgekinder). The resulting goals were:

- Buy a property in town.
- Put enough money into savings to live for a year while settling in to the new property.
- Start and develop a small business involving design and lifestyle products as well as hosting events.
- Start a family.
- Continue to build up a fund for retirement, recognising that the above goals may take priority for a short time.

We explored these goals at the meeting. He was keen to sell the flat and buy a house but was concerned by how to fund this. After the meeting we updated his Truth cashflow and provided him with a cashflow report detailing each scenario.

Each scenario considered him leaving his current employment and finding work more locally. We planned holistically, looking at his tax situation, investments and pension savings, including his state pension.

Tom had nine full years on record in his state pension forecast. As he is likely to be self-employed when he returns full time, we recommended that he should register to pay the self-employed contributions to enable him to start accumulating accredited years. He has plenty of time to accrue the 35 years' contributions necessary to be eligible for the full flat rate pension.

The result

Tom had the reassurance that he could afford a house and change his job using only a small amount of savings. He found a suitable house and was able to obtain the mortgage and purchase the property. We haven't yet discussed his long-term idea of setting up a local business, but we have every confidence that he will return to us when he is ready to explore this idea further. ●



ELEANOR CLARK

Eleanor joined Ashlea Financial Planning in October 2016. She has completed her full apprenticeship and gained a distinction. She is now fully qualified to level 4 and looking forward to moving into a full adviser role.

Eleanor is passionate about educating the young about financial planning and has devised a workshop for years 5 and 6 in primary schools. This has been presented successfully to two local schools and there are plans to extend it to others in the autumn term.



WHEN A FIRM REPLACES AN EMPLOYEE WITH A CHATBOT, AT FIRST CLIENTS DON'T NOTICE THE DIFFERENCE. BUT WHEN THINGS START TO GO WRONG, SENIOR MANAGERS MUST DECIDE WHAT TO TELL CLIENTS AND THE REGULATOR

Jane Doe

// CLIENTS SAY THAT *JANE* IS UNRELIABLE, DOES NOT PROPERLY RESPOND TO THEIR QUERIES AND SEEMS RUDE AND DISMISSIVE //

Jane has worked as a customer services administrator for Identity Finance, a medium-sized wealth management firm, for five years. The job is a step down for Jane, previously head of customer relations at a prestigious firm, but, at 64, she had wanted to take on a less taxing role before she retired. Nevertheless, because of her experience and reputation for excellent customer service, Jane receives a higher than average salary.

Jane's job involves liaising with clients via email and phone – everything from booking appointments to managing complaints. Over the years, clients have come to trust and rely on Jane; she takes her responsibility as a brand ambassador seriously.

Knowing that Jane wishes to retire before 70, senior management at Identity task Sammy, the head of operations, with finding a solution for when she leaves. They can't afford to hire another person of Jane's calibre and sterling reputation, so Sammy looks for alternatives, one of which is a new chat software run by AI Made Simple. AI Made Simple's director of development assures Sammy that the service its 'chatbot' function offers is as good as the real thing and that it can 'learn' Jane's tone and preferred language, thereby providing a seamless transition for when Jane retires.

Sammy presents the idea of a chatbot to the Board, saying that it will not only replace Jane, but will also be cheaper, and

will streamline all client communications, including messaging via a chatbot on the company's website. The software can chat to more than one client at a time and will record all client satisfaction data, plus information about the types of queries, response time and how the problems are resolved. The chair of the Board is impressed, but some members express reservations about moving to AI. They cite the trust the clients have in Jane and wonder whether they will be happy speaking to a robot instead. The Board advises Sammy to ensure a smooth transition to the new program and comes up with the idea of calling the bot *Jane* so clients don't notice any difference in the service.

The software is added to the firm's system and starts to learn from human Jane. Jane's picture, with a friendly greeting message, is added to the chat function. Jane agrees to this, as she is eager to ensure a smooth transition for the clients after she retires.

Jane's last day arrives, and she is bid a heartfelt farewell. The next day, *Jane* the bot takes over. The launch seems to go well, with *Jane* proving to be efficient and helpful for clients. Nobody seems to notice they are talking to a robot.

A couple of months later, however, several complaints are received by Alfie, the head of client services, about *Jane*. Clients say that *Jane* is unreliable, does not properly respond to their queries and seems rude and

dismissive. Unaware that they have been speaking to a chatbot, clients ruefully ask Alfie to take disciplinary action against *Jane*. Alfie apologises to the clients, informs them that the matter will be dealt with and contacts AI Made Simple, which adjusts the software to fix the problems.

At its next meeting, the Board reviews the usual papers, which include information about the number of complaints received. Company policy states that complaints about staff members must be escalated to the FCA. However, despite the numerous complaints about *Jane*, the paperwork says that none have been received or reported to the regulator. Alfie explains that because *Jane* is a computer program, it does not fall under the category of staff member.

What should the chair recommend?

1. If the firm does not wish to escalate complaints about an AI program to the regulator, the complaints should be assigned to Sammy, the person responsible for finding and implementing the program, or to Alfie, the head of client services, and escalated to the FCA.
2. The chatbot should be amended to inform clients that they are talking to a robot. However, Alfie has dealt with the complaints to the satisfaction of the clients, so the FCA need not be informed on this occasion.
3. All clients should be written to, informing them that for the past two months they have not been speaking with Jane, but with a robot. A message will be put on the website noting that the *Jane* program has been running for two months and on all future communications it will be made clear that clients are speaking with a robot. The complaints will be logged, in case of a visit by an FCA supervisor.
4. *Jane* is clearly a liability. This is a failed experiment and the company should either stop using the program or hire a junior client services administrator to work alongside the bot and monitor responses. ●



WHAT WOULD YOU ADVISE?
Visit cisi.org/janedoe to share your views. The survey results and CISI's opinion will appear in the December 2019 print edition of *The Review*.

CPD (continuing professional dishonesty): The verdict

This Grey Matter, published in the July 2019 print edition of *The Review*, presents a dilemma for a CISI Chartered member, Chris, who suspects that his manager, also a Chartered MCSI, is claiming CPD for events at which she has not remained for the duration.

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

Suggested solutions and results are as follows:

1. Speak to Joe, and establish if Monica lets him know when she has had to leave training sessions early. If she does not, Chris should inform the learning and development manager that Monica has been leaving internal CPD training sessions early. (57%)
2. He should do nothing – this is not his responsibility and Monica is responsible for her own learning and development. Besides, everyone has busy periods where they are unable to dedicate huge amounts of time to attend training sessions. (5%)
3. Report his suspicions to the CISI, as they may add Monica to their next CPD audit. (18%)
4. Approach Monica and indirectly enquire about her CPD (for example, by saying “I had to leave a CPD session early last week, do I need to let anyone know?”), hoping that this will lead to a change in behaviour or perhaps even an explanation. (20%)

Responses received: 427

Chris has found himself in an awkward situation, where his position as a CISI member and an employee of Hardworking Investments (in particular, as a member of the investments team led by Monica) seem to be in conflict.

Option 4, the second most popular solution, allows Chris to gather further information from Monica before taking action. However, as one commenter astutely points out, it may lead to further trouble as “he’s going to have to lie to Monica about leaving a session early, or actually leave a session early to be able to tell the truth to Monica about doing so”.

The CISI’s CPD auditing system relies on trust, as individuals and firms upload and verify CPD records and attendance in accordance with the CISI’s motto ‘My Word is My Bond’. However, some who commented recognise that the weakness in a firm’s internal attendance logging leaves the system open to manipulation and could be tightened up in order to reduce actual or perceived misconduct.

For that reason, our recommended option is Option 1.

Should it be established that Monica has deliberately claimed CPD for events which she did not attend in full, the firm should report this to CISI so further enquiries can be made, which may result in disciplinary investigation.



IMAGE: ALAMY

“
To name things wrongly is
to add to the misfortune
of the world.”

Albert Camus, French philosopher

Not waving but drowning: navigating the oceans of ‘green finance’ speak

FOR MARK CARNEY, GOVERNOR OF THE BANK OF ENGLAND, THE “GLOBAL PROBLEM” OF CLIMATE CHANGE IS CRYSTAL CLEAR. BUT DO WE YET FULLY UNDERSTAND THE WORDS AND THE CONCEPTS?

Albert Camus did not know the worlds of green, or responsible, or sustainable, or ESG, or impact investing. But he would have empathised. The facts of climate change speak for themselves – see City View on page 5 of this issue – but the investment world is yet to arrive at a precise definition of what these many and overlapping words and concepts mean. Uncertainty abounds and unlike its cousin risk, the lifeblood of the financial world, it is not a welcome guest.

Climate change presents an unprecedented challenge to the financial system. Financing the transition to sustainability is key to success. To tackle that, investors need transparency on what ‘sustainable’ finance frameworks mean and, in particular, on definitions.

Taxonomies – classification systems – are essential to defining what we mean. Brazil, China and other countries already have their own. The EU’s High-Level Expert Group on Sustainable Finance launched a

study on the subject in 2017. In March 2018, its recommendations were incorporated into the EU’s ‘Action plan: financing sustainable growth’, which established a technical expert group (TEG) to develop an EU-wide taxonomy, a green bond standard (GBS), benchmarks for low-carbon investment strategies, and improved climate-related corporate disclosures. And in June 2019, the EU expert group published reports on a taxonomy of sustainable activities, the EU GBS and climate benchmarks, and the European Commission published guidelines on corporate climate-related information reporting.

Investors, both institutional and retail, need clear ‘labels’ tied to the coming taxonomy to ensure their money is going where they think it is. This surging business has attracted huge and growing funds, and the related baggage of unwelcome activity, such as ‘greenwashing’ and worse. Asset managers, institutional investors, and pension fund trustees also need clarity when bringing non-financial measures into

their decision-making. Retail advisers need to know how best to assess their clients' wishes in this arena. And at the other end of the scale, the issues involved have strong, tidal pulls on prudential and disclosure requirements for institutions. The latter is in the ambit of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), which is encouraging "voluntary, consistent climate-related financial risk disclosures" for use by companies in providing information to investors, lenders, insurers and other stakeholders.

Taxonomy for sustainable activities

The taxonomy starts with climate change mitigation and adaptation. At present, this does not cover social objectives, apart from minimum social safeguards for all environmentally sustainable activities. But the June proposal does commit the Commission to publish a report on the appropriateness of extending the taxonomy to other sustainability objectives, notably social ones.

In its June report, the TEG proposes some 67 activities that significantly contribute to climate change mitigation, together with relevant technical screening criteria. These cover seven sectors, including energy, transport, agriculture, manufacturing and buildings – and together present the most comprehensive classification system for sustainable activities to date. The TEG report also presents principles for climate change adaptation, which can be applied to a wide variety of sectors.

The EU green bond standard

The experts' June proposals to the Commission involve the creation of a voluntary, non-legislative GBS to "enhance the effectiveness, transparency, comparability and credibility" of the green bond market and to encourage participants to issue and invest in green bonds. It has four key strands:

- ▶ Alignment with the EU taxonomy for use of proceeds – in other words, assurance that the bond proceeds are being used appropriately.
- ▶ The publication of a green bond framework, which will confirm the (voluntary) compliance of EU green bonds with the standard, and in particular how the issuer's strategy aligns with the environmental objectives. It will also encourage the publication of details on all key aspects of proposed use of proceeds, processes and reporting.
- ▶ Following the bond issue, the report envisages mandatory reporting on use of proceeds (an allocation report) and on environmental impact (an impact report).
- ▶ A further mandate will involve verification of the green bond framework and a final allocation report by an independent third party.

The next moves on these are down to the new Commission, which starts work in November.

The importance of disclosures

Measuring the effects of climate change and translating these into hard reported figures is

another challenge. Climate and broader sustainability issues are key elements in long-term value creation. Sound information is vital if investors are to develop and maintain properly informed strategies. The TCFD report is a major milestone to set a common standard around the definition of material climate information.

Veronica Poole, Deloitte NSE head of accounting and corporate reporting, believes that "climate change is an existential threat that demands urgent attention; there can be no more 'business as usual' if companies are to protect their value, manage risks and future-proof their organisations.

"Climate change is likely to drive some of the most profound changes to businesses in our lifetimes. Impacts on products and services, supply chains, loss of asset values and market dislocation are not only being caused by more frequent and severe climate-related events, but also by the accelerating pace of policy and regulatory change."

The TCFD proposals on reporting are key to obtaining and maintaining a grip. Dr Nigel Sleight-Johnson, head of financial reporting at the Institute of Chartered Accountants in England and Wales, says: "The support of G20 governments and the distinctive approach adopted by the TCFD – focusing on communication of the financial impact of climate change on the organisation – mean that the recommendations could act as a catalyst for significant improvement in the quality and consistency of disclosures and governance." ●

*George Littlejohn MCSI, senior adviser, CISI
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Quick quiz answers:

1.A, 2.A, 3.C

THE GREENING OF EUROPE

Wherever Brexit leads, Europe has a key role to play in the development of taxonomies.

Ursula von der Leyen, president-elect of the European Commission, laid out her political guidelines this summer in a 24-page manifesto that emphasised the 'greening' of policy – including the green commitment of the newly appointed European Central Bank President Christine Lagarde.

Euro-guru Graham Bishop (see page 8) comments: "The greening of finance will be the hallmark of the next European legislative period and the Commission's 2018 proposals are now grinding their way through. These cover the framework for sustainable investment – including the key

taxonomy of definitions, corporate disclosures, green bonds and green benchmarks.

"The difficulties in creating a taxonomy of conditions to be fulfilled to avoid 'greenwashing' triggers much discussion. It is becoming apparent how wide-ranging the TEG proposals will be as banks will soon find that it becomes a part of the supervisory review and evaluation process through which regulators assess and measure the risk for each institution, to show how their loans are helping to meet the targets. Importantly, Europe may get the first-mover advantage by developing these standards first – though in consultation with other global authorities."



Ask the experts:

Effective global stewardship

While progress has been made towards more effective stewardship, the overall evidence on whether and how it is happening is mixed. **Guy Jubb**, an honorary professor at the University of Edinburgh Business School, sheds light on the state of global stewardship

What is effective stewardship, in the UK and globally?

There are many shades of investor stewardship – the nurturing of investments and the engagement with companies by investors on behalf of their clients, with a view to aligning the interests of all parties. At one end of the spectrum, some investors may be totally focused on maximising returns within a short period of time; at the other end are asset owners and managers who take a long-term view and are very concerned with good corporate governance.

In January 2019, the FCA and Financial Reporting Council (FRC) published a joint report – *Building a regulatory framework for effective stewardship*. Why did they decide to look into this issue?

While the FRC's UK Stewardship Code provides a generally accepted framework for enabling investor stewardship, it has not been backed up by effective enforcement, which is an essential ingredient for effective regulation. The FCA has responsibility for the vast majority of regulation affecting the investment sector. Therefore, it seems appropriate that it should devote more resources to embracing stewardship within its scope and, working with the FRC, strengthen the overall approach.

Many institutional investors use proxy advisory firms when voting on issues where companies seek shareholder votes, and investors often vote the same way. How do investors differentiate themselves, and why is this beneficial?

Proxy advisory agencies tend to benchmark their voting recommendations against the UK Corporate Governance Code without having a full understanding of the company's circumstances and their recommendations. This can undermine the principle of 'comply or explain', which lies at the heart of the Code. Many small investment houses do not have the resources to evaluate all the voting resolutions, so vote

in accordance with the recommendations of a proxy advisory agency. The larger investment houses tend to have dedicated in-house teams which are responsible for voting, using guidelines that are approved or supported by their clients and are applied to the particular situation. They further differentiate themselves by using different approaches to the public reporting of their engagement and voting activities. It is generally accepted that 'one size does not fit all' when it comes to investor stewardship, and this is reflected by the different approaches taken by different houses.

How do they ensure they are achieving best practice in stewardship, particularly when voting on contentious issues?

There is a reasonable degree of thoughtful scrutiny and careful consideration that is given by many (but not all) investors to a company's circumstances, with a view to

voting in the best interests of their clients, customers and beneficiaries, as appropriate.

Has any progress been made in persuading hedge funds to vote?

Hedge funds will very often not vote. However, it has to also be recognised that hedge funds will often short on shares and therefore the voting decision-making is compromised. There's a lack of transparency around where the true ownership position of institutional investors lies, and this should be addressed by regulators.

If an institutional investor is unhappy with the direction a company is taking, should they stay invested and try to influence corporate governance or walk away?

Ideally, institutional investors should engage with the company with a view to exercising their influence individually and collectively to achieve the desired change. If the company is unwilling or unable to respond in a positive way, then the investors should sell their investments in the company and be transparent as to why.

Earlier this year, the FRC consulted on proposed revisions to its Stewardship Code. What do you make of them?

The proposed new Stewardship Code is more like a checklist than a code. That said, some of the revisions are a step in the right direction. We are on the cusp of moving from the spirit of effective investor stewardship to merely Code compliance, and that may not be the best way to proceed in the long term. There should be more emphasis on regulatory monitoring of the way in which institutional investors fulfil their stewardship responsibilities, rather than just on Code compliance. ●

GUY JUBB is an honorary professor at the University of Edinburgh Business School and the former global head of governance and stewardship at Standard Life Investments.

VOTING PATTERNS ON PAY-RELATED RESOLUTIONS AT SHAREHOLDER AGMS (2014–2019)

8.8%

Average level of shareholder dissent

11%

Percentage of resolutions that attracted 'significant' dissent levels of over 20%

91%

Average percentage of approval with which resolutions were waved through

100%

Percentage of FTSE 100 company pay policies put to AGM and approved by shareholders

Source: High Pay Centre

“
Sir Thomas Gresham’s guiding hand
at the helm helped to keep England
safely afloat financially in some of the
most turbulent of times”

Sir Thomas Gresham: Tudor, trader, shipper, spy, pp.67–69

IMAGE: GETTY

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FROM THE EDITOR

THIS SECTION PROVIDES REGULATORY AND STRATEGIC INFORMATION FOR SENIOR MANAGERS. IT DESCRIBES THE POSITION AS AT 19 AUGUST 2019. THE REPORT CAN ALSO BE ACCESSED AS A PROFESSIONAL REFRESHER AT CISI.ORG/PR OR BY LOGGING IN TO MYCISI.

CHRISTOPHER BOND, CHARTERED MCSI, EDITOR, REGULATORY UPDATE,
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SOME CITY TALKING POINTS

- Changes to funds' liquidity rules after Woodford
- Dusting off preparations for business post Brexit
- Asset managers cutting costs under market and FCA pressure
- Taxation changes driving out non-domiciled individuals
- FCA reluctance to authorise cryptocurrency firms
- The FCA's campaign against claims management companies
- Regulators and clients drive on climate change
- The problems of challenger banks
- The increasing list of 'scandals' being dealt with by the FCA
- The risk of global recession
- The continuing high cost of compliance and risk in a low-volume business environment
- The LSE/Refinitiv merger and high data and benchmark costs

REGULATORY CHANGES

1. Brexit

Most relevant firms had prepared for a post-Brexit world (including the loss of the trading passport) before the original March 2019 deadline. In the summer there were other priorities, such as the Senior Managers and Certification Regime (SMCR) preparation. Now firms are refocusing on doing business after a hard Brexit. There is an overall EU/UK approach of giving temporary equivalence until March 2020 to enable EU firms to access UK/EU clearing houses such as LCH and Euroclear, and vice versa; and individual EU countries are varying their approaches to permit UK firms to do business (contrast this with France where there are no dispensations to Scandinavia, where some form of passport is often available). The expiry of the equivalence agreement between the EU and Switzerland gives a clear and recent example of what may happen to trading

in dual-listed equities – the EU banned trading in these on Swiss Exchanges, which then reciprocated. Stocks such as Novartis can now only be traded on Zurich, while stocks such as Nestlé only on an EU exchange. There are many UK/EU listed stocks such as Shell and Unilever. Much trading has also moved to alternative trading venues, such as bank-sponsored matching systems, outside the exchange rules. The UK is likely to apply for equivalence under some 40 separate EU laws, but this is a lengthy process and ultimately a political decision. A tie-up with Switzerland and possibly others, such as the US and Singapore, is an interesting possibility.

Firms' preparations include setting up subsidiaries in the EU for EU clients, using the non-solicitation rule with professional clients and moving sales teams to the EU, while keeping trading and investment management in the UK. However, this 'delegation' route has been challenged by some EU countries, such as France, which sees it as part of its call for a wholesale review of funds' rules. France is particularly keen to give the country where funds are sold (the 'host' country) more regulatory control compared with the regulator of the country where the fund is based (the 'home' country) – often Ireland or Luxembourg. Currently, the Undertakings for Collective Investment in Transferable Securities (UCITS) directive gives sole authority to the home state regulator. The EU Commission opposes this change as part of the wider debate on giving more power to national regulators to 'interpret' EU rules. This would be a reversal of the Markets in Financial Instruments Directive (MiFID) II changes towards EU-wide detailed trading rules to create a single market.

Meanwhile, the EU national authorities which have benefited from Brexit, such as Frankfurt (for banks), Dublin and Luxembourg (for funds) and Amsterdam and Paris (for a range of activities), are stepping up their requirements on new authorisations from UK firms, such as insisting on substance in decision-making staff in the new EU businesses. Long delays in authorisation, increased demands for executives to be based there and surveillance visits once started are common. However, some of these regulators lack staff with knowledge of markets and wholesale, which leads to frustration on both sides. Much revolves around the extent to which the new EU business delegates decision-making to the UK. There is a wide range of models, from minimal involvement of the UK to total control of activity by the new EU entity.

Finally, Andrew Bailey, CEO of the FCA, has said he wants to review the UK conduct rules after Brexit, to replace UK-detailed rules with wider principles where the spirit of the rules is key. He instanced the Woodford Equity Income Fund, which arranged the listing of some unlisted investments on the Guernsey International Stock Exchange to get around the UCITS investment limits on unlisted holdings. Meanwhile, firms wonder about how the FCA will view European Banking Authority guidance on outsourcing and EU rules starting in the autumn, for example the Central Securities Depositories Regulation.

2. The FCA

The FCA Board has taken the highly unusual step of deferring 60% (£40,800) of Andrew Bailey's bonus for 2018 until March 2020, when an independent review will report on the FCA's handling of London Capital & Finance (LCF), where 14,000 bond holders are at risk of losing their investment. Meanwhile, the Financial Services Compensation Scheme (FSCS) has said that it has found evidence of misselling of the bonds by LCF's marketing agent, Surge Financial, which gives hope to investors. There are other lesser troubles:

- ▶ The Complaints Commissioner (CC) has asked the FCA to take "urgent steps" to ensure staff in its supervision



REGULATORY UPDATE AUGUST 2019

unit understand the consequences of "inadequate investigation and insufficient follow-up". It arose out of a whistle blow and Financial Ombudsman Service recommendations about a regulated firm that were ignored.

- ▶ The FCA has also been told to record telephone calls between its supervision unit and firms. The CC found that it had kept no record of important conversations. The complainant claimed that the FCA had emailed him outside of normal working hours, had provided conflicting deadlines for responses and had placed a supervisor in a meeting with the enforcement unit team (which could not find records of discussions between the firm and its supervision unit).
- ▶ The time taken for the FCA to respond to CC enquiries is slowing.
- ▶ The FCA was criticised by the CC for its handling of whistleblowing information. It asked the FCA to consider carefully who met the whistleblower definition. The CC found a "lack of effective prompt action" in a number of cases where firms and consumers reported concerns. The FCA said: "We have ... been reviewing our practices on an ongoing basis, to ensure we maintain whistleblower confidentiality, track whistleblowing intelligence properly and share it across the FCA." There is an interesting recent case where the FCA placed a wealth manager (SVS Securities) into special administration following a tip-off.

// ANDREW BAILEY WANTS MORE FOCUS ON WIDER PRINCIPLES WHERE THE SPIRIT OF THE RULES IS KEY //

- ▶ Its associated body, the FSCS, is increasingly receiving claims from claims management companies (CMCs) rather than clients directly. About 70% of claims are now made by CMCs, who retain a percentage of compensation paid. As a consequence, the FCA has repeatedly warned clients that they will not receive 100% of any compensation and may not have a good customer experience if they use a CMC.
- ▶ The FCA is increasingly frustrated by its lack of authority over unregulated activities and the time it takes to expand it to cover scams. Cryptocurrencies, mini bonds, outsource service providers and spot currencies trading all lie outside the FCA's scope, and this is sometimes blamed for consumer losses. FCA chair, Charles Randell, said he is "personally very unhappy with the

complexity of the perimeter of regulation" and warned that "bad people" may exploit the grey areas. The FCA should have

formal powers to recommend to the Treasury, expanding its perimeter. An example of where the FCA has used its present authority is in its requirement of unauthorised firms Digital Wealth and Outsourcing Express (owned by the same people) to pay back investors £3.4m in an unregulated collective investment scheme. Perhaps there is a structural problem in the FCA's approach to authorising new

This update is available as a Professional Refresher in MyCISI. Log in and take the test after reading. You will earn one hour of CPD from passing the test.

businesses and supervising existing ones. Lord Myners, author of the Myners Review of Institutional Investment, said: “The core weakness of the FCA and of many regulators is that they are inherently poor at anticipating the future. [Their] natural instincts lie with the facts as they currently see them.” While having sympathy with the regulators, listening to sector experts more on how they are planning for the future may enable them to be proactive rather than reactive.

In the FCA’s *Annual report and accounts 2018/19* there’s an interesting costing of enforcement cases. In individual cases, these range from £2,000 to £1m. The average case with an agreed resolution was £253,000 for cases referred to the enforcement committee and £447,000 for cases which went to the tribunal. It increased enforcement action in 2018: 101 open retail conduct cases up from 78 the year before, with 25 misselling cases (previously 19) and 96 open insider dealing cases (73 before). This resulted in a threefold increase in fines to £227m. However, the majority of this leaves the FCA and goes to the Treasury.

3. Financial crime

► **Money laundering.** Retail banks continue their campaign against money laundering. Opening new accounts or changing bank signatories is increasingly difficult. There are concerns this will encourage the use of digital and token payment systems, commodities with high retail value (such as diamonds) and the use of offshore branches of firms which are

based in less regulated jurisdictions, such as Malta. For example, Lloyds Bank has spent three years trying to do proper due diligence on customers in the Channel Islands. If customers have repeatedly refused to provide information (5%) their accounts have been frozen (8,000). Sometimes a standard approach to information requests causes problems.

► **Fraud.** In an alarming report, the FCA and The Pensions Regulator disclose that 42% of pension savers in their sample have been scammed, and five million people have been at risk. There are five tactics used by fraudsters promoting investments to those wanting to increase their retirement income in a low-interest environment: overseas property, renewable energy bonds, forestry, storage units and biofuels – all high-risk investments. The average loss is £82,000. Reports to Action Fraud (funded by the banks and outsourced) have been criticised as being rarely followed up.

► **Cyber crime.** There has been a huge increase in the number of cyber attacks that have breached systems on financial firms. The FCA received 819 reports of cyber incidents in 2018, up from 69 the previous year. Retail banks are the most popular targets (60%) but wholesale financials and retail firms are also being affected, with asset managers and general insurers the least affected. Continued under-reporting of incidents by firms is suspected for fear of penalties. Some 21% of incidents were caused by third-party (outsource provider)

failure, highlighting the need for provider due diligence. Also, successful phishing attacks point towards staff awareness, as well as incidents related to change management.

► **Market abuse.** A listed company (Burford Capital) has claimed that a hedge fund (Muddy Waters) that published a negative report on it carried out market abuse through shorting the share price before it published its report. The report alleges “aggressive and unwarranted marks” (taking profits based on future success). The incident is an important test for market abuse.

4. SMCR

The start date in December is coming fast for firms. Preparing for the SMCR is many firms’ top regulatory priority. Most ‘core firms’ have identified their senior managers and certified staff, drafted statements of responsibilities for managers, mapped the designated functions and are well into training their staff in the conduct rules. This information should be contained in the monthly management information for senior executives and boards.

The FCA has said it will focus on firms’ implementation of the conduct rules under the SMCR. It has published its review into the SMCR by banks, which started about two years ago. This is a useful guide to advise firms. Main comments from the review include:

- The need to tailor conduct rules training to job roles.
- The need to understand how the conduct rules apply in practice to the firm’s business
- The need to map the individual conduct rules to the firm’s business products.

The FCA received only a small number of responses (29) to its final consultation on the SMCR. The policy statement confirms all eight proposals in its consultation paper, including that firms can exclude certain administrative staff from certification.

The FCA’s Register will continue to cover senior managers after the SMCR starts. The current Register has been



Book review – *Conduct and accountability in financial services: A practical guide*. Two CISI members have written a guidebook to the SMCR. Read our review at cisi.org/bookreview-smcr

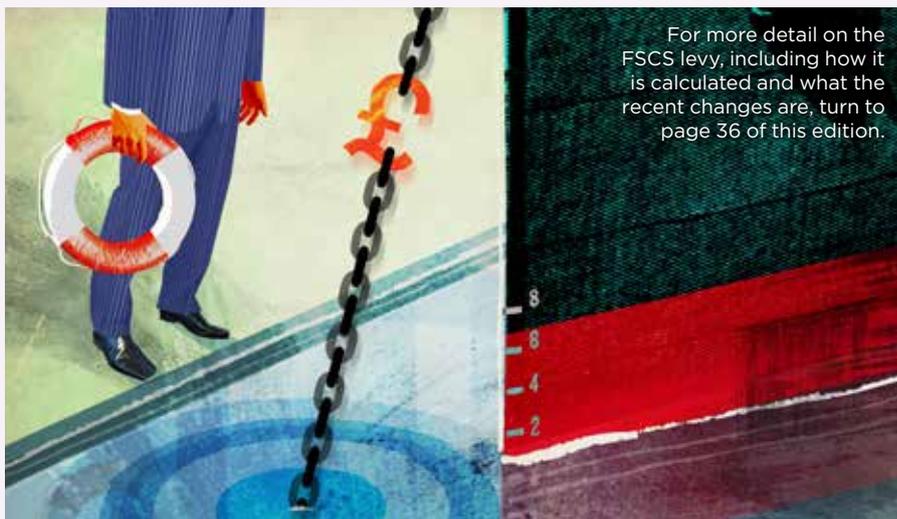
criticised by the CC as “seriously inaccurate” and “woefully inadequate”. The FCA continues to wrestle with data-quality issues, a task which should be made easier by the much-reduced number of entries after the SMCR starts in December and by the start of the new Directory of certified staff in March 2020.

SECTOR CHANGES

1. Wealth management

Developments here include:

- ▶ **Current FCA concerns.** The FCA has written a ‘Dear CEO’ letter to many wealth management and stockbroking firms, raising concerns over several issues:
 - The disclosure of costs and charges under MiFID II. In particular, its review of 50 firms shows that firms interpreted the duty differently and that they were “better at disclosing the costs of their own services than at disclosing relevant third-party costs and charges”. The FCA is encouraging firms to review their disclosure of implicit transaction costs and performance fees.
 - Improving the platform switching process remains a priority. The FCA will review progress by platforms later this year and in 2020.
 - Firms encouraging high-risk investments inappropriately – the FCA will use a range of data to identify the small number of these firms that damage client trust.
- ▶ **Regulator fees.** Advisers expected that their regulatory FCA fees would reduce this year after the FCA announced in April that they would be 2% less despite the FCA’s costs increasing. However, many were disappointed when receiving their bills to see that this reduction had been matched by the increase in the FSCS levy, which, in some cases, is up to 30%. ‘Good’ firms are frustrated that they are paying for ‘bad’ ones.
- ▶ **SIPP fees.** The FCA wants self-invested personal pension (SIPP) providers to fully disclose all set-up and ongoing fees. It sees “highly complex” fee structures as reducing competition and switching between platforms. The FCA invites providers’ views on whether only administration



For more detail on the FSCS levy, including how it is calculated and what the recent changes are, turn to page 36 of this edition.

and transaction costs are an appropriate charging structure. It also proposes that providers should regularly report standardised charges information to it so that it can publish a comparative list – more details from it in Q1 2020.

- ▶ **Pension transfer advisers.** The big news is that defined benefit (DB) transfers increased substantially to £34bn in 2018/19. The FCA wants to reduce these by banning advisers’ contingent charging. FCA studies have found that a high percentage of advice on transfers is inadequate and the transfer should not have happened. It considers the two to be connected. The FCA calculates that advisers in 2018 received between £360m and £445m for arranging the transfers. The FCA expects that some advisers will leave the market. However, it accepts this as worthwhile in order to reduce misselling and the cost of advice from £8,000 to £12,000 on a contingent fee basis for a portfolio of £400,000, and to £3,000 to £3,500 on a non-contingent basis. The regulator envisages “streamlined and cost-effective” advice (“abridged advice”): a lighter form of introductory pension transfer advice which cannot recommend a client to transfer, eliminating those who should not transfer. Advisers may also lose fees (estimated at between £399m and £598m) for future advice

if the transfers are made into workplace pensions rather than SIPPs, which then require ongoing advice. Separately, the FCA has issued a guide for DB transfers, which sets out good practice. This stipulates that pension schemes and administrators should provide a quote within seven or eight working days, and the time between receiving all forms and making the transfer should only take nine working days. There are template letters. The guide does not apply to partial or overseas transfers.

- ▶ **Robo-advice.** There is concern that full robo-advice is impossible to regulate, since artificial intelligence predictions are impossible to explain – the machine-learning models are full of numbers and not interpretable by humans. (In the *Hitchhiker’s Guide to the Galaxy*, the computer was asked for the answer to the ultimate question of “the meaning of life, the universe and everything”.

// PREPARING FOR THE SMCR IS MANY FIRMS’ TOP REGULATORY PRIORITY //

When Deep Thought gave the answer of 42, “calculated by a very big computer over a very very long time”, it was valueless because it could not explain how it had done it.) A hybrid machine/human system would be better at explaining how the advice or prediction was made – a warning to regulators and firms.

ECONOMIC CRIME – PLUS ÇA CHANGE

A warm summer’s evening, and a packed London Guildhall awaits the launch of an excellent new biography of Sir Thomas Gresham, Queen Elizabeth I’s banker. As opening praise for the great man of Tudor and Elizabethan times fades, the truth – from Cambridge historian John Guy – begins to emerge, and in waves. Alderman Professor Michael Mainelli, Chartered FCSI(Hon) reviews the book and provides an insight into Sir Thomas’s life, which paints a more graphic and nuanced picture of a grand wheeler-dealer (pp.67–69). Widespread economic crime of the kind practised by Sir Thomas – from market manipulation on an epic scale through false accounting to illegal arms dealing – still blights our world.

Addressing the opening of this year’s Cambridge International Symposium on Economic Crime – now in its 37th year and with record attendance of more than 2,000 from every continent but Antarctica – Michael Mainelli was fretting. “After nearly 40 years of our symposia, fighting economic crime still means wildly different things to different people,” says Mainelli. “To some, it’s fighting criminals, others terrorists, others tax evaders. To some financial institutions it’s a lovely barrier to entry, to challengers a

minefield. To lawyers, accountants, and consultants, a gravy train. To technologists an opportunity, for consumers a disaster. We are not losing the plot; we have yet to find the plot.”

Cooperation between the public and private sector is key, and Michael is in a unique position – as Aldermanic Sheriff of the City of London, he will live in and be responsible for the workings of the Old Bailey, London’s Central Criminal Court. So how can the public and private cooperate? “I believe that there are some basic economic forces we should amplify. First, we should be firmer about enforcing anti-competitive laws. Anti-money laundering and know-your-customer rules should promote trade, not hinder it. Fighting economic crime should ensure that account opening and switching will be easier and smoother, not harder and more complex.”

The ethical dimension is strong, he believes: “Having encouraged society to use markets for things like asset allocation, risk decisions, or solving systemic problems such as economic advancement or climate change, we have an ethical obligation to police those markets and prove that society’s trust was not misplaced.”

Charles Randell CBE, chair of Britain’s Financial Conduct Authority (FCA), warned the Symposium that “financial crime, specifically fraud against individuals, has reached epidemic proportions”. He stressed the FCA’s commitment to the success of the UK

// FIGHTING ECONOMIC
CRIME STILL MEANS
WILDLY DIFFERENT
THINGS TO DIFFERENT
PEOPLE //

government’s
economic
crime plan,
alongside
public and
private sector
partners,
to beat
investment

fraud. The plan, published earlier this year alongside the creation of the National Economic Crime Centre, “demonstrates a determination at the political level to coordinate strategy across the many bodies with responsibilities for financial crime.”

CISI chair, Michael Cole-Fontayn MCSI, followed through with a strenuous call for action. “Economic crime,” he said, “is the largest and fastest-growing category of crime in the UK, and it disproportionately affects the vulnerable. To tackle the challenges it presents, we need greater public-private cooperation. This could be significantly accelerated by legislation to improve the sharing of data, information and intelligence between and within government and industry, and wherever possible in real time.”

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THE TRANSATLANTIC VENTURE CAPITAL DIVIDE

DR KEITH ARUNDALE INVESTIGATES DIFFERENCES IN APPROACH BETWEEN EUROPEAN AND US VENTURE CAPITAL FUNDS



“While working in my former career at PwC, I became intrigued with the apparent underperformance of European venture capital (VC) funds compared to their counterparts in the US. I decided to undertake doctoral research – under the supervision of Professor Colin Mason at the Adam

Smith Business School, University of Glasgow – to investigate the difference in performance between UK/ European and US VC funds. I conducted a series of in-depth interviews with venture capitalists from 64 different VC firms on both sides of the Atlantic. I supplemented my VC interviews with 40 further interviews with other stakeholders in the sector, including limited partner investors, entrepreneurs, VC-related individuals, advisers to the sector and corporate VC firms.”

Dr Arundale’s thesis, with a comprehensive bibliography, is published on the University of Glasgow website at theses.gla.ac.uk/30827

Historically, there has been a long-standing difference in performance between European and US VC funds, though returns do now appear to be improving and the gap between Europe and the US is narrowing. For example, the ten-year VC returns data to 2017 show that UK VC funds achieved a 6.6% pa return, according to a performance measurement survey by the British Private Equity & Venture Capital Association (BVCA) and PwC, while US VC funds achieved a 9.0% pa return (Cambridge Associates). Earlier data from Invest Europe show that the ten-year returns for VC funds to 2013 were 5.03% for the US but just 0.84% for Europe. This historical difference in performance has led to reduced allocations of funds raised for European VC from non-governmental sources, such as the traditional institutional investors, and a reliance on government agencies, particularly the European Investment Fund, for the funding needed for investment into high-growth entrepreneurial companies in Europe. In 2017, government agencies contributed 27% of the total European VC fundraising amount, though this fell to 18% in 2018 (Invest Europe).

So what explains the performance difference? Are US VC firms simply better at investing in potential high-return investments? Previous studies have not

fully explained the performance gap between European and US VC funds, attributing some of the difference to “unmeasured fund characteristics or the environment in which funds operated”.

The study sought to ascertain if there are generally agreed factors that may give rise to the performance difference between European and US VC funds for the sample of firms investigated. Potential factors may be of three types, as depicted in figure 1 below.

First, they may be structural, resulting from characteristics of the funds themselves, for example the size of the funds, their strategic focus or the backgrounds of the investment executives who manage the funds. Second, they may be operational, such as the investment practices of the VC firms which manage the funds. Third, they may reflect wider environmental factors, such as culture and attitude to risk and the wider ecosystem in which the funds operate.

The principal findings of the research are summarised below. The aim is to communicate to institutional investors that the UK/European environment for venture capital is improving and, as UK and continental European VC firms adopt more best practices (some of which are based on those of the US VC firms sampled in this research), the performance of UK/European VC funds should improve even further, encouraging increased institutional funding for the sector.

METHODOLOGY: A PRACTICAL APPROACH

Embracing engaged scholarship with practical experience in the VC sector, the approach taken in the research was to carry out interviews of around one hour’s

FIGURE 1: OVERVIEW OF CONCEPTUAL FRAMEWORK

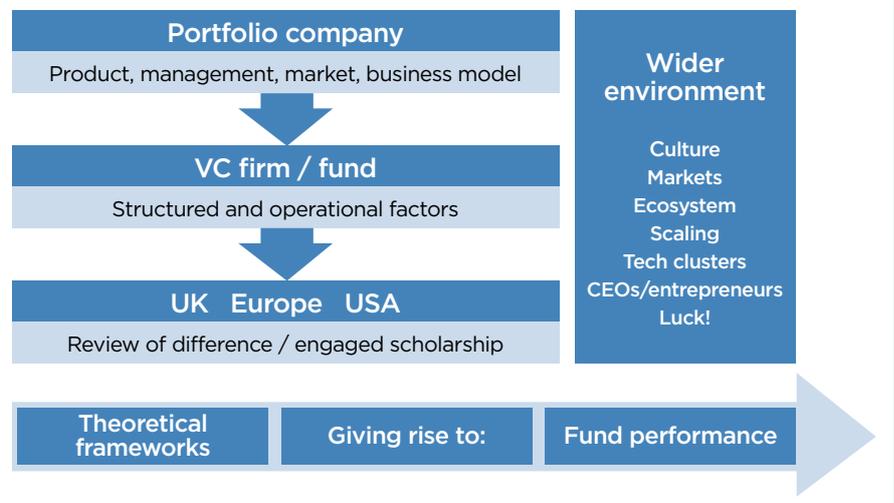


TABLE 1: SIZE OF FUND, SECTOR AND STAGE STRATIFICATION OF VC FIRMS IN SAMPLE

Number of firms	US	UK	Cont. Europe
Size of fund			
Small (<US\$84m)	3	9	8
Medium (\$US84m–US\$365m)	12	13	6
Large (>US\$365m)	10	2	1
Sector			
IT	10	8	2
Life S\$ciences	3	2	1
Mixed	11	8	10
Focused	1	6	2
Stage			
Seed / early	11	11	9
Venture (including early)	12	13	6
Growth	2	-	-

duration with senior VC practitioners and other stakeholders in both Europe and the US, using a semi-structured aide-mémoire approach. The interviews, which took place in 2013 and 2014, covered the entire investment process (origination, due diligence, approval, execution, monitoring and exiting). There are relatively few studies that have employed qualitative interview techniques to investigate VC fund performance and VC firm investment practices. The majority of the existing studies use quantitative techniques on large data-sets applying regression analysis of variables and/or survey techniques involving questionnaires sent to a large number of participants for completion.

The VCs interviewed in the research formed a purposive sample drawn from membership of professional VC associations and from personal and other contacts in the sector. The sample size of VC firms (64 separate firms) uses the concept of saturation and also allows for the assessment of variation between the distinct VC groups in terms of geographical location. The VC firms were sourced from a cross-section of stage and sector specialisms, as can be seen in the table above.

Half the VC firms were focused on early-stage ventures, the others invested across the venture stages, with two firms focused on growth deals. Firms invested across the broad spectrum of IT and life sciences, sometimes specialising in one or both of these sectors and sometimes having a narrow focus on specific areas, such as digital media.

Some 70 interviews (at 64 separate firms) were carried out with senior VC executives from 39 separate European and 25 separate US VC firms as follows:

Europe: UK 24, France 3, Germany 3, Ireland 3, Scandinavia 2, Spain 1, Switzerland 2, Netherlands 1.

US: California 13, Boston 4, Pittsburgh 4, Baltimore 1, Cincinnati 1, New Jersey 1, New York 1.

Interviews were also held with 40 other stakeholders, including limited partner

investors, entrepreneurs, corporate finance and other advisers and corporate VCs, comprising 19 from Europe (15 UK, 4 continental Europe) and 21 from the US. The ensuing thematic analysis involved over 2,500 pages of interview transcripts. While the research comprises some 110 interviews in total, which is certainly comprehensive for a qualitative study, the findings cannot be extrapolated to the full population of VCs.

FINDINGS

Several differences were found between UK/European and US VC firms and the structural, operational and wider environments in which they operate, as summarised here.

STRUCTURAL FACTORS

US funds in the sample (average size US\$282m) were considerably larger than UK (US\$168m) and continental European (US\$128m) funds. There is a shortage of finance, particularly of later-stage finance, for growing and scaling companies in Europe.

There's a massive inefficiency in the UK because you haven't got scale of funds; you're forever having to look to raise another round of funds and then another, and at each break point for the next fundraising, there are valuation and allocation disputes. It's hugely inefficient, a huge drain on management time.

UK limited partner

The larger size funds in the US allow VCs to follow through with their initial investments which, in turn, better permits investee companies to scale.

US VC firms have proportionately more partners with operational and entrepreneurial backgrounds than European firms, which may well assist in the screening and value-adding capabilities of US VCs. European VC firms have a greater proportion of partners with a financial, investment or consultancy background.

People who are good entrepreneurs are often the folk who end up becoming venture capitalists here.

US entrepreneur

US firms have around one more partner in total than European firms. The research also reveals that US firms share responsibility for deals more than UK and continental European firms, often having two partners working together throughout the life of an investment. Additional knowledge and experience gained by two partners working together reduces information asymmetries which could lead to better investment and consequent better fund performance.

There is also evidence of US VCs clubbing together to make relatively small investments in very early, seed-stage investments in order to 'test the water' and thereby reduce the risk of missing out on potential outlier investments which have the potential to contribute disproportionately to the overall returns of a fund.

OPERATIONAL FACTORS

For the sample of VC firms included in the study, there are a number of operational areas where the investment practices of European VC firms differ from those of US firms. A theme approach to identifying 'hot' future areas for potential investment is adopted more by US VCs than by European VCs, with the latter tending to follow the trend. US VCs put considerable resources into researching and developing innovative new areas for investment. Getting ahead of the competition in this way and investing at the earliest stages of new technologies could contribute to the better performance of US VC funds.

About ten times per year, partners decide where to put resources to try and identify an investment thesis, and present it to the group with respect to: is there an investable idea behind that?

US VC

In addition, more US VCs have pursued a home run, 'one in ten' investment strategy than European VCs, perhaps due to the intensely competitive environment in which US firms operate, where taking a middle ground approach does not work, compared to Europe where there are constraints with funding and scaling.

When we speak with one of our LPs in particular, their constant push is "are you taking enough risk in your portfolio?"

UK VC

With a one in ten investment strategy, it could be that one or two stellar-performing investments achieve outlier returns of 10x or more and return the fund as a whole, compared to more of a growth strategy where several investments might achieve more modest 2x or 3x returns.

The brand strength of US VCs has an impact on attracting quality deal flow, whereas European VCs have more of a proprietary approach to generating deals.

I can't think of European VC-backed firms that would have the same kind of brand franchise for a start-up that would be as attractive as some of the Silicon Valley groups here in North America.

US limited partner

While most US VCs in the sample reach investment decisions unanimously or by consensus, a senior partner could force or 'railroad' the decision in some US VCs. Consensus may 'kill' the outlier deals which may produce outlier returns.

More US VCs, particularly West Coast based VCs, have 'entrepreneur-friendly' terms in their term sheets as opposed to the 'investor-friendly' terms found with European VCs and with some East Coast based US VCs. This again demonstrates US VCs' focus on the upside of investment growth as opposed to the

European concern to protect the downside risk.

Europeans are saying "how do I not lose?" and Americans look at the question "how do I win?"

US Silicon Valley VC

There is perhaps a greater use of milestone-based financing/drip-feeding by European VCs.

American CEOs think that European VCs just want to drip-feed them; the European VCs under-capitalise companies.

US Silicon Valley VC

US VCs focus on the metrics portfolio companies need to manage to determine how much money to continue to invest at subsequent rounds.

The US VCs know exactly what metrics they're willing to fund. The reason they're willing to put another US\$X in is because they've seen that happen before.

UK corporate VC

European VCs syndicate with other VCs, often for monetary reasons. US VCs may not need additional finance but collaborate to pool expertise and know-how.

We syndicate not because we need to, but because we want to.

US VC

European VCs appear to keep poor-performing investments going for longer than US VCs. On the other hand, more US VCs wait for the best exit than European VCs, who tend to exit early, perhaps due to fundraising pressures from their investors or issues with scaling in Europe. US VCs appear more able to achieve optimal exits for their investments as a result of their wealth of contacts with potential trade buyers, such as large technology companies, and an overall easier exit process in the US, including a stock market that is more receptive to technology companies. European VCs achieve less than optimal realisations for their investments,

which result in less profitable exits and lower returns for their funds.

You've got to take the best offer on the table for the money that you've got so you're maximising your return within the capabilities you have of limited fund sizes, and that is a big issue for the UK.

UK limited partner

WIDER ENVIRONMENTAL FACTORS

There are several differences in the wider environments in which European and US VCs operate.

European VCs have a lower propensity for risk and do not 'think big enough' with their investments.

There are just as many smart people with good ideas in Europe, [but there's] a lack of entrepreneurial capital and mindset.

US adviser

US VCs' risk approach is perhaps exemplified in their one in ten home run investment strategy, noted above. There is also more of a willingness to share contacts, talents and information in the US, particularly in the unique environment of Silicon Valley, versus more of a proprietary approach in Europe.

There is a relative lack of experienced CEOs and serial entrepreneurs in Europe compared to the US.

I think Europe is getting there but we don't have that large enough base yet of entrepreneurs and CEOs that have done it before.

UK corporate VC

The difficulty of scaling by investee businesses in Europe is well known, largely due to a relative shortage of funds and the fragmentation of the European markets.

In Europe we don't have big enough home markets to build great home run returns, so companies need to be international from day one.

UK VC

There is also complexity due to copyright law in Europe.

While there is now a unitary patent system and copyright across Europe, the issue is who licenses it for which territory. This puts off US VCs from investing in the UK.

Patent expert at Silicon Valley based tech company

There are difficulties of exiting in Europe with less receptive stock markets and poorer connections with large corporates.

You don't IPO your company in London unless there's something wrong with it usually. Because it's not an exchange that's going to value a high-tech company.

UK corporate VC

Overall there appears to be a more open and sharing approach in the US, contrasted with a more proprietary, protectionist, hierarchical approach in Europe.

Silicon Valley was specifically highlighted with its unique open but tightly networked ecosystem.

The investments, the CEOs and their teams are surrounded by a phenomenal ecosystem [in Silicon Valley]: connected advisers, connected partners. The Valley is just unique.

UK VC

CONCLUSION: THE WAY FORWARD?

The different structural aspects of European and US VC firms and the differences in their operational investment practices may well contribute to the historical difference in performance between European and US VC funds, along with various cultural and economic differences as noted above and summarised in figure 2, right. The differences that have been identified in this study make an important contribution to explaining some of the unmeasured differences in performance between UK and US VCs referred to in earlier studies.

The implication of this research is that the solution to the funding gap in the UK and continental Europe is not simply a matter of increasing the supply of finance. Rather, there is a need for fundamental changes in both the practice of European investors and in the wider ecosystem in which they operate. European VCs could consider adopting more of a higher-risk,

'home run' investment strategy if considered practical and rational, the pursuit of outlier deals championed by senior, experienced partners, the use of 'entrepreneur-friendly' terms and less focus on the downside, and a 'theme' approach to identifying hot areas for investment. European VCs could also consider raising larger funds, if practical, for follow-on funding and scaling, hiring more partners with operational and entrepreneurial backgrounds and exiting from investments when the most value can be achieved, depending on market conditions and scaling potential.

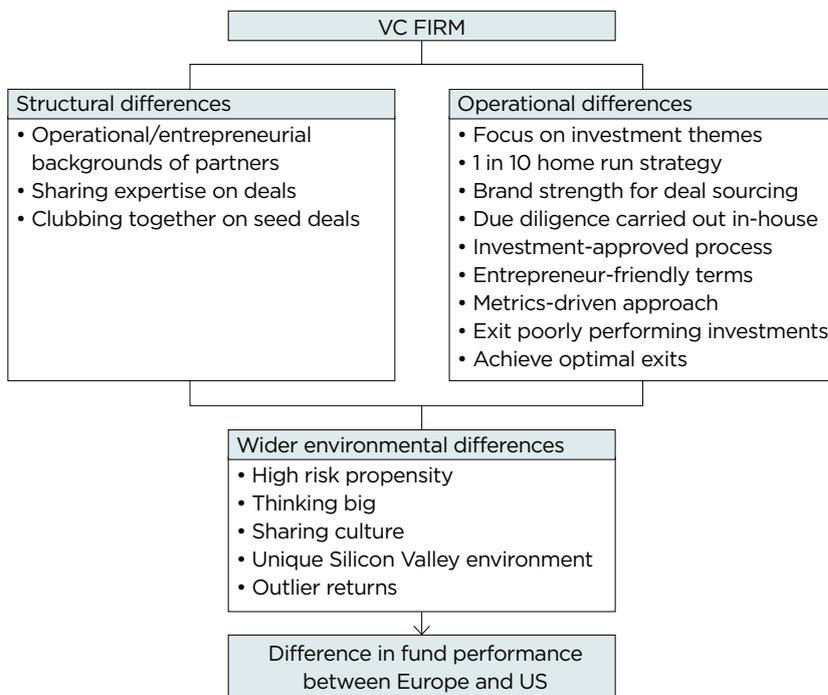
A less proprietary approach, more networking and sharing of information, including dissemination of best practices, and building collegiate syndicates could also be encouraged. In the wider environment there is a need for more receptive public markets for technology companies, together with a ready supply of good CEOs and entrepreneurs willing to form serial ventures.

As noted at the beginning of this paper, European VC returns do appear to be improving. There are many excellent features about the VC sector in Europe. For example, in the UK we

generally have an adequacy of start-up finance with business angel syndicates and crowdfunding, as well as some VCs willing to take the risk of investing at the very early stages. We have much technological innovation from the universities, centres of excellence in artificial intelligence, fintech and other areas and more people studying entrepreneurship and joining entrepreneurial companies. However, there is more that we can learn from the US VC sector. US VC firms are more aggressive. UK/European firms are more timid. This is not a cultural issue. It is due to real economic factors, including a more competitive environment in the US and issues with scaling, fragmented markets and a relative lack of later-stage finance in Europe.

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FIGURE 2: DIFFERENTIATING FEATURES OF US VENTURE CAPITAL FUNDS IMPACTING ON FUND PERFORMANCE GAP



GROWING THE DIGITAL ECONOMY – THE ROLE AND PURPOSE OF FINANCE IN THE FOURTH INDUSTRIAL REVOLUTION¹

DEVELOPING COUNTRIES HOLD THE KEY TO SUSTAINABLE INCLUSIVE ECONOMIC DEVELOPMENT. THEY NEED TO DEVELOP CAPITAL MARKETS, STIMULATE ENTREPRENEURSHIP, CAPTURE VALUE-ADDED THROUGH SUPPLY-CHAIN INTEGRATION, DEVELOP PHYSICAL INFRASTRUCTURE AND LEVERAGE THE CIRCULAR ECONOMY

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Links to sources in footnotes included at CISI.org/rofm-oct19

INTRODUCTION

International trade is the exchange of capital, goods, and services across international borders and has existed throughout much of human history. Without it, citizens of countries would only have access to the goods and services produced within their national borders. In emerging markets, international trade represents a substantial and increasingly significant share of gross domestic product (GDP). International trade has helped in reducing extreme poverty throughout the world.² At the same time, it has become central to the climate change debate, now that the world is at a tipping point, to try to address it and prevent the worst from happening.³

The world is also transitioning from the third to the Fourth Industrial Revolution (4IR). This paper explores the role that the capital markets of emerging market countries along the New Silk Road could play in growing the digital economy and contributing to sustainable economic development now that the era of 4IR is emerging.

THE TRADITIONAL SILK ROAD

The original Silk Road was a 6,500km network of trade routes that connected the East (China) to the West (Southern Europe). Travelled by traders, merchants, pilgrims, monks, soldiers, and nomads, the Silk Road routes were central to the development of the civilisations of China, the Indian subcontinent, Persia, Arabia, and Europe. People from eastern China to those living along the Mediterranean Sea benefited not only from the trade of goods such as silk, porcelain and teas, but also from the exchange of ideas (for example, religions) and technology (for example, gunpowder from China). The traditional Silk Road was instrumental in the cultural interactions between the inhabitants of these regions for centuries.

THE EMERGENCE OF THE NEW SILK ROAD

Historically, China's coastal regions, such as Shanghai and Guangdong, have been destinations for low-cost manufacturing, providing easy access to labour and convenient import and export options for raw materials and finished goods. For China, as well as Kazakhstan, state capitalism was at the core of rapid economic growth, but both countries recognise that state capitalism has largely run its course. This is because governments are good at infrastructure investment, but not so good at innovation.

In 2012 the Chinese private sector overtook the public sector in terms of share of China's GDP, adding over 60% to the country's GDP. China has developed, and continues to develop, its economy based on the existing 22 hub-and-spoke⁴ clusters, which are making a rapid transition from labour-intensive to capital- and technology-intensive industries, such as pharmaceuticals (around Shijiazhuang) and civilian aerospace (around Xi'an). Each of these is an ecosystem in its own right, driven by innovation and private enterprise. What is also increasingly apparent is that China

has been pushing manufacturing westwards for the following five reasons:

- 1. Improved infrastructure:** impressive investment over the past 20 years in infrastructure provides access to most cities and provinces in China.
- 2. Access to labour:** a large and largely untapped pool of workers is available in China's western provinces.
- 3. Lower cost:** labour, land, construction, management supplies and overhead costs are all significantly lower than in China's coastal regions.
- 4. Strong local government support:** municipal governments of China's smaller cities are likely to provide strong support and reduce the red tape for manufacturing businesses willing to invest.
- 5. Proximity to markets:** Europe can be reached faster and more cost-effectively over land from western China than from over land and sea.

The New Silk Road, a term first coined by Alexander Van de Putte, Ged Davis and Wai Chiew Chik in the World Economic Forum's report from 2006, *China and the world: scenarios to 2025*,⁵ is an ambitious multibillion dollar project to connect China with Western Europe along a 2,500km railway through Kazakhstan.

Just as the ancient caravans transformed the world, bearing ideas and cultures along with their silks and spices, Kazakhstan is a partner in the modern equivalent to this central Eurasia trade route to stimulate economic growth, with potential repercussions the world over.

¹ This paper is based on a presentation made by Van de Putte at the 'Belt, road & bridge: creating new China-Europe connectives' conference on 1 May 2019 in London. His speech is available on CISI TV.

² 'Towards the end of poverty', The Economist, 1 June 2013.

³ 'Trade and climate change', World Trade Organization, 2009.

⁴ 'What's next for China?' McKinsey & Company, January 2013.

⁵ 'China and the world: scenarios to 2025', WEF, 2006.

Connecting China with Europe, Turkey, and the Middle East will encompass more than just a transit route from point A to point B; this New Silk Road will create an economic corridor and promote stability, and energy security, while opening up trade. China and Kazakhstan will be among the many beneficiaries. The New Silk Road is the gateway to the world economy, and it is the mission of our governments to develop that gateway to the fullest. The New Silk Road offers major time and cost advantages over alternative transport corridors. For example, to transport goods from Western China to Central Europe over the Trans-Siberian land-bridge takes 14 days, by sea up to 45 days, while over Kazakhstan, it could be as little as eight-ten days. This makes the New Silk Road an interesting transshipment alternative for time-sensitive and/or medium- to high-value density products (for example, raw materials and grain) or for subassembly (for example, computers, printers, gearboxes for cars, cars).

The massive investment required to make the physical infrastructure portion of the New Silk Road a reality has not gone unnoticed, and many countries along its path entered into heavy debt financing often provided by Chinese institutions. As a result, many developing countries in the Eurasia region have unhealthy country-level balance sheets that are overleveraged.

THE FOURTH INDUSTRIAL REVOLUTION WILL INCREASINGLY DRIVE DIGITAL TRADE

The global economy was growing rapidly until the 2008 financial and economic crisis, when it experienced its biggest test since the Great Depression. Since then, global physical trade and financial flows have struggled to find a new growth model. Digital trade, on the other

// THE NEW SILK ROAD IS THE GATEWAY TO THE WORLD ECONOMY //

hand, has taken off and continues to grow exponentially.⁶ This shift from physical to digital trade is largely driven by the emergence of 4IR.

In 2016, Klaus Schwab of the World Economic Forum argued that we stand on the brink of a technological revolution that will fundamentally alter the way we

live, work, and relate to one other. He defines 4IR as “a range of new technologies that are fusing the physical, digital and biological worlds, impacting all disciplines, economies and industries, and

even challenging ideas about what it means to be human.”⁷

Economies and companies that want to experience sustainable business growth need to harness 4IR. Hubs such as the Astana International Financial Centre (AIFC) consist of two interrelated sub-ecosystems. Sub-ecosystem 1 comprises traditional financial sector players, such as commercial banks, private banks, investment banks and insurance companies. Their main objective is to provide financial products and services to the economy and society at large. Sub-ecosystem 2 (AIFC fintech) comprises start-ups, tech entrepreneurs, and other technology companies that focus on the crucial technology aspects of 4IR, such as blockchain, cyber security, and AI. Professional services firms operate at the intersection of the two sub-ecosystems, alongside VC firms, R&D centres and training providers. Successful AIFC fintech companies

eventually become financial sector players or help transform traditional financial sector players to disrupt their business model. These two reinforcing sub-ecosystems make it a dynamic and innovative financial sector ecosystem ready to compete in 4IR.

AIFC fintech will leverage the following 4IR technologies:

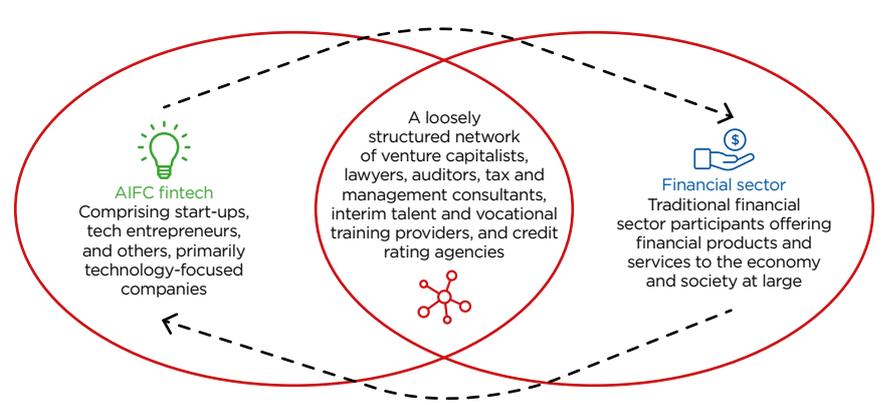
- 1. Datacentres and big data:** Big data, data over the size of a petabyte, is driving the need to develop datacentres and network infrastructure. With 4IR, data centres need to be designed with the future in mind and need to be highly scalable.
- 2. Blockchain and distributed ledger technology:** Blockchain has application areas in finance, logistics, global value chains, mining, and oil and gas, and is therefore important for the various aforementioned sectors. At AIFC, blockchain is at the core of the fintech revolution and will enable traditional banks to become digital banks.
- 3. Internet of things (IoT), connected devices and artificial intelligence (AI):** Two countries have a nationwide IoT network: the Netherlands and South Korea. The IoT, combined with connected devices (for example, robots), has the potential to provide seamless automation to otherwise mundane manual tasks, such the automation of forex and stock trading.⁸ For example, robots connected through an IoT network and enabled by AI could autonomously improve agricultural development from seed dispersal to weed removal and

⁶ ‘Digital globalization: The new era of global flows’, McKinsey Global Institute, 2016.

⁷ The Fourth Industrial Revolution, Klaus Schwab, Penguin, 2017.

⁸ A forex or stock trading robot is a computer program based on a set of forex or stock trading signals that helps determine whether to buy or sell a currency pair or stock at a given point in time. Forex or stock trading robots are designed to remove the psychological element of trading and improve the efficiency of digital trading.

FIGURE 1: THE AIFC AS A DYNAMIC ECOSYSTEM



Source: Astana International Financial Centre; Sustainable Foresight Institute

TABLE 1: FINANCING LANDSCAPE FOR SUSTAINABLE PROJECTS

Commercial	Development institutions	Government
Banks • Debt/equity, guarantees on loans, funds	• Multinational • Bilateral • National	• Grants • PPPs • Guarantees on loans • Sovereign debt
Asset managers • Debt/equity, funds, SPVs, leases, private placements	Private	
Private equity/Venture capital • Equity, funds, SPVs, private placements		
Institutional investors • Syndicated loans, private placements, debt	Project developers • Equity/leases	

Source: AIFC Research

harvesting, thus improving crop yields and virtually eliminating the need for pesticides, thereby resulting in healthier crops.

4. Security and cyber security: With the benefits of 4IR also come additional and emerging risks, such as cyber security. In the age of 4IR, companies need to protect every node in the system through comprehensive cyber security that is robust, resilient and secure.

Based on a 2016 McKinsey Global Institute study,⁹ digital trade and especially digital finance has dramatic upside potential, especially for developing markets, along the path of the New Silk Road, including:

- providing access to financial services for 1.6 billion in developing countries, especially women
- boosting annual GDP of all developing markets by US\$3.7tn by 2025 – a 6% increase
- creating nearly 95 million new jobs across all sectors – a 3.5% increase.

However, one cannot explore the opportunities without considering the risks. Challenges include: 1) rising inequality because of job losses due to automation and the use of artificial intelligence, 2) data privacy issues, 3) cyber security and cyber crime, 4) dealing with bias within artificial intelligence, and 5) the overall resilience of the global financial system.

⁹ 'Digital finance for all: Powering inclusive growth in emerging economies', McKinsey Global Institute, 2016.

¹⁰ 'Global wealth: reigniting radical growth', Boston Consulting Group, 2019.

¹¹ 'Amundi and The Economist release a study of asset-owner priorities for ESG investing in Asia', Amundi Asset Management, 26 June 2019.

CAPITAL MARKET DEVELOPMENT TO ENHANCE LIQUIDITY AND INCREASE CAPITAL INFLOWS

There is also no shortage of capital or sources of capital to finance the sustainable trade over the New Silk Road and globally. According to the Boston Consulting Group,¹⁰ global wealth now exceeds US\$200tn and, since the 2008 global financial and economic crisis, this wealth has struggled to find bankable projects anywhere in the world. The global renewable energy internet could provide this opportunity for global investors to make a game-changing contribution to sustainability, while at the same time provide superior returns in line with the findings of the 2019 Amundi study.¹¹

Sources of capital are diverse and growing and include banks, asset managers, private equity, institutional

investors, development institutions and government financing (Table 1).

The Morgan Stanley Capital International (MSCI) Emerging Markets Index is used to measure equity market performance in global emerging markets and is the de facto index used by investors to channel investments to growth markets. The MSCI Emerging Markets Index grew from 10 countries in 1988 to 24 countries today and represents 13% of world market capitalisation. Most developing countries are currently not part of the MSCI Emerging Markets Index and need to explore ways to upgrade from frontier to emerging market status. This is relatively straightforward, while the benefits are significant.

Benefits include:

- Increased capital inflows: The MSCI Emerging Markets Index has over US\$2tn of assets benchmarked against it. Inclusion in the Index would not only increase the exposure of developing countries' stocks to international investors, but also lead to passive inflows from funds that follow the Index's progress.
- Enhanced liquidity: Liquidity in developing countries' stock markets is typically very low. Capital inflows resulting from inclusion in the Index will substantially boost liquidity in developing countries' stock market and economy.

TABLE 2: MSCI MARKET CLASSIFICATION FRAMEWORK AND REQUIREMENTS

Criteria	Frontier	Emerging	Developed
A. Economic development A.1 Sustainability of economic development	No requirement	No requirement	Country GNI per capita 25% above the World Bank high income threshold* for three consecutive years
B. Economic development B.1 Number of companies meeting the following Standard Index criteria • Company size (full market cap)** • Security size (float market cap)** • Security liquidity	3 US\$776m US\$776m 2.5% ATVR	3 US\$1,551m US\$776m 15% ATVR	5 US\$3,102m US\$1,551m 20% ATVR
C. Market accessibility criteria C.1 Openness to foreign ownership C.2 Ease of capital inflows/outflows C.3 Efficiency of operational framework C.4 Availability of investment instrument C.5 Stability of the institutional framework	At least some At least partial Modest High Modest	Significant Significant Good and tested High Modest	Very high Very high Very high Unrestricted Very high
* High income threshold for 2018: GNI per capita of US\$12,056 (World Bank, Atlas method) ** Minimum in use for the May 2019 semi-annual index review, updated on a semi-annual basis			

Source: MSCI Market classification framework, June 2019

- Reduced cost of capital resulting from increased trading volumes: Being part of the MSCI Emerging Markets Index should lead to a fall in the equity risk premium because of risk diversification. This will help draw in new investors, such as endowment funds and hedge funds. As stock prices swell as a result, even more investors are drawn to developing countries, effectively creating a virtuous circle.

Small and medium-sized enterprises (SMEs) play a critical role in the economy. They tend to be more nimble and dynamic compared to larger companies and therefore drive innovation and more sustainable business growth. SMEs, however, need access to growth financing to scale their business. In most developing countries, a capital market for SMEs does not exist. There are at least four benefits for developing

countries to develop an SME market: 1) it provides access to equity capital to scale the business beyond what would be possible through venture capital (VC) funding; 2) it provides exit options for VC firms. Therefore, VC firms are more likely to provide risk capital at earlier stages of the SME development; 3) a listing often requires SMEs to bolster corporate governance, including the recruitment of independent non-executive directors. A well-composed board will help SMEs identify viable strategic growth options beyond those that typically the founders were able to identify, 4) over time, a lower cost of capital which in turn will help the SME to grow more sustainably, and 5) increased visibility to a diverse group of stakeholders, which could result in additional revenue growth.

WHERE WILL ALL THE CAPITAL GO?

With enhanced liquidity and improved equity capital flows, the question arises: where should all the capital go to drive sustainable economic development? There are three areas that come to mind:

¹² 'What is the circular economy?', Ellen MacArthur Foundation, 2015.

¹³ 'Europe's circular-economy opportunity', McKinsey & Company, September 2015.

¹⁴ Estimate based on the Ellen MacArthur Foundation circularity indicators.

// THE CIRCULAR ECONOMY IN NATURAL RESOURCE-RICH COUNTRIES WILL CREATE SKILLS AND JOBS //

1. Doing things smarter: Leverage the circular economy (CE) to make existing assets more sustainable and competitive. A CE is one that is restorative and regenerative by design and was popularized by the Ellen MacArthur Foundation and McKinsey & Company.¹² According to McKinsey, the CE has the potential to create €1.8tn of incremental value in Europe by 2030.¹³ In natural resource-rich countries, the potential (as a percentage of GDP) is much larger and estimated at up to 2% of incremental annual GDP growth.¹⁴ This is because there are many

opportunities to reduce, reuse and recycle waste in the extraction industries' value chain by leveraging skills, enabling infrastructure, and SMEs. The circular economy in natural resource-rich

countries will create skills and jobs, improve – or at least help maintain – natural capital, and create financial capital that is not dependent on the volatility of the demand for natural resources.

2. Capture value-added: Capture value-added through supply-chain integration and the development of physical infrastructure. To connect the more than five billion people who live in the Eurasian region, Kazakhstan plays a central role given its geographic location and its good relationships with its neighbours. Investment in infrastructure, including clusters, will be key to making the New Silk Road a success, given infrastructure has a high economic multiplier. The Asian Development Bank estimates that, on average, US\$750bn per year of infrastructure investment is required until 2030 in Asia alone. Not all will be destined to make the New Silk Road a reality, but it is probably the largest multi-country infrastructure project ever undertaken to enable east-west trade.

3. Leapfrog into the future: Given 4IR, it would be unwise not to leverage some enabling technologies to make better use of infrastructure. For example, the internet of things (IoT), combined with autonomous vehicles, has the potential to dramatically

improve the efficiency of how infrastructure is used, because logistics providers will now be able to track each item in the supply chain and ensure that it finds the fastest and most cost-effective way to its ultimate destination. The potential for digital technologies to disrupt value chains is enormous.

CONCLUSION

As mentioned earlier, all this requires large amounts of investment and, under the initiative of China, the Asian Infrastructure Investment Bank (AIIB) was created in late 2015. The AIIB has 37 founding members and 20 non-regional members and has, according to the UN, the potential for scaling up financing for sustainable development.

However, countries along the New Silk Road's path cannot rely purely on China and primarily debt financing. Instead, they should develop their own capital markets and promote SMEs to drive innovation and entrepreneurship. The New Silk Road has the potential to accelerate trade, economic growth and sustainable development for all the countries along its path.

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SIR THOMAS GRESHAM: TUDOR, TRADER, SHIPPER, SPY¹

BY ALDERMAN PROFESSOR **MICHAEL MAINELLI**, CHARTERED FCSI(HON),
EMERITUS PROFESSOR OF COMMERCE AT GRESHAM COLLEGE

Alderman Professor Michael Mainelli, Chartered FCSI(Hon), profiled in this edition on pages 30 to 33, has made a special study over many years of the life and work of Sir Thomas Gresham, founder of the eponymous college and subject of a vibrant new biography by Tudor historian John Guy.

The following article has been updated and adapted from Michael's website at mainelli.org. It is one of the most eye-opening studies of a revered historical figure for many years. While Sir Thomas was indeed the founder of the first serious English challenge to the power of Oxford and Cambridge as seats of learning, and a (mainly) loyal servant to monarchs, he had a more robust side, from which many lessons – particularly on ethical behaviour – are still to be learnt.

THE LEGEND

Sir Thomas Gresham (1519–79) is the best known of all 16th-century English merchants and financiers. Gresham served four Tudor monarchs, managed to keep his head, and all the while made money.

He helped to make London a great international financial centre by importing from Antwerp the idea of a 'bourse' or 'exchange' for items such as shipping and insurance. He built the Royal Exchange and installed the first English shopping mall or bazaar on the first floor of the building. His will enabled a challenge to the dominance of Oxbridge in higher education at the time.

Sir Thomas was a true cockney, born within the sound of Bow Bells on Cheapside around 1519. He attended St Paul's School and Gonville Hall (later to become Gonville and Caius College), Cambridge. In 1543 the Mercers' Company admitted the 24-year-old Gresham as a liveryman dealing in cloth. In the same year he went to Antwerp to make his fortune.

¹ Mainelli.org/?page_id=1497.

² greshams.com/prep-schools-2/archives/history-society-lectures/sir-john-gresham/.

His legend is as a wizard of global finance and one of the wealthiest men of his era. He rose through the mercantile worlds of London and Antwerp to become indispensable to Tudor monarchs. He was something of a maverick both in business and in life. His guiding hand at the helm helped to keep England safely afloat financially in some of the most turbulent of times, but he followed his own rules. Recent appraisals show that while he made money much of the time, his two biggest speculations for the Crown went badly wrong, and he died heavily in debt despite the vast scale of his reputed assets.

He made his greatest discovery as early as the 1550s – bankers and money markets could hold monarchs and sovereign governments to ransom, just as much as the reverse. We're still living with his legacy. Today his name is remembered in the institutions he founded (the Royal Exchange, Gresham College), through an economic principle (Gresham's law) that he did not in fact invent, and for starting to place the City of London at the economic centre of the world.

THE TUDOR

According to family legend, the founder of the family, Roger de Gresham, was abandoned as a baby in long grass in north Norfolk in the 13th century. A woman's attention was drawn to the founding by the chirping of a grasshopper, hence the family symbol. While this is a beautiful story, it is more likely that the grasshopper is simply a heraldic rebus on the name Gresham, with 'gres' being a Middle English form of grass (Old English 'græs'), and 'gressop' a grasshopper. The grasshopper emblem first appears in correspondence from London to the Pastons in Norfolk in the mid-1400s.

James Gresham, Sir Thomas's grandfather, was from the Norfolk town of Holt. He became a London legal agent working for Sir William Paston, a prominent judge from a family of Norfolk gentry.

Sir Thomas's father, Sir Richard Gresham, his uncle Sir John Gresham, and later Sir Thomas himself were merchants actively trading in Antwerp and London. They had a lucrative sideline undertaking specific missions for the Crown, for example supplying tapestries for Wolsey in the 1520s and armaments for Henry VIII in the 1540s. Richard, in particular, was also engaged in short-term lending (Tudor 'payday' loans) to Londoners and courtiers during these years, while speculating extensively, and highly profitably, in land

// HIS GUIDING HAND
AT THE HELM HELPED
TO KEEP ENGLAND
SAFELY AFLOAT
FINANCIALLY //

and lead after the Dissolution of the Monasteries.

Sir Thomas owed much of his success to the patronage of his father

and uncle; both were two of the most effective of the Tudor financiers, but were known to be ruthless, greedy and were widely hated.

The head of history at Gresham's, Simon Kinder, expanded on this in a History Society lecture called 'Shovellor of human manure':

Sir John was accused of crafty business dealings as early as 1526. In 1532 an Antwerp merchant, Nicholuccio Vinnaciese, pleaded with Henry VIII to give him protection from the Gresham brothers who, he claimed, had had him wrongfully arrested and had attempted to destroy his credit rating amongst his fellow merchants.

In 1535 Sir Francis Bigod wrote to Thomas Cromwell complaining that he 'dare not come to London for fear of Mr Gresham'. When Sir John Gresham died in 1556 his death was celebrated in verses which carried the following catchy title, translated from the original Latin – 'The epitaph of that stupid and squalid usurer, John Gresham, a soldier who shovels human manure ... who is buried in hell'. Similar verses celebrated the demise of Sir Richard Gresham in 1549.²

THE TRADER

Gresham was no stranger to rigging markets. He writes to Lord Cecil in 1558, “Dyd I not raise it to 23s, and paid his whole detts after 20s., and 22s whereby wool fell in price from 26s 8d to 16s., and cloths from ix li a packe to xl and xxxvi li a packe, with all other our commodities, and forrayners.”³

Throughout the 1550s and 60s, Sir Thomas continued to acquire significant properties in several counties, such as Osterley Park and Boston Manor in West London. He built his City mansion near Bishopsgate around 1563 on the site now occupied by Tower 42. The unsettled times preceding the Dutch Revolt against the Spanish rulers of the Netherlands compelled him to leave Antwerp for good and bring much of the trade with him to London. Queen Elizabeth I then found Gresham useful in other ways, including acting as jailer to Lady Mary Grey (sister of Lady Jane Grey) for three years.

Monarchs such as Holy Roman Emperor Charles V and his son Philip II, king of Spain, and big banking and trading firms, such as the German-based Fuggers, raised funds on the Antwerp Bourse. The extravagancies of Henry VIII and mismanagement of trade by Sir William Dansell, the king’s merchant in the Low Countries, financially embarrassed the English monarchy. By late 1551, Edward VI appointed Sir Thomas as Royal Agent in Antwerp. A shrewd dealer, Gresham advised the king to manage actively the value of pound sterling by buying low and selling high on the Antwerp Bourse.

THE SHIPPER

Antwerp was very cosmopolitan and large for the time, with a population approaching 100,000, double that of London or Rome. The growth of the cloth trade between London and Antwerp was the single most important factor in the City of London’s expansion. Just 25 merchants accounted for half of London’s cloth exports, and the two biggest exporters were the brothers, Sir John and Sir Richard Gresham.

³ archive.org/stream/in.ernet.dli.2015.40825/2015.40825.Life-And-Times-Of-Sir-Thomas-Gresham--Voll_djvu.txt.

// HE MAY NOT HAVE INVENTED GRESHAM’S LAW BUT HE UNDERSTOOD IT WELL //

Sir Thomas proved so successful at manipulating royal debt that within a few years King Henry’s successor, the young King Edward VI, had discharged most of his debts. On the accession of

Queen Mary in 1553, Gresham fell from favour, perhaps due to his Protestant leanings, and was relieved of office. Alderman William Dauntsey replaced him, but Dauntsey quickly proved unsuccessful at

finance and Gresham was reinstated.

Instructions in 1558 under Mary Tudor said: “Gresham shall with all diligence repair to Antwerp ... for the speedy receipt to our use of 100,000 pound bargained for by [a German banker] and for the borrowing to our use of 100,000 pound more ... at such favourable interest as he may [obtain].” Not only were his services retained throughout Mary’s reign (1553–58), but besides his salary of 20y shillings per diem he received grants of church lands to the yearly value of £200.

By Elizabeth’s accession in 1558, Sir Thomas was a royal favourite. He may not have invented Gresham’s law (‘bad money drives out good’), but he understood it well, explaining to Queen Elizabeth that because her father and brother, Kings Henry VIII and Edward VI, had replaced 40% of the silver in shilling coins with base metal, “all your fyne gold was conveyed out of this your realm”. William Cecil put Sir Thomas in charge of recoinage. To his, Elizabeth’s and Cecil’s credit, within a year (1560–61) debased money was withdrawn, melted, and replaced, with a profit to the Crown estimated at £50,000. The restoration of the coinage improved commerce and positioned London nicely to profit from increasing turmoil on the Continent. This also demonstrates that ultimately ‘good money drives out bad’, as people will revert to a strong currency backed by the appropriate authority.

THE SPY

On his own account, and on that of his father and uncle, Sir Thomas carried on

business as a merchant and acted in various matters as an agent for King Henry VIII. He was clearly a ‘merchant adventurer’ with an international network of agents, though the sobriquets ‘arms-dealer’ or ‘gun-runner’ might apply too. He procured armaments and munitions for the defence of the realm, particularly against Spain and France. There are tales of bullion concealed in bales of pepper or armour. In 1560 he writes to Queen Elizabeth I, “Yt maye please your most Excellent Majestie to understand, that for the better profe to your highnes: for the conveyans of soche bullion and golde as I shall provyde for you, I have sent you this letter inclosed in the stonne worke being no smale comforte unto me: that I have obteyned to the knowledge therof for the better conveyans of your treasure, which thing must be kept as secretlie as your Majestie can devize, for yf yt shulde be known or perseved in flandders it were as moche as my liffe and goods were worth, besides the lose that your highnes shuld susteyne therbie.”

Sir Thomas acted temporarily as ambassador at the court of Margaret of Parma, for which he received his knighthood in 1559. He passed intelligence to William Cecil (Lord Burghley, Secretary of State for

Elizabeth and her great spymaster) – such as King Philip’s plans to ally with the King of France. A ship from 1570 was discovered in the Thames in

// HE WAS CLEARLY A ‘MERCHANT ADVENTURER’ WITH AN INTERNATIONAL NETWORK OF AGENTS //

2003 with cannons inscribed with grasshoppers and marked ‘TG’.

Sir Thomas’s manoeuvring released English monarchs from some crushing burdens of debt and allowed for vital military preparations during the wars of religion, above all between England and Spain, that set Europe ablaze.

GRESHAM COLLEGE

Thomas married Anne Ferneley (1521–96), a widow with two sons. The only child they had together, Richard, died in 1564 at the age of 19 from ‘a fever’. He also had a daughter who

predeceased him, as did his sister. Despite his London marriage, Sir Thomas still continued to reside principally in the Low Countries. Later, in 1559, he bought a large house at 43 Lange Nieuwstraat, as well as a Flemish country mansion. Sir Thomas died suddenly of a stroke ('apoplexy') on 21 November 1579.

Sir Thomas's will of 1575 established his most enduring legacy, Gresham College:

I Will and Dispose that one Moiety.. shall be unto the Mayor and Commonalty and Citizens of London ... and the other to the Mercers ... for the sustenation, maintenance and Finding Four persons, from Tyme to Tyme to be chosen, nominated and appointed And their successors to read the Lectures of Divinity, Astronomy, Musick and Geometry... and distribute to ... Three Persons... and their successors from Time to Time, to be chosen and appointed meete to reade the Lectures of law, Physick and Rhetorick, within myne now dwelling House in Bishopsgate Street

His wife contested his will in favour of her sons from her first marriage for 17 years, but without success. After she died, College lectures began in the Bishopsgate mansion (now the site of Tower 42). The first professor of geometry was Henry Briggs, populariser of the logarithm. Other notables include Edmund Gunter, with his 'Gunter's chain', a distance-measuring device used in surveying; John Greaves, who set up observation posts in the Middle East in 1638 to observe the Moon's eclipse; and the composer John Bull, widely regarded as one of the founders of the modern keyboard repertory.

An intellectual high point followed a lecture by the professor of astronomy, Christopher Wren, on 28 November 1660. Thirteen men formed a 'College for the Promoting of Physico-Mathematicall Experimentall Learning'. A Royal Charter of 1663 named it The Royal Society of London for Improving Natural Knowledge. Many Gresham notables played a part in the Royal Society, perhaps none more so than Robert Hooke, a Gresham professor from 1664

to 1703, and curator of the Royal Society from 1661 to 1703.

After over 150 years at Bishopsgate, the College gained purpose-built premises on the corner of Gresham Street and Basinghall Street in 1842. In 1991 the College moved to Barnard's Inn Hall, a 13th-century hall located close to Chancery Lane. As well as the original seven professors of divinity, astronomy, music, geometry, law, physick, and rhetoric, an eighth of commerce, now business, was added in 1985. The disciplines covered by the College's sponsored and visiting professors now range widely from the environment to information technology.

SIR THOMAS GRESHAM'S LEGACY

Sir Thomas left many marks on the topography of the City of London. The grasshopper, his family symbol, can be spotted around the City, as weathervanes at the top of his major commercial contribution, the Royal Exchange, and in many crests, seals, and stained-glass windows. A large grasshopper hangs at 68 Lombard Street, site of St Martin's Goldsmiths.

His major philanthropic contribution, Gresham College, thrives, over four centuries on, at Barnard's Inn Hall in Holborn. Its former location still exists, and a street before the Guildhall commemorates the family. His grave is prominent in one corner of St Helen's Bishopsgate. At least three statues of Sir Thomas stand in the City, one in a north-facing alcove of the Royal

Exchange, one on Holborn Viaduct, and the other in the Old Bailey.

A portrait by Holbein

in Mercers' Hall, where Sir Thomas was Master Mercer three times, is possibly the first full-length painting of a 'commoner' in Britain. Outside London his various properties extended well beyond his Norfolk origins to include estates such as Mayfield House in Sussex. Sir Thomas is a tough subject for biographers accustomed to focusing on monarchs, their families and their

wars. He traded in several lands and worked in several languages. To some he was austere, to others manipulative, to others ruthless. How did he really make his fortune? How rich was he in

modern terms? Was his support for 'new learning' in his will a commitment that education should be available to

merchants, tradesmen, and navigators, rather than just to gentlemen scholars, or was it a throw-away bequest?

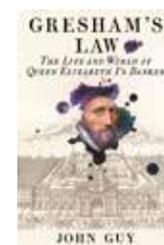
// TO SOME HE WAS AUSTERE, TO OTHERS MANIPULATIVE, TO OTHERS RUTHLESS //

FIRST NEW BIOGRAPHY SINCE 1839

Drawing on extensive new research and several startling discoveries, the eminent Tudor historian John Guy recreates Sir Thomas's life and singular personality with astonishing intimacy. He reveals a survivor, flexible enough to do business with merchants and potentates no matter their religious or ideological convictions. Sir Thomas's mind was a calculating engine; he was a smuggler and arms dealer, an extortioner who was backed by royal authority, and he was a coldly unsentimental figure even to members of his own family.

Even Elizabeth, England's steely young queen, found herself disconcertingly at odds with Sir Thomas's ambitions. In their collisions and wary accommodations, we see our own conflicts between national sovereignty and global capital foreshadowed. A story of adventure and jeopardy, greed and cunning, loyalties divided, mistaken or betrayed, this is a biography fit for a merchant prince. Five hundred years after his birth, now is the time to take stock of his legacy.

// AN INTELLECTUAL HIGH POINT FOLLOWED A LECTURE BY PROFESSOR CHRISTOPHER WREN //



Gresham's Law: The Life and World of Queen Elizabeth I's Banker, John Guy, Profile Books, 2019, 320 pages

ISBN: 978-1788162364



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LAST WORD

Twice the trouble

REGULATORS WHO WANT TO LEARN THE LESSONS OF THE LF WOODFORD EQUITY INCOME FUND SUSPENSION MUST CONSIDER A COMBINATION OF TWO POTENTIAL CAUSES: PORTFOLIO LIQUIDITY AND PORTFOLIO CONCENTRATION

“ This may sound like an odd observation, but, in effect, Neil Woodford came unstuck because he turned his giant equity income fund into a bank. Not literally, of course, but in certain, important ways, the parallel holds. Banks take in customer deposits, most of which can be withdrawn without notice (like any open-ended fund that offers daily dealing), and they lend those deposits out as loans and mortgages that can take 25 years or more to be repaid. If too many people ask for their savings back at the same time, the bank goes pop, à la Northern Rock.

Put that way, it's hardly surprising that Mark Carney, governor of the Bank of England, has strong views on open-ended funds. “These funds are built on a lie, which is that you can have daily liquidity for assets that fundamentally aren't liquid,” he told the UK Parliament's Treasury Select Committee in June 2019. “And that leads to an expectation of individuals that it's not that different to having money in a bank.” Observant readers will note that Carney, in effect, admitted that banks are also built on a lie, but let's move swiftly on for the moment.

Why, then, did disaster strike Woodford's funds? The answer everyone is talking about is liquidity, or the lack of it. This is certainly one aspect of the answer, although I think there are other lessons from this too.

But to begin with the obvious reason: this happened because the rules permit it. Open-ended funds like Woodford's can hold up to 10% of their portfolio in illiquid assets. Once enough investors start to flee, there's no choice but to sell the most liquid stuff to release cash. This necessarily increases the weighting of the more illiquid holdings that are left behind, eventually tipping the fund over the 10% limit and making it

non-compliant. As it struggles to meet redemptions and breaches the regulations, it will have to lock in the remaining investors' money and restructure itself.

In search of returns

That, though, begs the question of why an open-ended fund would choose to hold assets that could get it into this kind of trouble. The explanation lies in the financial world's search for higher returns from illiquid investments, which runs far wider and deeper than Woodford's fund. Uninspired by the returns on offer in liquid, public markets, many investors have chosen instead to seek an ‘illiquidity premium’ from holding non-traded, private assets: from commercial property and private loans to essential infrastructure and unquoted, early-stage companies.

“ Daily dealing seems a clear case of telling investors they can have their cake and eat it ”

This trend is based on the idea that we can earn a higher return from assets that are illiquid and therefore hard to sell in a hurry precisely because we accept the risk that we won't be able to get our money back whenever we feel like it. Looked at that way, Carney's stance is justified: daily dealing seems a clear case of telling investors they can have their cake and eat it.

The idea of investing to earn an illiquidity premium goes way back, notably to David Swensen, manager of the huge Yale endowment in the US. And for that kind of institution, and increasingly insurers' pension investments, it makes

sense. They must pay out an income for many years into the future so it doesn't really matter that they can't sell the assets that are providing that income at the drop of a hat. They don't need to – they need the income to keep coming in.

But the same cannot be said of funds offering daily dealing. That's why ideas are gaining ground, such as requiring investors to accept either notice periods for redemptions or discounts on the value of their holdings in return for instant access. Changes like this would make a lot of sense.

A second problem

Woodford's fund wasn't purely an issue of vanishing liquidity, though – it was also caught out by a second major problem. Not only did he have large illiquid holdings (early-stage, private company shares), but he also held investments in companies whose shares are theoretically liquid, such as Alternative Investment Market (AIM)-quoted stocks, but that in his hands were anything but. This is because he bought such large stakes in these companies: 25%-plus holdings were not uncommon. Stakes this large are almost impossible to sell quickly, no matter the market conditions.

As a result, his portfolio was in fact much more concentrated than a list of its shareholdings might have suggested – but the concentration lay in its very high exposures to individual underlying stocks. For other investors in those mainly AIM-quoted companies, the results have been brutal – prices have crashed because the market knows the number one shareholder is a forced seller.

So, the effects of this blow-up ripple out beyond the investors with money trapped in the fund. And they show that it is not just portfolio liquidity that regulators need to ponder, but portfolio concentrations. ● ”

ILLUSTRATION: PADDY MILLS/SYNERGY