

SECURITIES & INVESTMENT

REVIEW

THE JOURNAL OF THE CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

CISI.ORG/SIREVIEW

JUNE 2014

Question of trust

Are whistleblowers getting the support they need?

Breaking the shackles

Adjusting to new pension rules

Cold comfort

Economist Albert Edwards on the world's deflation risk



Banking on change

SIR RICHARD LAMBERT
ON THE TASK AHEAD
FOR BRITISH BANKS

The CISI Financial Regulation Summit 2014

Wednesday 9 July 2014

America Square Conference Centre, London EC3

Address the challenges facing compliance departments which are juggling numerous regulatory demands on a daily basis.

- ✓ Ensure compliance with UK & EU regulations
- ✓ Hear the latest strategies from the FCA
- ✓ Effectively manage regulatory risk in your firm
- ✓ Connect with industry peers



Guarantee your seat at cisi.org/summit
CISI members can enjoy a 50% discount



Welcome to the first issue of the larger, redesigned quarterly *Securities & Investment Review*, which is complemented by our in-depth academic journal and our redeveloped, always-on digital portal that will be updated weekly throughout the year. Together, these publications are intended to keep CISI members informed and entertained and your Editorial Panel hope that you will find them useful and interesting.

We have a wealth of treats for you in this first magazine and online. There is an exclusive interview with Sir Richard Lambert FCSI(Hon), who was tasked with reviewing the UK's problematic banking system. Janice Warman meets the man behind the report that proposes a new Banking Standards Review Council – and a new world in which banks will be motivated to serve the public interest rather than simply their own.

Chris Alkan asks what can be done to support whistleblowers, who all too often face disciplinary action and even dismissal, while Louis Cooper explains how best to secure that first non-executive director role.

Maverick SocGen economist Albert Edwards warns about global deflation and the overuse of QE. It's a view that not everyone agrees with but he is used to being a lone voice: as he says, "Though I look like an idiot 90% of the time, I am now used to this state of affairs."

In the Grey Matters feature, we consider whether an employer who learns a startling fact about a prospective employee's past should discount her outright, or give her credit for her disclosure and offer her the role.

Chris Adams, the *Financial Times'* markets editor, warns that data crunching on bubbles reveals that this one is likely to burst shortly after the next US election. And our new Last Word columnist, Andrew Davis, former editor of *FT Weekend*, says the list of misselling scandals is simply too long and the gulf in knowledge between buyers and sellers is too great; something must change.

We are calling on your creative skills, too. Once you've read our book review of *Flash Boys*, by Michael Lewis, on page 9, we'd like to hear what books you have read recently that you've enjoyed. And if you like eating out, we would like to see reviews of your favourite restaurants for a business lunch – the best review each quarter will appear in the *S&IR* print edition and there will be a foodie prize for the best entry over the year. See page 11 for more details.

Don't forget that once you have read this issue from cover to cover, you will be able to turn to the online edition of the *S&IR* for fresh copy each week. Let us know what you think at cisi.org/sireview, emailing richard.mitchell@cisi.org or tweeting us at @CISI.

Peter Land
Chairman, CISI Editorial Panel



Join our winning team

Beaufort Securities continues to expand. With well established UK offices in London and Bristol, as well as international operations in Dubai and Mauritius, we are now heading to Manchester.

- ***Are you RDR qualified?***
- ***Do you want to be part of a growing business?***
- ***Ready to hit the ground running?***

If so, we want to hear from you. Please contact:

Jim Dolan, Beaufort Securities Ltd, 131 Finsbury Pavement, London, EC2A 1NT
Tel: 020 7382 8301 | Email: jim.dolan@beaufortsecurities.com

Beaufort Securities is an award-winning independent stockbroker which has been trading for over twenty years. We are currently looking for both stockbrokers and wealth managers to join the team in our new Manchester offices. Offering a full traditional stockbroking service to private clients as well as corporate broking services to a number of companies on AIM, Beaufort provides its clients with access to a wide range of investment opportunities including CFDs and new issues.

BEAUFORT

Editor
Janice Warman
Consultant Editor
Andrew Davis
Art Director
Steven Gibbon
Account Director
David Poulton
Production Director
John Faulkner
Managing Director
Claire Oldfield
Chief Executive
Martin MacConnol
Advertising Sales
Yanina Stachura
+44 20 7010 0945
yanina.stachura@wardour.co.uk
Cover illustration
Stuart Briers

Published on behalf of the
Chartered Institute for Securities & Investment
by Wardour, 5th Floor, Drury House
34–43 Russell Street, London WC2B 5HA
Telephone: +44 20 7010 0999
Fax: +44 20 7010 0900
www.wardour.co.uk
ISSN: 1357-7069

**Communications Editor, Chartered Institute
for Securities & Investment**

Richard Mitchell
8 Eastcheap, London EC3M 1AE
Telephone: +44 20 7645 0749
Email: richard.mitchell@cisi.org

Editorial Panel

Peter Land, Chartered FCSI, <i>Chairman</i>	Brewin Dolphin
Suren Chellappah FCSI	Sanford C Bernstein
Moorad Choudhry FCSI	Brunel University
Simon Culhane, Chartered FCSI	Chartered Institute for Securities & Investment
Paul Dawson, Chartered FCSI	Fidelity Worldwide Investment
Scott Dobbie FCSI(Hon)	Deutsche Bank
Mike Gould FCSI	Investment Management Association
Amy Lazenby, Chartered FCSI	Cloche Brothers
Jeanette Lichner MCSI	FTI Consulting
George Littlejohn MCSI	Chartered Institute for Securities & Investment
Gregor Logan MCSI	Rathbone Investment Management
Paul Loughlin, Chartered MCSI	Chartered Institute for Securities & Investment
Robert Merrifield, Chartered FCSI	JM Finn
Richard Mitchell	Westport Global
Frank Reardon, Chartered FCSI	Charles Stanley
Patricia Robertson, Chartered FCSI	Sage & Hermes
Jeremy Robinson, Chartered FCSI	BPP Professional Education
Nimrod Schwarzmann	Chartered Institute for Securities & Investment
Arjuna Sittampalam, Chartered MCSI	
Nigel Sydenham, Chartered FCSI	
Alan Yarrow, Chartered FCSI(Hon)	



© The Chartered Institute for Securities & Investment (CISI). All rights reserved. Reproduction in whole or part prohibited without prior permission of the CISI. The CISI and Wardour accept no responsibility for the views expressed by contributors to the *Securities & Investment Review*, or for unsolicited manuscripts, photographs or illustrations, or for errors in articles or advertisements in the *Securities & Investment Review*. The views expressed in the *Securities & Investment Review* are not necessarily those held by the CISI or its members.



Contents

6 NEWS REVIEW

News and views from the CISI

7 CITY VIEW

The Banking Review needs an immediate, positive response from international banks

13 FIRST PERSON

The bubble will burst after the US election, says *Christopher Adams*

14 THE TASK AHEAD

Sir Richard Lambert explains the thinking behind his banking reforms to *Janice Warman*

18 A QUESTION OF TRUST

Chris Alkan asks what can be done to support whistleblowers

20 BREAKING THE SHACKLES

Andrew Davis examines how the annuity market is coming to terms with new pension rules

23 NETTING A NED ROLE

Louis Cooper explains how to secure a non-executive role

24 SPOILT FOR CHOICE

Well-heeled investors face a bewildering array of options, writes *Chris Alkan*

26 THE BIG FREEZE

Economist Albert Edwards issues a global deflation warning

29 REVIEW OF FINANCIAL MARKETS

Turn to the centre pages for the latest academic journal

41 PEOPLE: PERFECT PÉTANQUE

Brigitte Ibitson on her passion for playing pétanque

42 A PUFF OF SMOKE

A job applicant's past provokes an ethical dilemma

44 CPD: MANAGING CONDUCT RISK

Only when they understand it can companies manage conduct risk, says *Jeanette Lichner MCSI*

46 LAST WORD

Our new columnist *Andrew Davis* on product innovation and misselling

S&I REVIEW

The Journal of the Chartered Institute for Securities & Investment

Your digital magazine, cisi.org/sireview



60-SECOND INTERVIEW

Ruth Martin is to step down as CISI Managing Director in January 2015 after 12 years at the CISI and ten years in the role. She looks back over the past decade and ahead to some exciting new challenges



What are your thoughts looking back on your years at the CISI?

I have been privileged to serve such an important sector as financial services, and a body which

proclaims high standards of competence and integrity as cornerstones of professionalism. It has been an exhilarating journey, from opening our markets in the Middle East and India, to leading the project to attain Chartered status and the sponsorship of a teacher in Liverpool. I have had numerous exciting opportunities to innovate and develop policy across a very broad canvas.

How different is today's CISI to the organisation you joined?

It is very different. The Institute has increased its membership by 50%, opened five international offices and, from offering only a few qualifications, now annually provides exams in more than 100 countries 'making geography history'. When I joined, the CISI had no close working relationship with regulators either in financial services or in education, whereas today we are accredited by a number of them. The education penetration was very small, the Institute having links with four schools and two universities; now there are nearly 40 universities and 20 schools.

What three changes have been of greatest benefit to members?

- The achievement by the Institute of Chartered status in 2009.

- The introduction of the continuing professional development (CPD) scheme, which now has 14,000 registered users. All CISI CPD activities are automatically recorded to members' CPD logs, enabling us to meet the needs of regulators too.
- The vast expansion of CPD opportunities, from professional forums and seminars to CISI TV, which enables members to watch popular events at a time convenient to them; 'learning on the go'.

What plans do you have for the future?

I still have much to do and new roads to travel, particularly those that align with my interest in professional standards in the workplace and in education. For example, I am chair of governors of a comprehensive school, so I need to keep my hand in on education matters anyway!

Go online to read our digital edition

Have you caught up yet with the new digital edition of the *Securities & Investment Review*?

The tablet and smartphone-friendly online issue is updated each week. It provides exclusive access for members to features, opinions and analysis on hot industry topics, over and above what you will read in the new-look quarterly *Review*.

Latest highlights include a focus on UK financial centres outside London and a profile of Paul Craven, behavioural economist and Magic Circle member, who will speak at the CISI Annual Conference on 17 June. There is also an archive of articles from past print issues of the *S&R*.

Taken together, the launch of the digital edition and this new-style journal will mean the *S&R* will deliver 50% more feature content, helping members to keep up to date with the latest developments and talking points in financial services.

- View the digital edition and leave your comments on featured articles, or the issue as a whole, at cisi.org/sireview



CISI AGM details

This year's Annual General Meeting will be held at the CISI, 8 Eastcheap, London EC3M 1AE, on Thursday 25 September 2014, commencing at 10.30am.

A Member (MCSI) or Fellow (FCSI) of the Institute may be nominated for elected vacancies on the Board. Board members retiring by rotation may stand for re-election and the Board itself may also sponsor candidates for any vacancies arising. Nominees will be required to meet with members of the Board Nominations Committee before going forward as a candidate for election.

A nomination form, which includes an explanation of the requirements for the election of candidates to the CISI Board of Directors, is available on the CISI website. Alternatively, a hard copy of the form is available, on request, from Linda Raven at linda.raven@cisi.org or +44 20 7645 0603.

The closing date for nominations for Board membership is Monday 14 July 2014.

- CISI Chairman Alan Yarrow, Chartered FCSI(Hon), would be happy to speak to any potential nominee or sponsor before a formal application is made. He can be contacted at alan.yarrow@cisi.org or +44 20 7645 0603.

City view



SLIGHTLY LATER THAN PLANNED AFTER THE LARGE RESPONSE HE RECEIVED TO HIS HALF-TIME REPORT,
SIR RICHARD LAMBERT ISSUED HIS FINAL RECOMMENDATIONS ON HOW BANKS CAN ACHIEVE HIGH STANDARDS OF COMPETENCE AND BEHAVIOUR

As you would expect from a former *Financial Times* editor, Sir Richard Lambert FCSI(Hon) has consulted widely and deeply, contacting all the major stakeholders including banks, professional bodies, consumer groups and influencers. He commissioned papers from a number of these, including the CISI and Chartered Banker Institute.

With the handicap of having to rely on co-operation and exhortations rather than formal authority – though the Bank of England Governor's agreement to lead an independent panel to appoint the chairman of the Banking Standards Review Council is encouraging – Sir Richard has trodden carefully. After careful consideration he has decided against starting up a new professional body, preferring to 'support not duplicate' by encouraging banks to recognise and promote the value of professional qualifications. This is a welcome and long overdue message. Sir Richard also pushes the banks on continuing professional development (CPD). His eye-catching way to encourage participation is to ask the banks

to publish various criteria on an annual basis, such as the percentage of staff taking exams or completing their CPD.

REAL CHANGE

However, the public may be more sceptical. Banking professional bodies have been around for many years, so what is new? What would be different is if Sir Richard had gone further and strongly encouraged banks to ensure their staff belonged to an appropriate professional body, which his group would accredit to guarantee quality. This would have provided significant, immediate leverage and could have been implemented within six months.

That would be a real change because, as well as providing qualifications, members of a professional body, especially at Chartered level, have to complete their 35 hours of CPD and adhere to high standards of behaviour.

Secondly, very few international banks have publicly signed up. Apart from the original 'magnificent seven' (the top six UK retail banks and Nationwide) there is no representation from the investment banking

or international community. For every PPI scandal, there's a LIBOR. For every interest rate swap, there's an FX probe. Sir Richard rightly said his review is for the whole of banking, not a subset, so the sceptics will

“Very few international banks have publicly signed up”

be proved right if this report has only seven supporters from a population of over 250 London-based banks.

THE TONE FROM THE TOP

Only if there is an immediate, positive response from some of the big international banks, which means action in support of these recommendations, will there be a chance that it will take less than a decade for the tone from the top to trickle through to the tone at the till.

- See our profile of Sir Richard Lambert, page 14

The knowledge

What it takes to succeed in stockbroking

Redmayne-Bentley, a long-standing supporter of the CISI, has been judged Stockbroker of the Year 2014 at the City of London Wealth Management Awards. So what does it take to achieve success in the sector? Here Redmayne-Bentley's Lauren Charnley MCSI, Stockbroker and Investment Services Executive at the firm's head office in Leeds, provides five top tips.

1 Be in the know: In all industries, it's important to stay well informed; however, in the stockbroking world it is paramount. The market shifts at a meteoric pace, so even a week away from the office without

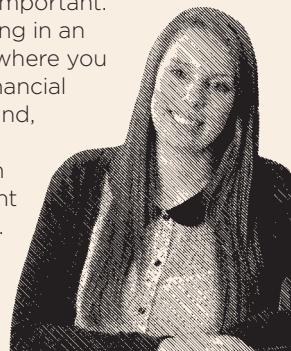
checking on goings-on can mean missing key events and data.

2 Be qualified: We live in a world of continually evolving regulation, where the financial services sector is under close scrutiny following the financial crisis of 2007-08. Changes in regulation must be adhered to, and meeting this requirement can mean sitting more exams as well as ensuring CPD is kept up to date.

3 Be a people person: People skills are essential, as you interact with individuals on a daily basis. Being able to listen, to speak effectively and accurately, and to build relationships all help.

4 Stay calm: When the market swings drastically one way or the other, it can get chaotic. Panicking in busy times is not an option and keeping a cool head is a must.

5 Be meticulous: Attention to detail is very important. You are working in an environment where you are making financial transactions and, if you make a mistake, it can have significant repercussions.



Art in the City

There is a dazzling art collection in the City and in corporate collections across the world that few of us will ever see. In each issue of the new quarterly *S&R*, we will bring you an example.

It is thought that the first corporate collection was formed during the Renaissance in 1472 by the Monte dei Paschi Bank in Siena. It is a collection that survives, and thrives, to this day. By the mid-1990s, half of the Fortune 500 companies and another 2,000 companies in the US and Europe were actively collecting art.

Now authors Peter Harris and Shirley Reiff Howarth have set out to document this hidden collection in their book, *A Celebration of Corporate Art Programmes Worldwide*.

They quote corporate art consultant Susan Abbott, who notes that: "A corporate art programme is there for a purpose, and the purpose is always business. There would be no art on the walls if the collection

did not do something for the company, either by projecting a particular image, or by improving the relationship between the company and the community, or by refreshing and stimulating the company's employees."

Notable collections in the UK are held by insurance company Hiscox, the Fleming-Wyfold Art Foundation (where the John Watson Nicol oil, right, hangs) and law firm Clifford Chance. There is a predominance of modern art in these collections: artists included in an exhibition at Bonhams earlier this year included Magritte, Delvaux, Tracey Emin, George Grosz and Cornelia Parker.

- Do you have a favourite piece of art in the City? Email richard.mitchell@cisi.org



John Watson Nicol, Lochaber No More, 1883, oil on canvas
© The Fleming-Wyfold Art Foundation

OUT OF HOURS

Film offer is just the ticket

CISI members in the UK can save an average of 38% on cinema tickets.

Simply purchase vouchers to be used at your nearest participating cinema (including Cineworld Cinemas, Empire and Showcase) at discounted prices. Members can buy up to five pairs of cinema vouchers per calendar month. Better still, these vouchers are valid for a minimum of six months, so place an order now, ready for your next visit to the cinema*.

Order cinema tickets through CISI Select Benefits via cisi.org/mycisi

*Terms and conditions apply. See website for details. Offers subject to change without notice. Discounts vary between cinema venues. Please check when booking.

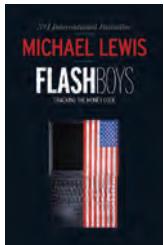


Book review



FLASH BOYS

Michael Lewis, Allen Lane, 2014



In *Flash Boys*, author Michael Lewis takes aim at high-frequency trading – that corner of financial services where profits are determined not by the skill of a fund manager or a stock-broker, but by computer programmers and their hardware.

The book follows several morally minded finance professionals who, having grown weary of the corrupting technology on Wall Street, seek to expose the rigged nature of markets and create their own 'fair' stock exchange.

Given Lewis's back catalogue of successful, popular books on the financial world, including *Moneyball*, *Liar's Poker* and *The Big Short*, *Flash Boys* succeeds in translating the horrendously complex world of algorithmic trading for the lay audience. But therein lies its potential flaw for a more knowledgeable audience – financial professionals might not feel there is enough detail in the book, even if he does capture some of Wall Street's devil.

Rob Haynes

• Read a good book lately? Send your reviews to richard.mitchell@cisi.org



The S&R's quick quiz, *In the know*, features questions from CISI elearning products, which are interactive revision aids to help candidates prepare for their exams. The answers are at the bottom of page 11.

1. Which of the following statements best describes financial capital?

- A The deposits made by investors that will need to be repaid
- B The accumulated financial wealth of a business
- C The nominal value of equity and preference share capital
- D The minimum amount of regulatory capital required under regulations

2. Which of the following is typically regarded as the simplest operational risk assessment method?

- A Scenario analysis
- B Ranking
- C Benchmarking
- D Key risk indicator

3. An employee of a firm would be considered to hold a 'significant influence function' if the role primarily involved:

- A Giving investment advice
- B Drafting marketing material
- C Dealing with complaints
- D Conducting oversight duties

4. Which of the following is a prime reason for a demerger?

- A Diversification into new product areas
- B Improving market competitiveness
- C Reaching a wider customer base
- D Release of capital to reduce debt levels

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

BACK STORY

*Kevin Milne,
Chartered FCSI, Owner,
Due Diligence Reports*

Kevin Milne recalls a lunch at the end of his first week at the London Stock Exchange (LSE) with a broker, who drew his attention to the motto underneath the crest on his business card: *Dictum meum pactum* – ‘My word is my bond’.

“He said: ‘If you take nothing else away from this lunch, remember: “My word is my bond”. If you always try to live up to that, you’ll have a long and successful career in financial markets. If you don’t, you’ll have a spectacularly successful one, but it’ll be quite short!’”

Kevin joined the LSE in time for the Big Bang in 1986



As his career suggests, Kevin did remember. He had joined the LSE after early jobs in the financial technology sector in time for the Big Bang in 1986. He was part of the services marketing team, whose role was essentially “to make sure that, when they flicked the switch, everything worked!”

After five enjoyable years, he decided to move to a more commercial environment. So he joined Extel to help run its financial systems business and prepare it for sale, a task he achieved after restructuring the company.

A series of successful posts followed before his world came full circle in 2010, when he was invited to rejoin the LSE. He worked on the executive committee, running post-trade businesses in the UK and Italy until June 2012.

In the wake of the financial crisis, he was encouraged to see the concepts of decency and integrity returning to the markets. That was one of the attractions of working with Rate Validation Services (RVS), a small Australian-based company with a smart system that enabled benchmarks to be automatically created and validated using trade information. Kevin joined the board to help the business to focus on London. RVS’s new LIBOR administrator service, provided to the Intercontinental Exchange, went live on 1 February this year and Kevin stepped down as CEO a month later, as planned.

Since then, he has been enjoying a rare opportunity to spend time with his family while he decides on his next move. In the meantime, there is his advisory work for large private equity firms, which he has run for the past ten years as Due Diligence Reports. Whatever he decides to do next, you can be sure it won’t be dull.

- Do you have a back-office story?
janice.warman@wardour.co.uk

Events preview



The CISI runs a varied programme of events, both to support the continuing professional development of members and to provide networking opportunities. Here are two dates for your diary.

17 JUNE CISI ANNUAL CONFERENCE 2014

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

The CISI's Annual Conference this year will feature a blockbuster programme focusing on two themes – the economic, investment and political climate, and the steps members and firms can take to enhance their performance.

Called ‘Driving Ambition – the role of wealth management in supporting global economic growth’, the event has a glittering array of speakers including:



Dr Vince Cable MP, Secretary of State for Business, Innovation and Skills (pictured left); Sir Richard Lambert FCSI(Hon), whose radical recommendations on professionalism in finance were published in May (see Profile, page 14); Sir Andrew Likierman, Dean of London Business School, and Chairman of the National Audit Office; and Rear Admiral Chris Parry CBE, looking to lessons for finance from the high seas.

9 JULY FINANCIAL REGULATION SUMMIT

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

The Financial Regulation Summit 2014 will address the vast amount of regulation that compliance departments have to adhere to on a daily basis. It will help attendees to keep abreast of latest regulatory changes in the UK and eurozone, discover the latest strategies for running an efficient and effective compliance department, and benchmark their progress and processes with peers.

Speakers will include David Saunders, Senior Adviser, Financial Conduct Authority. His speech will discuss what to expect and what is involved in competition regulation. The event will be chaired by Julian Sampson, Chartered FCSI, Chairman of the CISI Compliance Professional Forum.

CISI members can attend each conference for just **£200 (non-members £400)**. For details of conferences, training courses, CPD and social events available to members, visit cisi.org/events or call +44 20 7645 0777.

Ask the experts: What is Mifid II?

How does Mifid II differ from the original?

The first Markets in Financial Instruments Directive (Mifid I) has been in force since 2007 and is a cornerstone of the EU's regulation of financial markets. It sought to improve the competitiveness of EU investment services and investment activities by creating a single market in them, and ensuring a high level of harmonised protection for investors in financial instruments, such as shares, bonds and derivatives. Mifid I is thought to have brought greater competition across Europe between trading venues – there are now more participants charging lower fees – but investor protection remains mostly national.

The financial crisis highlighted this and other weaknesses in the original Directive, so it is being updated through a new Directive and by a regulation, Mifid II, which is not expected to come into force until 2016 or even 2017.

What does Mifid II do?

Mifid II aims to establish a safer, more transparent and more responsible financial system that works for the EU economy and society as a whole. It aims to do this by several means: by ensuring that trading, wherever appropriate, in equities, bonds and derivatives, takes place on regulated platforms – by an authorised multilateral trading facility (MTF – which matches client orders automatically) or by a new entity called an organised trading facility (OTF – which matches client orders on a discretionary basis, for example some broker crossing networks) or by a regulated exchange such as the London Stock Exchange (market makers may also become systematic internalisers with obligations to maintain quotes); ensuring pre- and post-trade price market transparency for liquid equities, bonds and derivatives, causing major changes in the over-the-counter (OTC) markets in these instruments; breaking the sometimes exclusive link between markets and their clearers found in some ‘vertical’ market structures; strengthening supervisory powers and a harmonised position-limits regime for commodity derivatives; improving conditions for competition in the trading and clearing of financial instruments, essential for the integration of efficient and safe EU capital markets; trading controls for algorithmic and high-frequency trading activities (such traders

must be more regulated, and provide liquidity if they pursue a market-making strategy); stronger investor protection via more detailed conduct rules to be made by the European Securities and Markets Authority, including banning firms calling themselves independent from receiving benefits from product providers (with significant differences from the UK's Retail Distribution Review regime – which will need to be resolved); organisational requirements, such as client asset protection, product governance and independence of the risk function; limiting the ability of non-EU firms to sell investments to retail clients without establishing a branch in the EU (which they can only do if certain, quite tough, equivalence standards are met, but when established will have a pan-EU passport); and strengthening the existing regime to ensure effective and harmonised administrative sanctions.

The costs and benefits

Some commentators estimate that Mifid II will have one-off compliance costs of between €512m and €732m, plus ongoing costs of between €312m and €586m per year, but this does not take account of the impact on firms' and markets' earnings from the consequent strategic changes.

Regulators expect the benefits to be an increase in cross-border EU investment; increased market transparency of OTC transactions reducing investors' costs; better transparency through more transaction reporting towards regulators that will have stronger powers; and increased investor protection benefiting the confidence retail and wholesale investors have in financial markets.

Further information: CISI Professional Refresher: Mifid II – cisi.org/refresher. CPD training course: Mifid II and the New Regulatory Structure, next dates 24 June and 2 September – cisi.org/courses



Christopher Bond, Chartered MCSI,
Senior Adviser, CISI

Restaurant reviewers required

Do you have a favourite restaurant that you use for business lunches? Or have you had a terrible experience while entertaining a client? We need you

The S&R is launching a restaurant review competition to celebrate its makeover. We are looking for the best restaurant reviews – or terrible tales of lunchtime meetings gone wrong. We will publish the



best online and the top three will feature in the print *Review*. The final winner will receive a foodie prize. The competition is open to all members, so please send your reviews to richard.mitchell@cisi.org. Details at cisi.org.



Minds, markets & magic

Former Goldman Sachs man Paul Craven has swapped a long career in the City for life as a behavioural economist – and member of the Magic Circle....



Read now via your new online Securities & Investment Review –

cisi.org/sireview



Irrational exuberance strikes again

DATA CRUNCHING ON MAJOR MARKET BUBBLES OVER 88 YEARS SUGGESTS THAT THIS ONE IS LIKELY TO BURST SHORTLY AFTER THE US ELECTION

CHRISTOPHER ADAMS JOHANNA WARD

With the US stock market trading close to record highs and now into the sixth year of a bull run, the B-word has returned to investors' lips. For some, the exuberance has become symptomatic of a bubble, stoked by an assumption that central bankers, who by way of quantitative easing (QE) have encouraged investors to pour money into risky assets, are ready to support falling markets.

Jeremy Grantham of the fund manager GMO has recently made the most eloquent case for this. His detailed look at why today's market conditions mean we are headed for a correction in the not too distant future merits scrutiny, not least because GMO has crunched the data on more than 300 major – and minor – market bubbles over 88 years.

The veteran fund manager draws on research by John Hussman, who argues that US markets were overpriced by between 75% and 125% at the end of March. He writes that GMO "very much agrees with the spirit of this data, but our preferred measure for our seven-year forecast has the market slightly less overvalued at 65%."

To get to what Grantham calls a two-sigma event – akin to the US stocks bubble before the plunge of 2008 – the S&P would need to rise from current levels to around 2,250. This is within reach, given that the driving force behind recent bubbles has been the Greenspan Put, the market-friendly approach of former Federal Reserve Chairman Alan Greenspan. Indeed, Grantham,

taking account too of how markets move with political cycles, predicts that stocks are likely to rise at least until the next US presidential election in 2016.

History shows, he says, that strong gains tend to come in the third year of the presidential cycle. So from October this year until April 2015, the market is likely to be strong, the S&P perhaps even rallying past the 2,250 level in the following 18 months up to the election.

"And then, around the election or soon after, the market bubble will burst, as bubbles always do, and will revert to its trend

“To get to a two-sigma event, the S&P would need to rise to 2,250”

value, around half its peak or worse, depending on what new ammunition the Fed can dig up."

This might seem a simplistic take on historical trends, but then compare the now seemingly unbelievable view at the peak of the last credit boom that history was no longer a guide to the future. Remember the 'this time is different' mentality of the dotcom mania that led to the stock market bubble in 2000?

Grantham's colleague at GMO, Edward Chancellor, defines this mentality as one of the typical characteristics of stock market mania. That same thinking, he

says, is evident today among those who believe US profit margins, now at peak levels, have reached a permanent plateau. For good measure, he throws in some other defining characteristics. These include easy money, overblown growth stories, conspicuous consumption and Ponzi finance.

The Fed's QE programme ticks the first of these, while biotech and internet stocks are today's overblown story. The pumped-up art market and charge into junk bonds, where the quality of credit has deteriorated in a 'dash for trash', are examples of the last two. A composite model of market sentiment, drawing on more measures, suggests it is above the level of 1996, when Greenspan first spoke of "irrational exuberance".

Plenty of reasons to be cautious, then; but if we are in a stock market bubble, there are missing ingredients still. One is the lack of strong growth in private sector credit. The Fed has helped fuel a rally in asset prices, but its huge monthly asset purchases have yet to boost lending by US banks.

Remember, too, that just because people say the stock market is overvalued does not mean a correction lies ahead. Birinyi Associates has reviewed more than 300 pages of news headlines from 2010, when the S&P gained 13%. Headlines from the first quarter of that year include: "Bull looks long in the tooth" and "The markets have good reasons to be nervous".

Christopher Adams is the Financial Times' markets editor



“ I don’t want to claim hindsight. I felt uneasy about the degree of financial engineering developing in the ’90s ”



SIR RICHARD LAMBERT'S CAREER AT THE FINANCIAL TIMES AND THE CBI COULD NOT HAVE PREPARED HIM BETTER FOR THE TASK OF MAKING A ROOT-AND-BRANCH CHANGE TO THE BRITISH BANKING SYSTEM

◆ JANICE WARMAN ◆ DAVID RYLE

The task ahead

Sir Richard Lambert FCSI(Hon) has had an unrivalled career at the heart of the British financial establishment: after 30 years at the *Financial Times* (*FT*) and a spell as Director General of the CBI, he was then charged with the biggest gig in town: the reform of Britain's banking system, which was so damaged by the 2008 crisis and subsequent events that true change seemed impossible.

On the day I meet my former editor at the banking standards review headquarters in Gresham Street in the City of London it is no surprise that he is running late – he has been with his advisers ahead of the launch of the Banking Standards Review, which was itself delayed by the torrent of responses he received during his research.

It's the eve of his announcing his recommendation: an independent Banking Standards Review Council (BSRC), funded by the banks, which will drive up standards of behaviour and competence in the industry.

He is charming, urbane, apologetic about the delay, but clearly unflustered. First he swiftly delivers a minute to camera, urging people to attend the CISI conference on 17 June at which he is a keynote speaker.

Then it is my turn. We kick off with his career: Balliol (history), then, "Well, I worked for 200 years at the *Financial Times*. I left university and went straight there."

He is steadfastly modest. "My comparative advantage, if I had one," he declares, "was that I was interested in finance – unlike quite a few of my colleagues. So I did the financial jobs. I did the Lex column and I

was financial editor and New York bureau chief. And then for a long time I was a deputy editor to Geoffrey Owen (who I saw yesterday) who is a great man.

"He's my hero still. We have breakfast every three months. He's writing a book on biotechnology. Why has the UK not created any great biotechnology firms when we had all the intellectual property?

"He's 80 next month. And he keeps saying, 'What do you think I should do next, Richard?'"

And he returns to the story of his time at the *FT*. "I tended to do the financial bit of the paper and Geoff tended to do the industrial bit of the paper. And then I was editor for

"It shows how ignorant the FT was in those days: they sent me. I couldn't read a balance sheet"

ten years. I spent 18 months doing the US edition, which was really good fun."

Lambert got an early inkling of what a scandal-ridden place the City was. One of his first stories was "the terrific scandal of a fund management group called Investors Overseas Services, which was based in Geneva.

"And it shows how ignorant the *FT* was in those days: they sent me. I couldn't read a balance sheet. The editor came out and said does anybody know what IOS stands for and I said yes." And he said, "Go there. Oh God, it was a nightmare."

Lambert must have done a good job, because there were many similar stories to follow. "There was the secondary banking scandal, the crisis of the year 1973–74. Then there was a big Bank of England rescue of the secondary banks. And then the structure changed completely with the removal of foreign exchange controls in 1979.

"Until then, UK banks had been entirely domestic. Then there was the Big Bang and everything changed.

"After that came a whole series of bank failures. Johnson Matthey, where the Bank of England bailed it out without telling the Treasury. And then Barings. That was very exciting and dramatic. So they were a pretty regular occurrence."

"At any point did you feel uneasy about the way the banking system was changing? I don't know if you could pinpoint anything?" I ask.

"I don't want to claim hindsight. I felt uneasy about the degree of financial engineering you saw developing in the '90s, which encouraged industrial companies like ICI or GEC to commit hara-kiri, which happened. But I wasn't a banking correspondent and I can't claim any great insights."

"So it wasn't that you felt at that point that you could foresee it?"

"No."

"Well, perhaps changing the question then: At what point did you feel uneasy?"

"Too late."

"And when was that?"

“Well, maybe we should fast-forward a couple of years. I left the FT in 2001 and I did a few other things. And then I went to join the Monetary Policy Committee (MPC) at the Bank of England, from 2003–06.

“I was completely preoccupied with inflation. The statutory responsibility individual members of the MPC are tasked with is setting interest rates, so as to keep inflation under control. We would spend lots of time thinking about how credit was being priced.

“For me it was all about inflation. ‘How could what’s happening to house prices feed through to inflation? What are the risks of house prices falling?’

“And you would look and say, well, house prices never actually have fallen in nominal terms. I remember a piece of analysis showing that mortgage holders in the UK on average had an equity buffer of £60,000 each. Which seemed to be quite cosy. And what I didn’t say was, well, hang on, where’s the money coming from?

“It was obvious that risk had been mispriced. But it never crossed my mind that there would be a bank failure”

“The average mortgage holder had an equity cushion. And you could see the rise in household debt. But that was accompanied on the other side of the balance sheet by rising household assets in terms of housing and shares. So it didn’t look as though the gearing was all that dreadful.”

The wake-up call came, he says, after he had left the MPC and saw an analysis of the building societies: “Suddenly I realised that... two-thirds of all new mortgages in the UK before the bubble were being financed by US money funds.

“So I was slow off the mark: it was obvious that risk was being mispriced. And it was obvious that there would be some biteback for that. But it never crossed my mind that there would be a bank failure.

“I’d spent my whole life – and maybe the FT encouraged this – thinking, probably it is a great drama, but actually it’ll be all right in the end. I’d always thought that things worked themselves out. So for me, seeing the news shots of the queues outside Northern



Rock was the most shocking thing. Because here was something that shouldn't have happened. And we hadn't muddled through; we'd shot ourselves in the foot. With enormous consequences."

When we speak, just ahead of the review's release, he has seven banks signed up to the proposed Banking Standards Review Council (BSRC), which have 75% of the employees in the British banking system. "It's a big chunk. But it's the big investment banks that I'm keen to get in. As well as that, I'm keen to get in the smaller challenger banks, the Metros and the Virgins and Handelsbanken."

The new council will publish an annual report on progress for the banking system and the performance of individual banks. "And it will be looking for excellence." The report will be vital, he warns. "That will be where its credibility is damaged or not. If it turns out to be a PR document for the banks, then you can forget it. It will have to be prepared to annoy the banks."

There are already signs of change, he maintains – like the recent Financial Conduct Authority report that said "all major British retail banks had significantly changed for the better the incentives in their retail branches," particularly regarding the sales of products such as PPI.

What lies ahead is important: "There are three pieces in the jigsaw puzzle. The big

one is, the leadership at the banks: are they going to do different things from what they were doing in the run up to the catastrophe? Is the regulation proportionate and sensible? And will that change incentives so that bankers are motivated to serve the public interest rather than their own interest?

"If those are in place, then this body that I am proposing will make a useful contribution. If they are not, this will be a waste of time."

"Professional bodies will have to think about whether they need to have more ways of disciplining poor behaviour"

More qualifications are needed, he says. "This is something that the CISI and others are working on, and I hope that this new body will be able to work with them as well. These qualifications need to have more economic value that they have had recently. It used to be the case that you couldn't progress in your career, especially on the retail banking side, unless you had got them.

"What would be great is if the qualifications you got from the CISI made you more likely to be promoted and get paid more. So I hope that this new body will be a facilitating organisation, which will bring together the banks and the professional bodies and look for common agendas.

"The professional bodies will have to think hard as well about whether they need to have more ways of disciplining poor behaviour among their own members, for example. Because if you're going to say a qualification has to have value, then if something has value, it has to be something you can take away."

"I was very impressed by the Salz Review of Barclays Bank, which I think could apply to quite a few banks, and which said in that hectic period of growth from the mid-1990s to 2006–07, its sense of purpose became a short-term return on equity. And that had the consequences we know about." What is needed instead "is a sense of purpose that recognises that the people who run banks, in rather pompous words, are custodians of institutions of great public importance in which the public has a legitimate interest, as well as in the profit-earning business."

Lambert was born in Manchester and went to Fettes College in Edinburgh, where other alumni have included the actress Tilda Swinton, former Labour Prime Minister Tony Blair, the late advertising legend David Ogilvy and even James Bond. He is happily married to Harriet, who was a book editor and later a marriage counsellor, and has "two grown children of whom I'm ridiculously fond, and I'm now a grandfather. Or 'We are a grandfather,' as Mrs Thatcher said."

His three grandchildren came along quite quickly, "like buses," he says, smiling. His daughter Caroline is a nurse and has just started a new job at Great Ormond Street Hospital in London, and his son Peter is a film editor, one of whose recent projects was the vampire blockbuster *Twilight*.

"We went to see it and you could see everybody in the audience thinking, who are these old geezers, and then at the end, every time Robert Pattinson's name came up, everybody screamed. And then at the very end, when it said, editor, Peter Lambert, we screamed." He laughs at the memory.

So how is he going to relax in the wake of a flat-out finish to a long career?

"I'm going to be Chairman of the British Museum!" He grins and punches the air with both arms. "Lucky me!"

"That's how you're going to relax?"

"Yes."

The new position is one of the reasons he didn't put his name forward to lead the banking standards council. The other is "I'll be 70 in September and it's time to grow up."

He is enthusiastic about the performance and prospects of the Museum. "They have over 6.5 million visitors a year. It's in great shape. It's got a brilliant director.

"A life of leisure for me lies ahead," he says cheerfully. But not before he has helped find a chairman and panel for the new BSRC.

"I have got a dream team," he confides before we part, though he won't reveal who they are. But then, a good journalist never reveals his sources.

 Watch an interview with Sir Richard Lambert, in which he speaks about his recommendations, at youtube.com/cisisite

THE CV

2012-14 CHAIRMAN OF BANKING STANDARDS REVIEW

2011 KNIGHTED FOR SERVICES TO BUSINESS

2008 CHANCELLOR, UNIVERSITY OF WARWICK

2006-11 DIRECTOR-GENERAL OF CBI

2003-06 INDEPENDENT MEMBER OF THE BANK OF ENGLAND MPC

2001-03 WRITES LAMBERT REVIEW OF BUSINESS-UNIVERSITY COLLABORATION

1991-2001 EDITOR, FT

1966 GRADUATES FROM BALLIOL, OXFORD (HISTORY), JOINS FT

A question of trust

WHISTLEBLOWERS OFTEN FACE WORKPLACE DISCIPLINE AND EVEN DISMISSAL. WHAT CAN BE DONE TO SUPPORT THEM?

CHRIS ALKAN

Drawing attention to the bad behaviour of your employer can be a thankless and even risky activity. Those who take a stand are often ignored, disciplined or fired. Sadly, the financial services sector is no exception, according to a recent report by the charity Public Concern at Work (PCAW). More than three-quarters of whistleblowers in the industry are ignored when they first raise concerns. Almost half of those who persist are fired, the study showed, compared with just 30% in other industries.

In the US, the response to this problem has been to hold out the prospect of financial windfalls to those who come forward with information incriminating their employer. In March, Keith Edwards, a low-ranking employee at J.P. Morgan, was awarded \$63.9m for his role in uncovering his bank's misdeeds in mortgage applications. That was about three times more than the firm's Chief Executive Jamie Dimon had earned in

"The perception is that the impact is not life-threatening and that the victims are often wealthy and sophisticated"

2012. The reason for the extent of the payout is that it related to the False Claims Act, which applies to defrauding US federal agencies. For those not claiming under this Act, the Securities and Exchange Commission has established its own

department for whistleblowers (see box, opposite). Overall, the US Justice Department paid out almost \$2bn to whistleblowers between 2009 and 2013.

Authorities in the UK are still deciding whether to adopt this approach. But many experts believe there are more effective strategies for encouraging openness and integrity in the financial services sector.

"The majority of people are motivated by a desire to protect the public or their company," says Cathy James, Chief Executive of PCAW. "There may be better ways of encouraging this spirit than offering financial rewards."

The UK already offers legal protection to whistleblowers through the Public Interest Disclosure Act, which came into force almost 15 years ago. This was designed to protect employees from reprisals – including unfair dismissal or demotion – if they came forward with damaging information about their employer. In theory, employees should be safe if they make the disclosure to their company, a regulator or a government minister and if their revelations are in the public interest. Yet there has been increasing recognition among regulators and experts that this law has been failing to protect whistleblowers fully.

STAYING MUM

The situation in financial services appears to be slightly worse than in some other industries, according to the research by PCAW. Its survey showed that one in five financial employees go directly to regulators with their concerns, without informing their company bosses first. That compares with

Getty



just 4% in other industries, the study showed. "This demonstrates a lack of trust in employers and internal structures that are supposed to be in place to protect whistleblowers," the research concluded.

The high financial stakes in the industry may be partly to blame, says James. "Misdeeds in the financial sector can be extremely lucrative, which means that employees have

"It makes a big difference when a top manager knows that they could face heavy fines or a ban from the industry"

a greater incentive to remain silent," she says. "In addition, the perception is that the impact is not life-threatening – as is often the case in healthcare abuses – and that the victims are often wealthy and sophisticated."

Yet financial misdeeds can have devastating consequences on individuals and the economy, as the 2008 financial crisis underlined. In the case of the J.P. Morgan abuse, for which Keith Edwards received his payout, the firm was submitting thousands of mortgages for government insurance when they did not qualify. This ultimately led to a wave of foreclosures and evictions, as well as forcing the Government to cover millions of dollars in losses.

IMPROVING OPENNESS

Despite the often strong incentive to stay mum, industry experts believe that whistleblowing can be made to work in financial services. The main question is how best to achieve this goal.

Many are sceptical about the American approach of offering large rewards. The PCAW report suggested that big payouts "undermine the moral authority of a genuine whistleblower", could lead to false reporting and "undermine the credibility of witnesses in future criminal or civil proceedings".

The CISI believes that other options are also available to improve openness. Andrew Hall, the CISI's Head of Professional Standards and Integrity, says: "A cultural shift within institutions is the first step, to make sure that bosses are receptive to reports of wrongdoing from staff. We are in the process of preparing a presentation to firms that underlines the

importance of being receptive to whistleblowers and the downside to sweeping aside their complaints."

The ultimate aim of most whistleblowers, he says, is to know that their reports will be taken seriously – for the sake of the public and the company itself.

In addition, whistleblowers need to feel that regulators will heed their concerns. "There has been a perception that you are casting your concern into the abyss by talking to a watchdog," says Nigel Sydenham, Chartered FCSI, who also sits on the ethics council of the CFA Institute. "But there are signs that this is finally starting to change, with complaints being taken more seriously and more investigations."

A second reason for hope, experts say, is that bosses have a greater incentive to pay attention to whistleblowers. For a start, fines for corporate bad behaviour have been getting bigger. At the end of 2013, the European Union fined six European and US banks a record \$2.3bn, with Deutsche Bank alone hit with a €725.4m penalty. In 2012, Barclays was fined \$451m by the US and UK authorities for manipulating the interest rate benchmark.

An even more powerful motivation is increasingly at play, says Sydenham. "Historically, in the event of wrongdoing, it was just the firm that was punished," he argues. "Recently, there has been a huge push to make individuals personally responsible. It makes a big difference when

a top manager knows that they could face heavy fines or a ban from the industry."

More important still, many whistleblowers need a reasonable assurance that they will not be fired, demoted or bullied as a result of their actions. Such protection, sadly, is still not guaranteed. Leaving aside outright dismissals, 21% of employees in financial services are formally disciplined for reporting misdeeds for the first time and 28% the second time the concern is raised, the PCAW report noted. Within financial services, whistleblowers are almost twice as likely to be fired outright if they make a complaint twice.

KEEPING THE SECTOR HONEST

There is a growing recognition among watchdogs and professionals of the role that whistleblowers can play in keeping the financial services sector honest and safe. Beefing up the regulators is one way to keep a careful eye on these firms. But insiders are much better placed to spot abuses at an early stage – limiting any damage to the public at a far lower cost to the taxpayer than an over-mighty regulator. Simon Webley, Research Director at the Institute of Business Ethics, believes progress is being made. "A more open culture is starting to emerge," he says. "Companies know that information can spread very quickly on social media and they want to make sure they know what is going on before reading about it." If all goes well, experts hope, the world will become a much safer place over coming years for such public-spirited employees.

WHISTLEBLOWING AT A GLANCE

In the UK, the amount of useful information the FCA received from whistleblowers increased by nearly two-thirds in 2013. As a result, the regulator plans to devote more resources to coping with the influx. It currently advises whistleblowers to raise concerns with their employers. If that route does not seem possible, then the regulator welcomes calls on **+44 20 7066 9200** or emails to **whistle@fca.org.uk**.

In the US, the Securities and Exchange Commission (SEC) set up its own Office of the Whistleblower in 2011. In 2013, it received 3,238 tips and complaints,

up from 3,001 in 2012. Under its whistleblower protection programme, whistleblowers are entitled to a payout worth 10–30% of any sanction by the SEC worth at least \$1m. To date it has awarded more than \$14m.

The European Commission is no exception. In February 2014, it approved a pan-European whistleblowing hotline under the UCITS V rules for fund managers. If an individual has reported an issue to their national regulator and they feel they are being ignored, the hotline offers a route to the European Securities and Markets Authority for further help.

AFTER THE ANNUITY SHAKE-UP, SALES ARE SET TO DROP BY 80% AND THE NEW MARKET WILL NEED TO BE MORE INNOVATIVE AND EFFICIENT

ANDREW DAVIS STUART BRIERS

Breaking the shackles

It is no exaggeration to call the changes to pension rules announced in March's Budget a bombshell. Even seasoned observers of the industry are not mincing their words, particularly where the annuity market is concerned.

"Everyone thinks this is the best thing that's ever happened," says Professor David Blake, Director of the Pensions Institute at Cass Business School. "I think it's almost the worst thing that's ever happened. It effectively means the end of pension plans in this country... I think the annuity market is going to collapse."

Others speak in less dramatic language but there is broad agreement that sales of annuities – particularly the single life level annuities that most people purchase

"It's better for insurance companies because the capital requirements are a lot lower because of lower longevity risk"

today – are likely to fall by 80% or more. Blake points to Australia – often used as an example of innovative pension practice – to illustrate his fears. There, he says, just 29 single life level annuities were sold in 2013, demonstrating how unpopular these products are in markets where people have free choice over how to manage their

retirement savings. The UK, by contrast, has the world's biggest annuity market, with some 420,000 policies purchased each year. Chile comes second, with 22,000 policy sales.

INEVITABLE CHANGE

An interlinked series of problems has brought the pensions market to the point where change was probably inevitable: increasing average life expectancy, little change in retirement ages, very low interest rates (and therefore low annuity rates), little genuine choice of pension products and insufficient saving.

Others argue that, on top of these factors, the way annuities were sold effectively made a bombshell inevitable. "There was no requirement for any suitability checks before selling a standard single life level annuity to somebody who had a partner with no pension, or somebody who was seriously ill and was in completely the wrong life pool and could never get out of it," says pensions campaigner Ros Altmann. "It could have been a potentially huge misselling problem."

Blake agrees: "The insurance industry has done itself no favours here."

Altmann says that the annuities sold to most people in the UK fail to meet their needs for several reasons. They have no link to inflation, so people's income declines in real terms through what is frequently a 20- to 30-year retirement; they do not preserve capital, so that it could be bequeathed as part



of an estate; and they do not enable people to access their money should they need to meet care costs in old age. Their lack of flexibility means that once purchased, the holder gives up the chance to benefit from future increases in interest rates and from continuing investment returns and cannot move to any new products that might be more suitable for them.

So what can we expect to emerge in place of the current set-up?



BlackRock, the world's biggest asset manager, has already signalled its intention to develop new retirement products for the UK market, that may be based on the LifePath products it offers in the US.

MORE CHOICE

David Hutchins, Head of Pension Strategies at AllianceBernstein, believes that the market will evolve to provide a new set of choices for people who reach their scheme's retirement age. He envisages trustees

offering members the chance to take their savings as cash or leave them invested with the fund and start taking an income without buying an annuity.

The aim, he says, would be to provide "a kind of mass-market drawdown product which is a fund that pays an income broadly equivalent to an annuity". Leaving retirement savings invested in financial markets beyond retirement age helps to preserve flexibility and access to the

capital. It can also offer a degree of inflation protection, depending upon what assets the fund is invested in.

AllianceBernstein already markets a version of this product as Retirement Bridge, says Hutchins. It is intended to enable people to put off buying an annuity until they are in their mid to late 70s, by which time they start to offer much better value and it makes sense to switch to a guaranteed income based on an insurance policy. ➤

"If you treat annuities as a pure investment and delay the purchase until your late 70s, the return exceeds anything you can get on the financial markets," says Blake.

Annuity best buy tables suggest a standard level annuity bought at 75 will provide about 33% more income than one bought at 65. Buying later is "better for everybody", says Hutchins. "It's better business for insurance companies because the capital requirements are a lot lower because of lower longevity risk." The point, he says, is that insurers face less risk of a big increase in average life expectancy at age 75 than at younger ages. "At 75, the risk is that individuals die young or late relative to the average, and that's what insurance companies manage really well. What they can't manage is where they can't diversify the risk."

So an important part of the future for pensions is likely to be the appearance of institutional 'scheme drawdown' options that allow people to take an income that is managed by their pension scheme until they are in their mid-70s and, while doing

"We now have genuine customers at retirement who have the choice not to buy any of our products"

so, to benefit from the lower costs that institutional buyers can negotiate on their behalf. They would then have the choice to take their savings as cash, buy an annuity, or take an "in-plan option that pays a much lower income because it preserves your capital", says Hutchins.

However, that scenario does not imply that the annuities they buy should be the same as those on offer today. "There needs to be some re-engineering in the product features to make it attractive," according to Hutchins. "The question will be how do we provide some sort of capital protection within the product, and do we provide some form of lump sum on death?" He points to

Challenger, the biggest annuity provider in Australia, as an example of what we might see in the UK market. Challenger offers policies that, for example, pay out a lump sum on death that diminishes the longer the policyholder lives, reaching zero if the annuitant survives past 95. There are also likely to be products that provide cover should residential care become necessary.

WIDER RANGE

Altmann argues that annuity providers need to offer a much wider range of product features that can adapt better to individuals' circumstances. "The more individual your annuity is, the more it can cater for the risks you face," she says. These include your health and the circumstances of your spouse, for example, as well as what other kinds of income you have.

"The 'one size fits all' mindset that has driven our pension system for so long simply doesn't fit all."

The hope, therefore, is that most people will be able to take what Altmann calls the "do nothing option" when they reach retirement age, leaving their savings invested while drawing an income and delaying big decisions such as when and whether to annuitise.

Rob Tinsley, Principal with Aspire to Retire, part of the Punter Southall Group, argues that the role of advisers is going to become more important as the choices open to people at retirement widen. "What we as a profession need to do is to educate people early enough not just to pull all their cash out and stick it in a bank account, which is probably the worst thing they can do," he says. "If we can get them to say 'I can have the money whenever I want it, so I don't need to make an immediate decision',

there's a reasonable chance they could put something in place that's suitable."

But the do-nothing option does not look like a sensible one for the insurance companies. They face the imminent threat of a big decline in new business coupled with a long run-off of legacy books where costs are under scrutiny and they have to continue to pay for the infrastructure to support those policies. Some could come under severe pressure, observers suggest.

However, Hutchins believes the effect of the changes will be to shift the annuity market to the 75 to 80 age bracket, so after a hiatus of perhaps ten years or so, a significant amount of money could still flow into new-style annuities. That ten-year gap will be a painful period of adjustment for many insurers, he says, although some are likely to benefit from increased sales of bulk annuities as defined benefit pension schemes move to offload their liabilities.

NEW ENVIRONMENT

Big changes lie ahead for the pensions industry, he concludes. "In the past, we didn't have genuine customers, we had people who were forced to buy one of our products. We now have genuine customers at retirement who have the choice not to buy any of our products. That new environment creates a far more innovative and efficient market over time."

- **Coming soon:** Pensions Administration, a new unit of the CISI's Investment Operations Certificate. Email crm@cisi.org for further information.



LOUIS COOPER, CHIEF EXECUTIVE OF THE NON-EXECUTIVE DIRECTORS ASSOCIATION, EXPLAINS HOW TO SECURE A POSITION AS A NED

◆ ROB HAYNES

Netting that first non-executive role

The picture of a ready-to-retire City executive relaxing into an easy life as a non-executive director (NED) has fast become a thing of the past. Prospective NEDs are now seen as multi-skilled professionals and candidates face increased competition for their roles.

"People want to become NEDs for a variety of reasons: many have gained a lot of experience and want to continue working in a business environment. Others may have worked in one type of business to executive level and want to do something different," says Louis Cooper, Chief Executive of the Non-Executive Directors Association. Some, he says, look to build up several roles as part of a portfolio covering a number of different organisations, but most want to give something back to their industries or sectors of expertise.

An obstacle facing an aspiring NED is the increasing demands of the role. "The problems associated with the 2008 financial crisis have highlighted that boards of directors need a broader range of experience and an ability to challenge the status quo," continues Cooper.

"NEDs must devote much more time to the role; in the past, a quarterly meeting might have been a low-key affair. Nowadays, NEDs face both greater demands

and increased expectations." The regular quarterly meetings, he says, now need a lot more preparation in terms of reading, liaison and analysis, and so do any meetings of board sub-groups, such as the audit committee and the remuneration committee.

So, with these caveats in mind, what is the best way of getting a foot on the ladder?

NED TIPS

Understand the role

Prospective NEDs need to learn what the position means. "A lot of people come at it from being an executive, and still like to get involved in the detail," says Cooper. "The problem is, when you are a NED you do not always have access to the detail – you need to operate at a more 'strategic' level."

"Think about who you can approach to ask for help"

Start with small steps

Many aspiring NEDs may not be ready to dive straight into a demanding NED role. Instead, Cooper recommends they start to develop 'boardroom' skills by becoming a governor at a school, or by taking a trustee role at a charity that interests them.

Set clear objectives

NEDs have to be clear about what they are looking to do. "If your experience has been in charities and the not-for-profit sector, you probably will not become a NED at a FTSE 100 company," says Cooper. "The key is matching your experience with the role, and having clear objectives."

Tailor your CV

NEDs should not just produce the traditional CV, listing experience by rote, says Cooper. "Instead, you need to think about some of the key traits and attributes that companies are looking for," he says. "In many cases, this means demonstrating how you motivate people, have skills in negotiation, can communicate at different levels and so on."

Raise your level of networking

"NEDs must network, network and network," advises Cooper. The trick to finding out about the right opportunities is to adopt a methodical approach about who can be of help. "Think about who can help you and who you can approach to ask for help, and especially consider reactivating past contacts."

Find a mentor

Of course, keeping an active contacts book may not be enough. "Mentors are great at



acting as a sounding board in finding out what roles might be suitable," says Cooper. They may also be good at helping you develop your skills, particularly with respect to how to present yourself as a 'professional' NED. Given the increased demands to rotate NED positions, there is a push to expand the pool of potential NEDs. Often the problem is getting the first role – someone needs to give you that break and you need to make it easy for them.

Boardroom diversity is also a hot topic, not just from a gender perspective but from the viewpoint of age and experience, too. The message from the 2014 Non-Executive Director Awards was: "The need to populate British boardrooms with able, diverse and enthusiastic NEDs is more important than ever."

For further information:

- CISI Professional Refresher: The role of NEDs - cisi.org/refresher
- Non-Executive Directors Association: nedaglobal.com
- CISI Annual Conference, 17 June 2014: Joëlle Warren, Executive Chairman, Warren Partners, will talk about how to be a NED. Visit cisi.org/ac2014 for further information and to register your place.

Spoilt for choice: the decisions facing major investors

INVESTORS WITH PLENTY OF CASH CAN OPT FOR A BESPOKE SERVICE, A MODEL-BASED APPROACH OR AN OFF-THE-PEG FUND, BUT WHICH IS BEST?

CHRIS ALKAN GREAT APES

Well-heeled investors face a bewildering array of options. A multitude of asset management firms are vying for their money. But almost all now offer varying degrees of customisation. Assuming they have enough cash to invest, clients can opt for a bespoke service – with a portfolio meticulously tailored to fit their needs and preferences. Or they can still choose a model-based approach. While this is adapted to a customer's general appetite for risk, the different portfolios will track the firm's house views. Finally, a completely off-the-peg selection is also often on offer. Investors can buy units in funds run by the wealth manager.

Each has advantages and drawbacks, explains Amy Lazenby, Chartered FCSI, Investment Director of Tailored Portfolio Services at Close Brothers Asset Management. "No one choice is superior or inferior," she says. "The choice really hinges on the individual circumstances of the investor."

Of course, below a certain threshold of investible funds, a purely bespoke approach becomes uneconomical both for clients and wealth managers. "The bespoke model tends to be pitched at a larger portfolio size mainly because a firm needs to justify the additional time spent on managing individual relationships and keeping abreast of ever-changing needs by managing bigger pots of money," says Lazenby. At Close, this cut-off point is around £1 million and upwards. But this varies from firm to firm, according to Frank Dolan, Chartered FCSI, a chartered wealth manager at Novatis Asset

Management. "At the larger end of the scale, the cost base is such that it may well be uneconomic for the business to entertain bespoke management for smaller portfolios. Many companies have a £250,000 bottom limit for basic wealth management services and a progressively more personalised service, the more you have to be managed," he says. "Companies such as UBS also have highly bespoke services available for the ultra-high net worth individuals."

As one might expect, there are certain perks to this high-end option. For a start, a portfolio can accommodate the quirks and philosophies of each individual. "A client who sits on the board of directors of a Tesco will likely already hold a large number of shares in the company and won't want any more," says Lazenby. "Even trading in the stock can create compliance problems. If the manager buys shares in the company just before good results – or sells ahead of bad news – that can create a compliance problem."

"There are many people who want a bit of individuality or extra performance"

What's more, the portfolio can be made to reflect very specifically the risk appetite and even personal interests of the client. The pure service element also appeals to many clients, says Lazenby. "A lot of people are motivated by intellectual interest," she says. "A bespoke service means you can call up the investment manager and talk through investment choices

on a regular basis. If you have a specific idea or interest it is possible to talk it through with an expert investor."

This option is analogous to buying a high-end car, suggests Dolan. "When I go out to buy a new car, I look for something that suits me which may not necessarily be the

"A portfolio might either be for growth, income or a combination of the two"

most practical or cheapest solution," he says. "There are many people who want a bit of individuality or extra performance and who buy a BMW or a Jaguar, for example, or extra luxury like a Mercedes-Benz rather than a bog-standard Ford."

But this is not always the choice even for the wealthiest investor. "Some clients have several million pounds in our less bespoke funds," says Lazenby. "They do not need tailored portfolios and they perhaps either do not want or do not have the time to have a personal relationship with their investment manager."

RETURNS ON FUNDS

There are other potential drawbacks to a highly individualised solution. The more constraints placed on the investment manager, the more difficult it becomes to generate the best returns. Some data suggests that in terms of pure capital growth, 'off-the-peg' funds can be best. Close Brothers funds that are focused on growth have returned 26% in the three years to March 2014, compared with 19% for the firm's bespoke clients. Returns on funds at each level of risk appetite – including conservative and balanced – show the same pattern. Asset Risk Consultants' indices, benchmarks that allow clients and managers to measure performance, also show a similar pattern. Their data shows the average bespoke steady growth fund returning 4.5% over the past 12 months. But the data provider said that returns could be up to 2% higher within the same investment firm for products that placed fewer restrictions on the fund manager. For some investors, a lower rate of return may be a price they are willing to pay for personalised service and the avoidance of any compliance pitfalls.

The mid-point in terms of customisation – a model-based approach – has many benefits, too, both for firms and clients. The client can benefit from having a portfolio that reflects their broad risk tolerance. "A portfolio might

either be for growth, income, or a combination of the two, and the asset allocation could vary from about 65% equity and 35% fixed interest through 50/50 to 35/65 the other way round," says Dolan, Deputy Chairman of the CISI Wealth Management Professional Forum.

In addition, it is usually possible to exclude the shares of companies in which they hold directorships or about which they might possess inside knowledge. Finally, there is typically some degree of personal contact – though typically with the adviser rather than directly with the investment manager. "But there is full transparency of holdings and a good flow of information relating directly to the underlying holdings in the portfolio," Lazenby says.

The benefit from a firm's perspective is that extra clients can be added at minimal extra cost. "This approach is easily scalable since the customer gets less individual attention," says Lazenby.

Finally, the funds, which offer the lowest level of tailoring, also have merits. Aside from giving the fund manager maximum flexibility to chase the highest returns, such investments are tax efficient. "While trading within both bespoke and model portfolios can generate capital gains tax liabilities, dealing within a fund does not," says Lazenby. "Capital gains are only incurred when the client sells the units in the fund if above the threshold."

Corporate actions – electing to take cash returns as capital or income, taking up or selling rights issues and so on – can also be looked after for bespoke clients much better than they can in a model approach.

The fact that investors can buy in units also makes them more affordable for those with modest portfolios. Finally, fees may also be lower, since less personal contact is involved. The downside is that such funds cannot accommodate any restrictions, unlike the two other forms of service. That can be a dealbreaker for investors who might face very specific compliance requirements or have other preferences, or reasons to invest in a certain way.

The upshot is that no level of customisation is optimal for all investors. The most deluxe option – purely bespoke – is not going to provide the best solution to those with very simple investment needs. Meanwhile, even those with relatively small portfolios might need a more customised option if their financial situation is complicated. Both bespoke and off-the-peg options, therefore, serve a purpose.

THE BIG

ECONOMIST ALBERT EDWARDS IS FAMOUS FOR HIS BEARISH, COLOURFUL TAKE ON MODERN ECONOMIES, FROM DEFLATION TO DECOUPLING. SO WHAT IS HIS VIEW ON THE WORLD'S MODERN PROBLEMS?

◆ ANDREW DAVIS ◆ PETER CROWTHER

Most investment bank strategists like to cultivate a measured, authoritative tone in the regular research notes they send to clients, putting the latest data or market movements judiciously in context and avoiding extravagant turns of phrase.

Not so Albert Edwards. The multi-asset strategist at French bank Société Générale is known for his colourful writing in the *SG Alternative View* (not the SG house view, his media handlers emphasise) and his willingness to express distinctive opinions in forthright terms. “Do not

rely on decoupling,” he warned in March 2014 as copper prices plunged, signalling possible threats to the growth outlook. “Do not rely on central bank liquidity. Do not rely on hope. Hope is a false friend in these markets. It will lead investors by the hand down the path to ruin.” Last October, he labelled the UK Government’s Help to Buy scheme for would-be homeowners “moronic”.

Not surprisingly, Edwards is a long-time favourite among financial journalists in search of an eye-catching quote. However, he also has the ear of many investors

around the world, thanks to the long-term consistency of his views on how the world economy will behave and – to date – the absence of any proof that he is wrong.

ICE AGE THESIS

Edwards is best known for his role in formulating the Ice Age thesis in 1996, while part of the strategy team at Dresdner Kleinwort. The key element is the idea that Japan’s experience of a credit-fuelled boom in the 1980s, followed by a savage bust and a long period of deleveraging, provided a template for the rest of the world.



"At the end of 1996, we said we knew from Japan that, with price stability having been reached [the Bank for International Settlements wrote an important article about this at the time], lower inflation would stop leading to price/earnings expansion in equities, but that bond yields would carry on falling," says Edwards. "We went one step further. We thought that, as we got nearer to deflation, the economic cycle would become more volatile and equities would de-rate in absolute terms and relative to government bonds."

As the name suggests, however, the unfolding of Edwards' Ice Age theory is likely to be a process that lasts decades and will be characterised by lower highs followed by lower lows in equity valuations and bond yields.

"The bull market in US equities ended in 2000," he says. "Then it takes many economic cycles for the de-rating process to fully play out. This ends with equities going from extremes of expense, as in 2000, to extremes of cheapness,

as in 1982, with the [ten-year average] price-to-earnings bottoming out at about seven times. The US has had three structural valuation bear markets like this before in equities. They take between four and six recessions to be completed. We have only had two – that is why people like me and Russell Napier at CLSA think the S&P did not see its bottom at 666 in March 2009. It will go lower still."

HIGH JINX

Looking around today, developed-world stock markets are largely heading in the opposite direction, recording post-crisis or even record highs – even as inflation around the world edges steadily lower. The US is now down to about 1% inflation and the eurozone is at just 0.5%. Parts of the southern periphery, including Spain, are already suffering deflation. What does Edwards believe is happening?

A key element of his current view is that major Asian economies, particularly Japan and China, are attempting to deal with their internal problems, including huge excess capacity and inflation that is

persistently too low, via their currencies. The appreciation of China's renminbi has recently gone into reverse and the Japanese yen has weakened sharply since Tokyo began its own programme of aggressively loose monetary policy a year ago. By weakening their currencies, Edwards says, these countries are driving down the price

"The market appears to be ignoring the risk of deflation because it thinks we are in a self-sustaining recovery"

of their exports and effectively imposing falling prices on their trading partners, particularly in Europe and the US.

Prices of US imports from Japan and China are falling, he noted last December, "sending a major deflationary impulse into the US economy". "The global pass-the-deflationary-parcel will end up with Europe and the US holding the deflated

baby," he then wrote in early March. Why, then, are markets apparently so unfazed by falling inflation around the world and the apparently growing risk of deflation, which could be extremely damaging for heavily indebted countries, companies and households?

Edwards believes the apparent disconnects – such as ten-year inflation expectations derived from the bond markets of about 2.5%, compared with levels of 1% or less in the US and Europe – can be put down to a basic misconception among investors.

"The market appears to be ignoring the risk of deflation and the reason it is doing so is because it thinks we are in a self-sustaining recovery," he argues. What markets are ignoring is that the current cyclical recovery is "very old – 57 months". Recent economic cycles have been unusually long by historical standards, says Edwards, and this has lulled investors into a false belief about where we are in the cycle. In fact, he says, the next downturn is closer than most people believe and could easily be sparked by a deflationary impulse from Asia.

"If the market thinks we are getting an interruption in growth, then it will very rapidly focus on what is going on: deflation. We are one recession away from negative inflation in the eurozone as a whole, and in the US, I think. Germany will be hit worst of all by the emerging-market slowdown and devaluation from Japan."

It is during recessions that equity markets give up their gains from bear market rallies, he says. "Markets have been buoyant for exactly the

same reasons we used to see strong rallies in the Nikkei in the 1990s. We are in a cyclical recovery caused by government policies, in this case quantitative easing [QE] specifically designed to drive up asset prices. History suggests that each bear phase of this structural valuation bear market occurs in recession. The equity market embraces it to take its next leg down."

NO OTHER TOOL TO USE

The only apparent defence the developed world has against the threat of renewed recession is QE – or "spraying money into the economy", as Edwards describes it. The problem is that no one really knows how and why QE works (or does not work), although Edwards believes that if QE carries on long enough, central bankers will eventually succeed in creating inflation.

"They have no other tool to use. There is already lots of inflation in financial markets from QE; it just has not spilled out into goods and services yet. In three to five years' time, it probably will start to do so. On that time horizon, government bonds are toxic assets, but on a 12- to 18-month view, I think yields will go lower."

Although Edwards concedes that the first round of QE in 2009 probably was necessary, he says subsequent rounds have done little or no good – and carry huge unknown risks.

"The economy is not in meltdown; it is just experiencing weak growth. The Bank

of England is printing unlimited quantities of money, but the consequences of what it is doing are very unpredictable in creating asset bubbles that may eventually burst and blow up in its face. It could be making things ten times worse."

"There is already lots of inflation in financial markets from QE; it just hasn't spilled out into goods and services yet"

Inevitably, Edwards' forthright and unorthodox views make him a frequent target for sceptics, but he remains unperturbed. "Though I look an idiot 90% of the time, I am now used to this state of affairs," he wrote in December. "To be fair, being an idiot 90% of the time is not so bad. It is a full ten points less than my former partner thought was the case."



ALBERT EDWARDS,
MULTI-ASSET
STRATEGIST,
SOCIÉTÉ
GÉNÉRALE

CONTENTS

Forward guidance: An effective tool to signal an end to policy duration commitment - Balamurali Radhakrishnan MBA	2
The effectiveness and challenges of ESG integration - Robert Schwarz MBA MS	5
Macroprudential policy: potential implications for investors - Colin Ellis, Visiting Research Fellow, University of Birmingham	9
List of journal panel members	12

EDITORIAL

I noted with interest recently some academic research on the causes and impact of the 1929 Wall Street crash. No doubt the more recent financial crash will still be exercising minds some 80-odd years from today, so we shouldn't be surprised that the effects of the crash are a big influence on current research output. In this issue we present three distinctly different but topical pieces that all reflect, in varying degrees, the impact on thinking since the events of 2008. Or should that be 2007? At least previous financial meltdowns could be identified explicitly with one year. Should our crash be dated to 2007, when the US sub-prime mortgage meltdown started hitting bank balance sheets to a significant extent? Or to 2008 when Lehman's went bust? Or 2009 when markets were at their all-time low and central banks implemented extreme monetary policy measures? This might explain why I usually go with '2007-09'!

The paradox of risk and regulation in financial markets is that they are at their most conservative and (to the regulated) onerous immediately following a crash, when everyone is risk-averse anyway and in the least need of regulation by fiat. But implementing the various regimes from Basel III to Volcker to Dodd-Frank and everything in between takes a long time (for example, Basel III has a 2019 timeline for implementation in some jurisdictions, over ten years since the onset of the crash). Will it still be what is called for then?

Take increased capital levels. In a remark attributed to former Deputy Governor of the Bank of England Paul Tucker, if a crash is severe enough, no amount of bank regulatory capital will be sufficient. In which case, is there merit in raising levels, as Basel III does? 'Tail risk', the risk attached to extreme events, has not been captured by bank risk models in the past and given that there has been no change in financial modelling methodology since the crash, probably still isn't. No one can tell what the next crisis will look like, so what we are doing now is essentially fighting the last war.

Is there a solution? Possibly not, but a more worthwhile – and more beneficial for systemic stability – approach lies in a reversion to simplicity and conservatism. Complex valuation and risk measurement models can be inaccurate by such large orders of magnitude that one wonders what the point is in having them. A good example was the loss reported by J.P. Morgan at the time of the 'London Whale' episode, which was higher exponentially than what the bank's published value-at-risk (VaR) number had been immediately prior. In the era before sophisticated financial mathematics and computer processing power, banks managed risk by following conservative asset origination principles and by sticking to the knitting – 'know your risk' is a good maxim to adopt at any stage of the economic cycle. Getting involved in products and markets outside your area of expertise is often a sure path to chucking shareholder value out the door.

In a previous era, banks also would not have bothered with the so-called 'exotic' derivatives and structured products that were around in 2008 and continue to be used today. Does anyone really need them? A very large proportion of the risk management, hedging and investment needs of the world's companies, sovereign authorities and fund managers can be met using vanilla products. Kicking out the exotic stuff would make banks' lives easier, because such instruments are harder to assess for valuation and exposure sensitivities purposes. Ally a conservative approach to loan origination with simple models and products and one is on a more solid path to market stability than by simply raising capital and liquidity requirements.

The cultural change could also come about more easily if it was proselytised by risk management departments themselves. Too often I have observed a desire in the Chief Risk Officer's (CRO) office to demonstrate a technical understanding of the products and debate their Greeks with the front office traders, and set exposure limits, when what the CRO's office should be doing is saying, "Hold on, we can't value or assess for risk this product, so we shouldn't be transacting in it, let alone setting limits for it." Years after the crash there are still products out there to which one could attach accurately this description (and I've ignored the zero level of liquidity for some of these products, so one can't observe any market prices to calibrate models to) and yet risk management departments aren't shouting that they should be dropped. Rather, they are keen to demonstrate a technical understanding of the maths and observe that limits are adhered to. It's not just an odd logic, but bad policy.

Risk management, as one might say, begins at home. Keeping things simple would be a good start. I hope you enjoy this issue.

Professor Moorad Choudhry FCSI, Editor

ABOUT THE EDITOR

Moorad Choudhry FCSI FIFS is Professor at the Department of Mathematical Sciences, Brunel University. He is also Honorary Professor, Kent University Business School and Visiting Teaching Fellow, Department of Management, Birkbeck, University of London.



Professor Choudhry is Managing Editor of the *International Journal of Monetary Economics and Finance* and on the Editorial Boards of *Qualitative Research in Financial Markets* and *American Securitization*.

He is also a member of the CISI Editorial Panel, which chooses key content for the *Securities & Investment Review*. He is author of *The Principles of Banking* (John Wiley & Sons Ltd 2012). mooradchoudhry@gmail.com

SUBMISSION GUIDELINES

CISI members are invited to submit to the Institute for consideration papers on any aspect of wealth management, capital markets and banking.

Articles must be:

- Original work and previously unpublished
- Between 1,500 and 3,500 words in length and accompanied by an Abstract of 80-150 words.

All papers submitted will be refereed by the journal editorial panel or its recommended reviewers. For further details about the Review of Financial Markets and how to submit articles, see cisi.org/academic

HAVE YOUR SAY

If you would you like to comment on any of the articles in this issue, contact CISI Communications Editor Richard Mitchell: email richard.mitchell@cisi.org or call +44 20 7645 0749

FORWARD GUIDANCE: AN EFFECTIVE TOOL TO SIGNAL AN END TO POLICY DURATION COMMITMENT

Balamurali Radhakrishnan MBA, Currency Analyst, IDEAglobal in Trichy, India

balakesav@gmail.com

ABSTRACT

Major central banks have tried various approaches to stimulate their domestic economies once interest rates hit the zero lower bound; forward guidance is one such approach. We suggest this has been an effective tool to drive down long-term rates by committing to keep the interest rate near zero for a period of time. But the big challenge facing central banks is how to signal an end to such commitment, especially as the cost of being misinterpreted would be quite high. So central banks that used forward guidance to clarify market participants that the zero interest policy would remain in place for a longer time should use the same tool to shorten such expectations. Threshold-based guidance has increased central banks' transparency but recent events have raised doubts over its usefulness. On the other hand, qualitative guidance with additional information on policy reaction functions and the likely pace of rate rises would be suitable for current circumstances.

BACKGROUND

After the global financial crisis in 2008-09, central banks in many advanced countries attempted to revive economic growth and consumer spending through measures that they had never tried before. Whether such unconventional monetary policies were effective or not is still debatable; what is apparent is that they did play a role in limiting the downturn in advanced economies following Lehman's collapse. Given abundant central bank liquidity in the financial system, major economies were able to withstand subsequent shocks. For instance, the US recovery was not derailed by sequester (the automatic spending cuts to US Federal Government spending), thanks to the Fed's commitment to keep accommodative policies in place. That said, as the recovery takes hold, the major challenge facing central banks in advanced countries today is how to exit from such policies without creating disruptions in the financial markets. The market's addiction to easy policies makes that task problematic.

In this article, we first discuss potential challenges of reversing unconventional policies and then look into various phases involved in this process. Drawing lessons from the Bank of Japan's (BoJ) exit experience, we argue that preparing market participants for the end of the policy duration commitment would be a big challenge for central banks. The article then investigates the effectiveness of various forms of forward guidance in helping central banks overcome this challenge and concludes that qualitative forward guidance with additional information on policy reaction functions should be an appropriate tool.

EXIT FROM UNCONVENTIONAL POLICIES IS NOT AN EASY TASK

The International Monetary Fund (IMF) classifies unconventional monetary policies into two types: the first type includes measures that should be used to bring dysfunctional financial markets into normal functioning while the other deals with supporting the economy when the zero lower bound is hit. It is relatively easy to reverse the first one; however, the exit would be difficult when central banks are engaged in the second type of unconventional policies. It is possible that those central banks can ensure a smooth exit if they deploy carefully chosen exit policies along with effective communication strategies.

The timing and pace of exiting will vary depending on economic conditions in individual countries and their financial markets' ability to withstand the shift toward a tightening of monetary policy. Central banks are expected to encounter the following challenges during the reversal of unconventional monetary policies.

Firstly, the financial markets have become increasingly reliant on central banks' support ever since the financial crisis hit the global economy. They are so dependent on central bank liquidity that doubt remains whether they can sustain their gains once the exit process gets underway. Concerned about the risk of market disruptions, central banks can delay reversing accommodative policies, but that move would lead to a build-up of financial imbalances.

Secondly, managing expectations about the future path of short-term interest rates after signalling an end to easy policies would be a complicated task. It is possible that being uncertain about the pace of rate rises, market participants would start to price in rapid rises in short-term rates, thereby increasing the risk of a spike in long-term yields. To some extent, central banks can solve this problem by clearly communicating to market participants that the pace of tightening would be gradual.

Thirdly, emerging markets that had benefited from easy monetary policies in the advanced world would face the risk of reversal in capital inflows. Central banks in advanced countries seem to disregard such concerns, arguing that domestic conditions determine their monetary policy responses. But one cannot ignore the fact that turmoil in emerging market nations could eventually spill over into advanced countries in terms of increased downside risks to their growth, not least because of the former's growing importance in the global economy.

And finally, advanced countries are now saddled with high debt burdens and their servicing costs are at historically low levels. The cost of servicing those debts will increase once central banks start to gradually unwind unconventional policies and that should presumably make treasury departments uneasy.

Overall, the exit from unconventional policies will not be easy. Given the fact that available exit tools are not fully tested, there remain substantial uncertainties about central banks' ability to ensure a smooth exit. Adding to the issue, the exit challenge has considerably increased as unprecedented easing measures have been in place for an extended period. Central banks might change their course of action if economies were badly hurt by a scale back in monetary easing, or if turmoil were to engross the domestic financial markets. Against this backdrop, as IMF head Christine Lagarde has opined, an exit from unconventional policies is likely to be slower and longer than one would expect.

According to the IMF (policy paper, 2013), the reversal of unconventional policies should be executed in three phases.

1. An exit plan should begin with altering conventional aspects like adjusting forward guidance on the future path of policy rates.
2. The short-term policy rate should be hiked even before a substantial reduction in excess reserves.
3. Finally, downsizing central banks' asset holdings is essential to reduce excess reserves.

So, the exit process does not necessarily need to start with increasing the short-term rate, and central banks have various options to reduce the size of their balance sheets without embarking on trimming bond holdings. For instance, after signalling a reversal in easy-money policies, they could unwind normal liquidity enhancing facilities and allow short-term securities to mature while not using the proceeds to buy bonds afresh. Since improving economic conditions might fuel inflation expectations, it is important that central banks must hold

high credibility for price stability; otherwise, the exit process would turn out to be bumpy. In the absence of high credibility, in order to contain inflation, central banks will have to bring forward selling of bonds while increasing the pace of interest rate hikes. Both actions would be risky to their domestic economies and financial markets.

JAPAN'S EXPERIENCE SUGGESTS AN ORDERLY EXIT IS POSSIBLE

It is debatable whether Japan's exit from unconventional monetary policies was successful; it was even argued that the BoJ's exit was incomplete as it still held long-term Japanese Government Bonds (JGBs) when it announced a new round of quantitative easing (QE) in response to the financial crisis (Syed and Yamaoka, 2010). The author believes the BoJ did succeed in aspects of its exit strategy. First, even after the BoJ ended its quantitative easing in March 2006, Japan's recovery was not jeopardised and most importantly the domestic equity market was not engulfed by turbulence (see Figure 1). Second, the BoJ was able to sharply downsize its balance sheet -- mostly through unwinding of funds-supplying operations and allowing short-term securities holdings to mature -- within a short period of time after officially announcing the end of QE. Such an abrupt withdrawal did not kill the recovery but it was suspected that could have adversely affected Japan's ability to grow strongly in the subsequent years. Third, the BoJ was able to initiate the exit process without embarking on selling long-term JGBs (Syed and Yamaoka, 2010), thanks to a self-imposed bank note rule that capped the central bank's JGB purchases to money circulated in Japan during that time. Because of this rule, the BoJ had the flexibility of downsizing its balance sheet with other instruments, and there was no immediate need to offload accumulated JGBs (Syed and Yamaoka, 2010). Overall, Japan's experience does show that central banks can withdraw unorthodox policy without stoking inflation and weighing on growth, provided exit plans are carefully framed and accompanied by effective communication strategies.

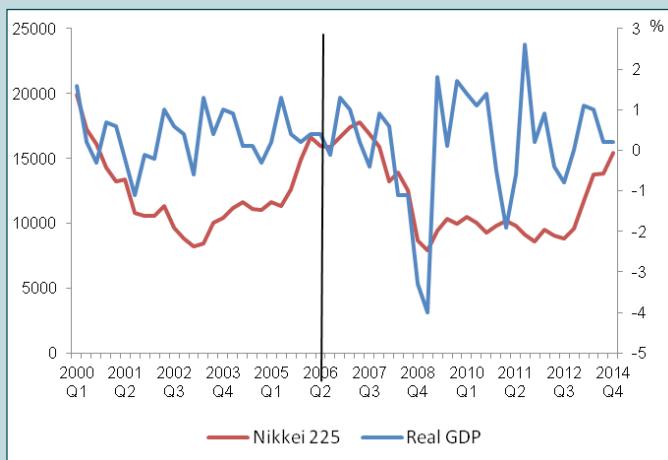


Figure 1: An end to BoJ QE & Japanese economy

Source: Cabinet Office, Japan

Since market participants had expected that the virtually zero interest rate would remain in place for an extended period of time, the BoJ first needed to get them to gradually price in an interest rate rise before tightening policies (Syed and Yamaoka, 2010). This was the biggest challenge for Japan's central bank as any sudden shifts in markets' expectations for the path of the short-term interest rate had the potential to derail the recovery by triggering abrupt upward moves in bond yields, especially as the policy duration effect stabilised market expectations to a greater extent (Okina, 2004). This problem is not specific to Japan; as advanced countries' central banks also committed to keep near zero interest rates for a considerable

period of time, they would have to persuade the market to adjust its expectations regarding interest rates smoothly before resorting to interest rate rises. In other words, an exit from the policy duration commitment is a prelude to monetary policy tightening. So, in order to exit smoothly, a central bank should deploy an appropriate forward guidance approach that is effective in shortening market expectations for the duration of the zero interest rate policy commitment.

Japan's experience also showed that it was relatively easier to cease ordinary liquidity enhancing operations once market conditions normalise than reducing bond holdings. The BoJ under its new easing regime, termed as qualitative and quantitative easing (QQE), has been accumulating unprecedented amount of JGBs with remaining maturities longer than those purchased during its previous easing episodes. So whether the BoJ can ensure an orderly exit from the QQE is an open question (We discuss challenges for the BoJ later).

SHORTENING EXPECTATIONS FOR POLICY DURATION COMMITMENT USING FORWARD GUIDANCE

Four major central banks adopted some form of forward guidance on the policy rates after they hit the zero lower bound. The main idea behind forward guidance is to have market participants believe that the short-term interest rates will remain near zero even after the economy recovers, thereby enhancing monetary policy's effectiveness. As we discussed in the previous section, when a central bank plans to exit, it should first prepare market participants for the end of the policy duration commitment. This can be achieved by tweaking existing forward guidance, along with effective communication strategies. In this section, we will discuss various forms of forward guidance and the effectiveness of each type in helping market participants adjust their expectations for the duration of the zero interest rate policy commitment.

Generally, central banks deploy three types of forward guidance to influence expectations and the Bank for International Settlements (BIS) defines them as follows: qualitative guidance (which doesn't provide quantitative information about the path of the policy rate); calendar-based guidance (where policy rate is committed to remain near zero for a clearly specified time horizon); and threshold-based guidance (where guidance is linked to specific economic variables).

Let us consider an hypothetical situation in which a central bank pursuing unconventional monetary policies deploys qualitative forward guidance (ie, saying that the policy rate will remain near zero for an extended period of time) and wants to signal to market participants that it will gradually withdraw monetary stimulus. To do so, it will have to shift to a different form of forward guidance because simple qualitative guidance would not be an appropriate communication tool given its vagueness. The central bank has two options: either to shift to calendar based forward guidance or threshold-based guidance. Calendar-based forward guidance would tie the hypothetical central bank's hands and therefore it could not act until the pre-committed time comes. On the other hand, threshold-based forward guidance would give the impression that the hypothetical central bank is giving more focus to real economic variables, thereby posing risks to its credibility for price stability (BIS Quarterly, 2014).

No sooner had Ben Bernanke, then Federal Reserve Chairman, first signalled a pullback in Fed's bond buying programme last June than the bond market started pricing in rapid increases in the path for US short rates, which in turn led to abrupt moves in long-term treasury yields. The Fed attempted to anchor such expectations by enhancing its communication efforts to clarify to market participants that tapering was not the same thing as tightening while assuring that low rates would remain in place even after the unemployment

threshold was hit. But the US central bank was unsuccessful in reining in a rise in long-term yields because market participants had believed that the fall in the unemployment rate would soon prompt the Fed to start hiking the interest rate. The Fed eventually scrapped threshold-based guidance in March 2014 and shifted to new form of guidance that ties economic conditions to a tightening of monetary policy. The Fed's experience showed the level of importance market participants give to a single variable; they started looking for a rate hike even as underlying conditions in the labour market were not warranting a policy tightening. As a result, the Fed had to abandon its employment threshold, undermining its credibility by doing so.

As we discussed in the first section, an exit from unconventional policies would not be a straightforward process and would include a number of phases. Therefore, it is important for central banks to be trusted by market participants in order for their policy actions to be effective. As such, a central bank must protect its reputation when it prepares market participants for exit from the policy duration commitment. We suggest that the right approach for that would be qualitative forward guidance with additional information on policy reaction functions. Under this approach, the risk of a central bank being seen as reneging on its policy commitment is minimal while it has the flexibility to adjust its monetary policy settings when economic conditions change. Both the Fed and the Bank of England (BoE) have successfully stabilised the market's expectations with this approach (see Figure 2).

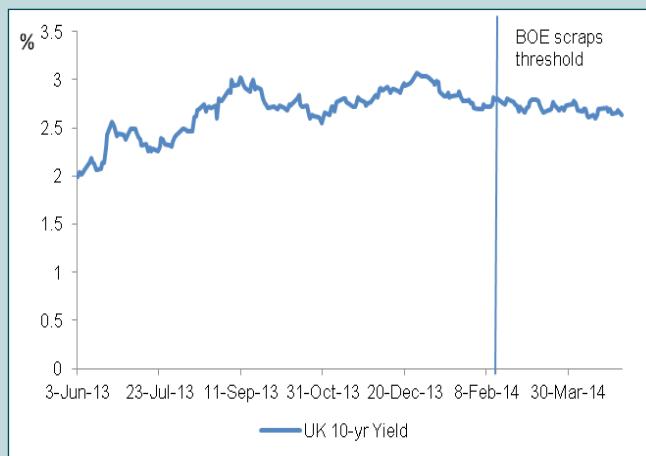
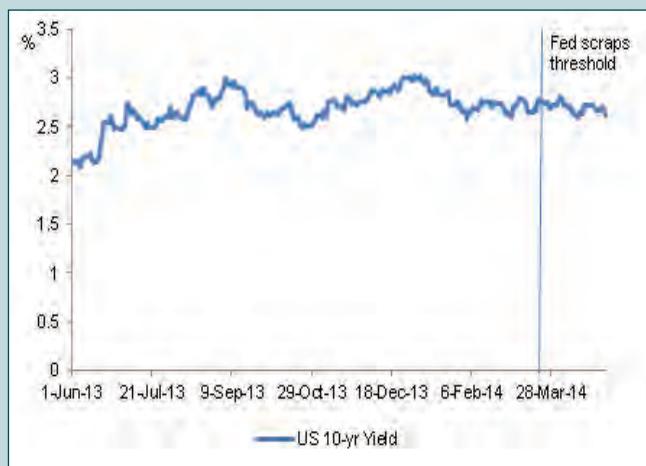


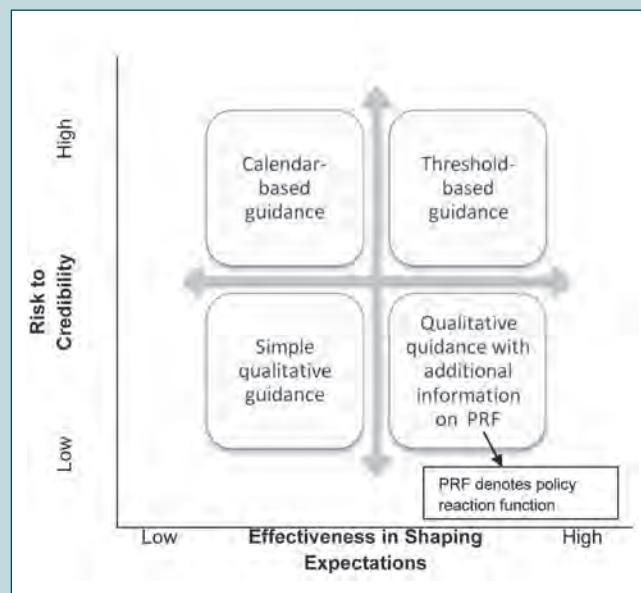
Figure 2: US Treasury and Gilt yields

Although tying the response of policy to the economy magnifies the uncertainties about the path of future short-term rates, central banks' forecasts and policymakers' speeches should help market participants build consensus for the timing of a first rate hike. When economic conditions broadly improve, market participants will gradually begin to prepare for a tightening and will have fully priced in a rate hike before the time -- when the majority of investors believe rates to be lifted -- comes. More information about the likely scale and speed of rate rises could rein in abrupt upward moves in yields during this period. Crucially, if a central bank deploys this approach, it should also include credible commitment to safeguard price stability in its communication strategies. This is because, when inflation expectations start to pick up, a central bank with high reputation for price stability would have the flexibility of unwinding other balance sheet instruments without engaging in selling long-term bonds.

The Bank of Japan's current easing programme (QQE) includes both threshold and calendar-based forward guidance. Its ability to exit from QQE without triggering disruptions in the financial market is questionable. For instance, unlike before, the scale of the BoJ's QQE is unprecedented in size and carried out without a self-disciplined rule. In case the BoJ succeeds in achieving the 2% inflation target, it will have to start offloading long-term JGBs because other strategies could not contain inflation expectations given the BoJ's already tainted credibility. That would in turn lead to a spike in bond yields, thereby substantially increasing debt servicing costs for the government. Needless to say, the value of the BoJ's bond holdings would see significant declines in that scenario.

CONCLUSIONS: FORWARD GUIDANCE AND CENTRAL BANK CREDIBILITY

While forward guidance plays a crucial role in helping central banks to smoothly unwind unconventional policies it does pose risks to their credibility; the exit process will become more complicated if central banks lose their reputation. Allan Blinder, former Vice Chair, US Federal Reserve, defines central banks' credibility as follows: a central bank is deemed credible if people believe it will do what it says. A central bank's credibility will be at stake if it first says that the zero interest rate policy will remain in place for two years but reneges on this commitment later. Likewise, a central bank that links its policy action to some real economic variable but abandons that relationship later will have its reputation severely damaged.



As Figure 3 shows, simple qualitative forward guidance does not pose risks to credibility as under this approach a central bank neither links tightening to an explicit economic variable nor commits to keep the zero interest policy in place for a clearly specified time horizon. But this approach would be ineffective in shaping private sector expectations in a manner consistent with policy goals, and thus a central bank that follows this approach could not begin a tightening of monetary policy without creating volatile moves in long-term yields.

On the other hand, a central bank deploying calendar-based forward guidance needs to keep the interest rate near zero for a specified time horizon. If improvements in economic conditions were to substantially exceed its expectations, then the central bank would have to start raising the interest rate even before the pre-committed time comes, a move that would badly damage its credibility. Nor can calendar-based guidance be seen as an effective tool to persuade the market to adjust expectations for the policy duration commitment. While threshold-based forward guidance increases a central bank's transparency, it would significantly impair its credibility if an economic variable linked to a tightening were to move toward the preset threshold faster than the central bank initially anticipated. Both the Fed and the BoE had their credibility eroded by abandoning this approach in response to the faster-than-expected drop in the unemployment rate in the U.S. and UK. **As the matrix shows, qualitative guidance tying economic conditions to policy actions is both effective and poses less risk to credibility than other approaches.**

- The views expressed in this article are solely those of the author and do not necessarily reflect the opinions of IDEAglobal

References cited in this paper are listed at cisi.org/rofmjune2014

THE EFFECTIVENESS AND CHALLENGES OF ESG INTEGRATION

Robert Schwarz MBA MS, an ESG Analyst living in New York City

apostrate@yahoo.com

ABSTRACT

The use of the sustainable and responsible investing strategy of ESG integration (ESGI) is well established; certain empirical data support its success in achieving superior risk-adjusted returns over the long-term, there is notable use of it among investment managers, an industry to support its use, and demand among investors for it. Many investment managers, however, have not implemented ESGI and attempts by ESGI's advocates to inform them of its benefits have seen limited success. Using sociological theory as a guide, this article provides an explanation for the limited success of these attempts by suggesting that acceptance of the effectiveness of ESGI represents a threat to an investment manager's identity. The article goes on to offer proposals for how to circumvent this challenge to getting investment managers to implement ESGI by appealing to their competitive nature.

INTRODUCTION

The objective of sustainable and responsible investing (SRI) is to generate long-term, risk-adjusted financial returns that outperform the market through the integration of environmental, social and corporate governance (ESG) criteria into investment decision-making processes throughout the investment cycle. Although

there is considerable evidence demonstrating the achievement of this objective and concerted efforts among its advocates to induce investment managers (IMs) to employ this strategy, it has not been widely implemented. The author believes that part of the reason for this is the challenge involved in the implementation of this strategy and the approach used by its advocates to overcome IMs' resistance. Given the evidence in favour of ESGI's benefits and the persistence of the efforts of its advocates, however, one would expect a greater degree of adoption despite the associated challenges. In search of reason(s) for this disconnect, the author sought answers in socio-behavioural theory. The answers found provide information useful in better understanding resistance to ESGI as well as in enabling advocates of SRI to formulate a more effective approach to getting IMs to implement ESG criteria into their investment decision-making processes.

In this article, ESG and ESG integration (ESGI) are defined and evidence supporting the benefits of both presented. Next, an overview of the challenges associated with ESGI and its implementation is set forth. The article proceeds with a brief discussion of the approach that has been used to argue in favour of ESGI and why the strategy employed has seen limited success despite the evidence demonstrating its benefits. From there, an exploration of socio-behavioural motivators and thought processes provides a deeper understanding of IMs' resistance to ESGI. Finally, based on the reasoning offered, suggestions for a new approach to getting IMs to implement ESGI by appealing to their competitive nature are provided.

DEFINITION OF ESG

For the purposes of this article, environmental, social, and governance (ESG) refers to the consideration of how these factors affect and are affected by the operation of a business entity. The proper management of ESG performance involves the consideration of these extra-financial factors at the operational level and within a company's overall business strategy. The actions needed to accomplish such an organisational synchronisation require a comprehensive understanding of the operational, financial, regulatory, and reputational risks related to global environmental, social, and economic issues that affect the viability of a company. Environmental risks such as those related to climate change and resource scarcity; societal issues such as supply chain labour conditions and maintaining environmental, health, and safety standards; and governance issues such as executive pay and board diversity. On top of this understanding, a significant commitment of organisational resources, courage, and conviction is required from corporate executives in order to institutionalise these considerations into decision-making and management processes.

These resources and efforts, in turn, enable the identification of opportunities that arise from the aforementioned risks. Such opportunities include improving upon environmental and social outcomes and the optimisation of corporate decision-making capacity through the implementation of technologies, programmes, and behavioural incentives. Due to the breadth and interdisciplinary nature of the competencies involved in managing such endeavours, it is a widely accepted notion that the management of ESG performance is a strong indicator of a well-managed operation. This positive correlation is supported by the highly qualified and capable leaders, managers, and staff needed to capitalise on the available opportunities.

The investment in organisational capacity required to successfully institutionalise ESG brings rewards in quantifiable forms such as increased operating and profit margins; improved access to capital; stronger brand reputation, enhanced employee satisfaction, and workforce and community development. These benefits drive long-term overall outperformance of the market, thus demonstrating the value inherent in managing ESG performance.

An example of how ESG performance management can affect stock price is provided by results of a Harvard Business School study shown in Figure 1, which compares, over the same 19-year time period, the stock performance of a portfolio of firms that successfully manage ESG with a portfolio of firms that do not manage ESG. The red line shows that US\$1 invested in a portfolio of firms that manage ESG would have grown to US\$22.60, whereas US\$1 invested in a portfolio of firms that do not manage ESG would have only grown to \$15.40.

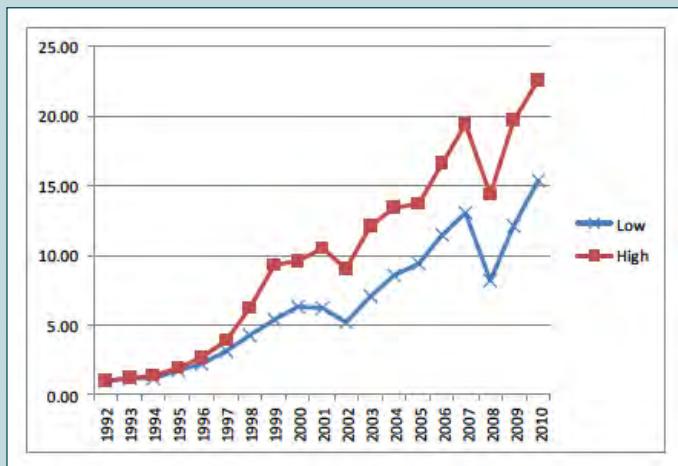


Figure 1: The effect of ESG performance management on share price

DEFINITION OF ESG INTEGRATION

ESG integration (ESGI) involves the incorporation of metrics associated with the results of managing ESG performance into traditional financial analysis. As ESGI considers factors that fundamentally affect a company's ability to create economic value, it enables a more comprehensive assessment of a company than financial analysis alone can. In doing so, ESGI enables the identification of market leaders and laggards in terms of their ability to capitalise on ESG-related risk-mitigation and margin-improving opportunities. These determinations are possible because ESG metrics provide analysts with quantitative and qualitative data, which enable operational insights across the value chain. Integrating these metrics into traditional financial analysis enables the construction of more informed risk profiles and financial models with greater explanatory and predictive power than conventionally built models, thereby enabling better evaluations of long-term potential to outperform the market. In the same vein, ESG metrics can be used to determine and monitor companies' ability to adapt to changing market conditions; quantify managerial performance beyond financial measures; enable more accurate industry peer comparisons; mitigate and take advantage of, respectively, newly identified ESG-related risks and opportunities, and to keep track of ESG-related incidents that may adversely affect a company's brand and value.

EVIDENCE OF ESGI'S EFFECTIVENESS

The theoretical benefits of ESGI are borne out in its practice. An example provided by AXA Investment Managers, which illustrates the identification and integration of ESG metrics into financial analysis is provided in Figure 2.



Figure 2: The effect of board score on share price

Figure 2 demonstrates that the share price of the companies with the best board scores¹ outperform companies with the worst board scores, ie, those with the best board scores returned 40% on an annualised basis, whereas those with the worst board scores returned -0.3%. Although this may not seem all that insightful, ie, one would expect poor leadership to result in poor company performance and vice versa, the fact is that analyses such as these are not undertaken outside of firms that have adopted ESGI. The potential negative consequences of not doing so are missed investment risks and opportunities that can affect portfolio value as exhibited in the above example.

In addition to the example above, there exists a body of evidence in support of the realisation of superior long-term, risk-adjusted returns by employing ESGI. Two² study-of-studies are here presented, which examined multiple academic and investment management firm conducted studies regarding the use of ESGI. The first, performed by United Nations Environment Programme Finance Initiative and Mercer, found that four of the five studies, which employed a pure ESGI strategy, outperformed the market. The second study, performed by Deutsche Bank Group, reviewed 100 academic studies, 56 research papers, two literature reviews, and four meta-studies of sustainable investing and found that 89% showed companies with high ESG ratings outperformed the market and 100% of the companies had a lower cost of capital in terms of debt (loans and bonds) and equity.

Further evidence of ESGI's effectiveness is found in the multitude of investment managers, pension funds, and private equity firms, collectively representing hundreds of billions of assets under management (AuM), which have implemented ESGI and outperform the market. Investment managers include: Calvert Investments, Parnassus Investments, HERMES, Deutsche Bank, Robeco SAM, PNB Paribas. Pension funds and endowments include: Harvard Management Company, Ontario Teachers Pension Plan (OTTP), APG, PGGM, HESTA, and CalPERS. Private equity firms include: TPG Capital Advisors, LLC, Apollo Global Management, LLC, The Blackstone Group, and The Carlyle Group.

1 'Board score' is a governance metric devised by AXA that rates corporate boards of directors on a scale of 1 - 5 using the following criteria, "[A]n appropriate mix of directors with the right skill sets that evolve in line with company strategy [;] [H]ealthy turnover and proper succession planning [;] [A] board composition that reflects workforce diversity and the firm's geographic footprint."

2 A compendium of additional studies can be found here: <http://www.sristudies.org/>

A specific instance of an IM who has achieved alpha using ESGI is Andre Bertolotti, Chief Investment Officer at Quotient Investors. He has outperformed the Russell 1,000 by 4.88 percentage points over the last three years. Extolling the effectiveness of ESGI he flatly states: "Without ESG, my portfolio would look like that of many other managers... But when you bring ESG into the picture, I end up buying a different set of stocks."

A similar example demonstrates how ESGI enables investment managers to avoid losses. Through its use of ESGI, Domini Social Investments, which manages mutual funds with a combined AuM of US \$1.3 billion, became aware of the type of regulatory and worker safety compliance issues at British Petroleum (BP) that were eventually recognised as the cause of the failure of the Deep Water Horizon oil rig. Based on its ESG analysis and rating, Domini did not purchase BP shares. This decision avoided what would have been a significant loss in the value of their fund.

Finally, there is an industry dedicated to providing ESG data precisely to enable ESGI and other SRI strategies. Companies in this industry include: Sustainalytics, TRUCOST, Asset4, MSCI, CSRHUB, Bloomberg ESG, RepRisk, FACTSET, and smaller boutique firms that often bundle consulting services with their data. In addition to these resources, there is an abundance of thought leadership, networking opportunities, information services, and other types of support for the use of ESGI available through organisations that exist to advance responsible investment practices, eg, United Nations-supported Principles for Responsible Investment (UN PRI), European Sustainable Investment Forum (EuroSIF), US Forum for Sustainable and Responsible Investment (US SIF), and many others.

DEMAND FOR ESGI

Connected to the empirical evidence supporting ESGI's effectiveness, there is demand for its use by investment managers from investors. For instance, US SIF reports that client demand is the top reason investment managers are implementing ESGI. Considering future demand, one may conclude from the following three findings that, "the emerging generation of investors is likely to seek achievement of social objectives in addition to financial returns," 1) 36% of respondents to a study of 5,000 millennials ranked 'to improve society' as the primary purpose of business, 2) millennials value price over brand, are not known for brand loyalty, are not averse to switching costs and, 3) millennials' use of the internet is significantly different than that of baby boomers. As such, an equally reasonable conclusion is that in order for investment managers to be able to take advantage of the expected wealth-transfer from baby boomers to millennials over the next 40 years, which is valued at US\$41 trillion, they will need to adopt ESGI in order to accommodate the disparate investor profiles of these two generations.

CHALLENGES ASSOCIATED WITH ESGI

As with any new investment strategy, resources are required for its implementation. In the case of ESGI, these resources could be considerable, as this investment strategy requires an entirely new set of skills and procedures to be included in investment decision-making processes. As such, consultants may need to be brought in, staff will have to undergo extensive training and/or new staff may need to be hired. Furthermore, depending on the degree to which ESGI is implemented, the following types of changes, potentially among others, may need to be planned and executed at a firm: 1) organisational structure adjustments, 2) data acquisition and

integration, 3) development of website and other marketing material, and 4) workflow reengineering. Moreover, from a Human Resources perspective, these types of changes require executive level support and a culture and level of employee engagement that is able to cope with the disruptions and natural resistance to change involved. Without these success factors in place, declines in morale and productivity are likely.

In addition to the resource and organisational level challenges, ESG data is known for having availability, consistency, reliability and verifiability issues. These issues are mainly related to the nature in which companies report ESG data, the frequency they do so, and legal concerns regarding data sensitivity. In some cases, these issues render the data difficult to work with in general and for the inexperienced, can lead to the misidentification of leaders as laggards and the converse. Similarly, there is an absence of a standard framework and methodology for scoring companies based on ESG performance, which can lead to misconceptions regarding which ESG data is material and which is not, the latter being irrelevant to ESGI.

EXPLAINING RESISTANCE TO ESGI

As counterarguments to the above challenges, ESGI advocates offer IMs variations of the benefits and demand for it previously cited. However, they also typically include fear-mongering, plays at sympathy, and information overload. Which is not to claim that the assertions made regarding, eg, habitat loss, sea-level rise, the health effects of pollution, etc. are not true and relevant, rather, that they are not effective towards inducing behaviour change among IMs' for which these negative consequences have no immediate bearing or significance. Also included in ESGI advocate's strategy to relay its benefits are the use of terms³ such as sustainable, responsible, environmental, ethical, etc., which for many IMs carry negative connotations. The thinking behind this strategy is that if the information and implications are properly explained and the data and methodology verified and substantiated, it will be accepted and ESGI implemented accordingly.

Ostensibly, the combination of the previously described challenges and strategy are the basic reasons behind investment managers' resistance to implementing ESGI. That is to say, IMs who have a successful strategy in place presumably find that the cons outweigh the pros of implementing ESGI. Given the steadfast persistence of the attempts to overcome this resistance, however, the author believes that an explanation is needed that provides a more complete account of ESGI resistance among IMs vis a vis its empirically based benefits and the existing and future demand for its use.

In recognition of this need, the author called upon sociological theory for insights into the possibility that there are deeper motivations and thought processes driving resistance to ESGI. The following five examples offer just that:

1. Cultural cognition theory posits that as scientific knowledge and numeracy increases, ie, the 'smarter' one is, among those with a world view that, "ties authority to conspicuous social rankings and eschews collective interference with the decisions of individuals possessing such authority," ie, the more one espouses the benefits of a hierarchical social order, the more likely one is to question the information with which they are presented. As IMs generally fall into this character category, it is reasonable to expect them to instinctively doubt the benefits of ESGI.

³ For some IMs, hearing or reading these and similar terms, is cause for concern regarding and even dismissal of the worth of ESGI.

2. Motivated avoidance theory posits that when faced with a complex and troubling issue, some individuals' instinct is to give up and not learn more about it, ie, they do not endeavour to come to an informed conclusion based on non-biased information. Thus, their resistance arises from their lack of knowledge being 'informed' by the disagreement surrounding the issue and any potentially conflicting information they are exposed to in their everyday life, such as, respectively, opposing positions in one's firm regarding the pros and cons of ESGI and news stories disseminated by the media regarding the risks associated with not managing ESG performance. With the risks of ESG in doubt, the relevance of ESGI is questioned.
3. Some hold that large sums of money are being made in the form of grants, subsidies, and donations from entities that accept the reality of the environmental, social, and governance risks facing society. Again, with these risks in doubt, the relevance of ESGI's is rendered moot.
4. Under the heading of fear, when some individuals are presented with threatening information their instinct is to deny the truth of the information and/or its applicability to them. Similarly, humans are notorious - among economists - for underestimating the risks associated with likely events and overestimating the risks of unlikely events. Thus, in both cases, the threat of imminent danger is denied. The danger in this case being that resistance to ESGI is unfounded.
5. Building upon the sociological concepts of confirmation bias, wherein one "give[s] greater heed to evidence and arguments that bolster [their] beliefs" and disconfirmation bias, wherein one "expend[s] disproportionate energy trying to debunk or refute views and arguments [they] find uncongenial," is the rationalisation explanation. That is, when presented with information that questions deeply held beliefs and/or that one's way of life could be fundamentally threatening to society, they reject the validity of the source of the information. Thus, the information itself cannot be correct.

These five explanations provide useful information regarding underlying subconscious biases that add to the previously stated challenges and help to better explain why attempts to overcome resistance to ESGI have seen limited success. To wit, they reveal that accepting ESGI's effectiveness may represent a threat to the basic human instinct of identity preservation.

An aspect of identity being preserved, through denial, is one's level of intelligence and self-worth as manifested in career performance. That is, if an IM admits that ESGI is an effective investing strategy, they will also conclude that their returns could have been greater. Such an admission, after years of claiming to have been doing the best for their employer, clients, etc, could be very uncomfortable and possibly embarrassing. Mental health professionals refer to this type of internal conflict as cognitive dissonance, ie, the discomfort felt as a result of attempts to simultaneously maintain two conflicting cognitions.

In this case, 'I have done my best' and 'I dismissed, without sufficient reason, information that would have improved my performance.' This discomfort often leads to decision-making that serves to moderate emotions that fuel anxiety. Denial of the effectiveness of ESGI would avoid the anxiety associated with accepting its effectiveness and, thus preserve one's sense of career accomplishment.

Another aspect of identity being preserved is one's self-image as a 'good person'. That is, admitting ESGI's effectiveness will force an IM to realise that businesses that do not manage ESG performance are significantly contributing to the environmental and social issues facing society. With this realisation may come another, ie,

as a consequence of not adopting ESGI, they may have made an outsized contribution to these issues. As such, they may have, albeit unwittingly, further jeopardised the health and future wellbeing of their family members, friends, themselves, and indeed the rest of the world, a notion certainly capable of inducing a fair bit of anxiety. Analogous to the previous example then, denial of the effectiveness of ESGI would preserve one's self-image as a 'good person'.

CONCLUSION: SUGGESTIONS FOR A NEW APPROACH

As the combination of the obstacles previously articulated virtually eliminates the power of an empirically based argument to overcome resistance to ESGI, the following suggestions seek to appeal to IMs' competitive nature, rather than attempting to show IMs the error of their position and the environmental, social, and economic benefits of ESGI. Thus, the author believes that this may be more effective in getting IMs to implement ESGI

1. Similar to the XPrize, a competition could be issued to achieve alpha through the use of ESGI. Similarly, more prizes like the Moskowitz Prize for Socially Responsible Investing could be made available to students.
2. ESGI coursework could be added to the curriculum of business classes and more ESG-focused extra-curricular opportunities such as the PRI Young Scholars Finance Academy could be offered. Similarly, more ESGI training, such as that provided by Responsible Investment Academy and Robert F. Kennedy (RFK) Compass could be made available. In addition, a Responsible Investor professional accreditation could be added as a sub-designation to a Certified Financial Analyst (CFA) or the CISI Masters in Wealth Management.
3. Mainstream, finance-focused media outlets could dedicate coverage to investment managers that are generating superior, risk-adjusted returns using ESGI.
4. A publicly available directory of sustainably managed investment products could be built to inform and drive retail investor demand for financial products and services using ESGI.
5. Investment management firms could align compensation structures and performance appraisals with the use of ESGI.
6. Eligibility for banking and investment subsidies could be restricted to firms that manage a predetermined minimum percentage of their AuM using ESGI.
7. Standard reports issued by indexes and exchanges could be benchmarked against a comparable index of assets determined as sustainably managed then distributed through social media applications and financial news outlets. The former links to 'connect now!'

This article has explained what ESG and ESGI are and presented empirically based evidence for advantages of both. It has also presented the challenges associated with implementing the latter and described why the efforts of its advocates to get IMs to implement ESGI have seen limited success. In addition, with the aid of sociological theory, suggestions have been offered to help induce IMs to implement ESGI so as to increase the percentage of global AuM which employ an SRI investing strategy. Given the ESG-related challenges facing society, it is the author's hope that this article will induce IMs to (re)consider implementing ESGI, the suggestions be acted upon, and that further use of the sociological insights provided will be made by ESGI advocates in their efforts to get IMs to leverage investors' capital resources and influence to invest in and advocate for sustainably run companies.

References cited in this paper are listed at cisi.org/rofmjune2014

MACROPRUDENTIAL POLICY: POTENTIAL IMPLICATIONS FOR INVESTORS

Colin Ellis, Visiting Research Fellow, University of Birmingham
c.ellis@bham.ac.uk

ABSTRACT

Since the financial crisis broke in 2007, policymakers around the world have sought to design and implement new tools to prevent future crises and limit spillover effects to the wider economy. These new 'macroprudential' instruments are still being developed in many cases, but have already had a discernable impact on financial markets. In coming years, macroprudential policy (MPP) is likely to exert significant influence on future investment decisions and returns. This article sets out the core toolkit of macroprudential policy, and discusses potential implications for investors.

INTRODUCTION

Policymakers have sought new ways to influence economies since the recent financial crises and subsequent recessions in advanced economies. Central banks have resorted to a variety of less conventional monetary policy measures to support growth, with questionable success (Sinclair and Ellis, 2012). And concerns about the potential macroeconomic costs of systemic risks (Ellis, 2011) have led to a set of new regulations and tools, broadly defined as 'macroprudential policy' (hereafter MPP).

LITERATURE REVIEW

Before the recent crisis, academic literature on MPP was limited, although Clement (2010) establishes that the term was used by policymakers in the 1970s. Borio (2009) notes that, prior to the crisis, 'macroprudential' matters were generally thought to relate to links between regulation and supervision and the macroeconomy, while BIS (1986) describes MPP as supporting the safety of the financial system as a whole. McCauley et al (1999) focus on addressing risks from increases in leverage.

Since 2007, research on MPP has become more widespread, and is only briefly summarised here. Initially the aim of MPP was unclear: for instance, while Caruana (2010) focuses on reducing interlinkages between institutions and the procyclicality of the financial system, Hanson et al (2011) suggest that MPP should control the wider costs of generalised shrinkage of the financial system. Meanwhile, Landau (2009) suggests that MPP should act to prevent asset bubbles; but in contrast Geanakoplos (2010) proposes that policymakers should respond instead to build-ups in bank credit and leverage during expansionary periods. Nier (2011) summarises the emerging consensus that MPP should focus on mitigating systemic risk.

One particular strand of the literature relates to identifying banking crises. Claessens and Kose (2013) provide an in-depth review of past crises, while Laeven and Valencia (2012) compile a comprehensive database. Several papers have examined potential leading indicators of financial distress that could guide policymakers, including those from balance sheets (Carson and Ingves, 2003) and financial markets (Illing and Liu, 2006, and Tarashev and Zhu, 2008). De Nicolò and Lucchetta (2009) jointly model macroeconomic variables and financial risk indicators using a factor-augmented vector autoregression (FAVAR) approach; Ellis et al (2014) demonstrate how FAVARs can capture evolving economic dynamics and transmission mechanisms. However, a key criticism of this strand of literature is that past crises were not typically preceded by poor economic conditions or other

indicators (Alfaro and Drehmann, 2009). To date, the ability to predict crises – and avoid false positives – remains unproven.

Hannoun (2010) and Bank of England (2011) offer generic discussions of potential MPP tools. More specific research has often focused on banks' capital, with papers examining the role of short-term debt in determining banks' vulnerability (Brunnermeier, 2009), the risk-mitigating role of contingent instruments (Sundaresan and Wang, 2010), and differences in the impact of price-based versus quantity-based tools (Perotti and Suarez, 2011). There is often disagreement. For instance, Shin (2010) discusses how countercyclical capital buffers (CCBs) can mitigate risk concentration; but in contrast Claessens et al (2013) suggest that CCBs are suboptimal, and argue that caps on debt-to-income and loan-to-value (LTV) ratios are more effective tools, having reduced vulnerabilities in emerging markets. Several papers have also addressed the challenge of incorporating MPP within macroeconomic models; for instance, Angeloni and Faia (2009) incorporate banks in a standard dynamic stochastic general equilibrium (DSGE) framework. However, the relative complexity of such approaches, and indeed wider concerns about DSGE models, means that they are not yet in common use. Finally, the International Monetary Fund (2013) provides a good recent summary of MPP, noting in particular that strong enforcement of policies must be complemented by appropriate monetary, fiscal and other financial policies.

CRISIS PREVENTION

Most macroprudential tools relate to either crisis prevention, or crisis management. The former seek to limit the incidence of financial crises. While regulatory efforts such as Solvency II have sought to harmonise capital adequacy metrics within the insurance industry, most of the recent focus has been on banks.

Banks suffer from a maturity mismatch – they lend over long horizons, but are funded with short-term money, such as deposits and wholesale market funds. Funding can therefore be withdrawn very quickly if trust in an institution is lost, even if the value of its assets is robust. Banks also suffer an uncertainty mismatch: the present and future value of liabilities are known with some certainty, but the return on assets will depend on credit risk and asset prices.

Banks cope with uncertain returns – and particularly unexpected losses – via capital buffers. Bank capital has the critical ability to absorb losses, so that the institution remains a going concern. Ordinary share capital and retained earnings are basic forms of capital, while other types include preference shares and hybrid securities. However, market participants focused on simple measures of capital during the crisis, reflecting uncertainty around the loss-absorbency of other types of capital.

The scale of some banks' losses during the financial crisis raised concerns about the adequacy of capital buffers. One of the first MPP acts was to require banks to hold more and better quality capital – to increase loss-absorbing buffers – but this was phased in (Figure 1) to give banks time to adjust.

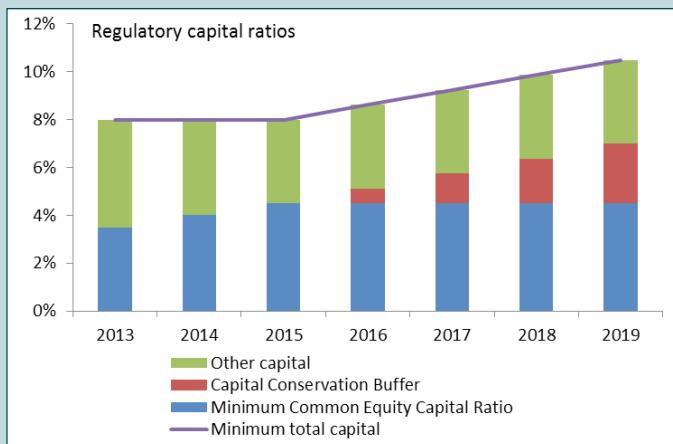


Figure 1: Initial phase-in arrangements for Basel III capital requirements
Source: Basel (2010)

Higher capital requirements are an implicit acknowledgement that regulators underestimated risks prior to the crisis. This is partly because inherent uncertainties in banks' risk models were often ignored, and they failed to capture the intrinsic risks that actually crystallised (Haldane, 2009). More stringent and public stress tests, designed in part to counter this, are now an important part of policymakers' toolkits.

Single measures of solvency may also be misleading, especially given uncertainties around risks. As such, some regulators have also introduced leverage ratios as alternative measures of capital adequacy. This essentially measures capital against total assets, without any risk weighting. One consequence is that banks that engage in relatively safe activities are penalised.

Failures of large multinational institutions are more likely to engender widespread economic externalities than smaller ones. As such, systemically important financial institutions (SIFIs) typically face higher capital requirements than smaller banks, with global SIFIs facing the highest requirements. However, given no cross-border agreement on resolution of global SIFIs when they fail, the default position is still for the home regulator and government to lead. Furthermore, concerns about regulatory arbitrage persist, with global co-ordination in banking regulation falling short of what is likely to be needed in a crisis, prompting fears of a 'race to the bottom' (Houston et al, 2012). This poses significant fiscal risks for countries where the banking sector is disproportionately large, as seen in Iceland and Ireland. Furthermore, many systemic transmission mechanisms persist: efforts to promote central counterparty (CCP) clearing for derivatives and securities, thereby limiting network effects, have had limited impact so far.

Most of these developments are essentially static in nature. But MPP can also be countercyclical, restraining booms and cushioning busts. In many countries, banks must now hold CCBs, while clear signals from policymakers could improve private agents' financial decisions in a more dynamic fashion (Giese et al, 2013). Sectoral capital requirements for specific markets or even limits on lending – for instance via caps on LTV ratios – could also vary as conditions evolve. Finally, closer links between macroprudential and microprudential regulation – the latter focusing on individual institutions rather than the financial system as a whole – could also result in higher capital requirements for individual banks. However, the slow implementation of regulatory capital changes limits their responsiveness to financial dynamics.

CRISIS MANAGEMENT

Crisis management tools seek to limit the impact on the wider economy when institutions do fail. The development of these tools implicitly recognises that policy will never eliminate the risk of large or systemic institutions failing.

First, many banks now require 'living wills' detailing how the institution should be managed if it fails. These process maps are still very opaque, but should ostensibly help regulators. The imposition of 'ring fences' within banking groups – essentially, trying to separate the utility aspects of banking from more speculative activities – should also help, by protecting the ordinary business of the bank from shocks arising elsewhere on the balance sheet (ICB, 2011).

Second, new resolution regimes often empower regulators to intervene early and break banks into 'good' and 'bad' parts. Typically, the bad bank with the underperforming assets is then run by the state, with the aim of recouping as much money as possible while insulated from liquidity concerns. Meanwhile, the 'good' bank starts afresh with a clean balance sheet. In practice, it is difficult to quantify prospective losses within poor credit and asset portfolios, and aggressive write-downs in asset values could result in the good bank requiring new capital.

New securities also ensure that bank creditors suffer losses alongside equity holders. In particular, some hybrid securities known as 'contingent capital' (or CoCos) will convert from high-yielding debt into loss-absorbing equity, where the trigger for conversion will often be prior to the bank's point of non-viability.

If these 'capital-like' instruments are insufficient, then losses can also be imposed on other junior securities, senior debt holders, and uninsured depositors. This 'bail-in' approach ensures that creditors suffer losses instead of fiscal authorities injecting money. The Cypriot banking crisis resolution in March 2013 followed this principle, and the EU's Banking Recovery and Resolution Directive is very much in this vein.

These crisis management tools aim to provide effective mechanisms for resolving failing banks while minimising taxpayers' costs and sustaining the normal functioning of the banking sector. However, financial market conditions are likely to deteriorate markedly in any period of significant stress; and here the traditional role of the central bank remains.

LIQUIDITY PROVISION AND MARKET-MAKING

When shocks to the demand or supply of money crystallise, banks can face funding shortfalls even if their overall solvency is not threatened. However, in the absence of such short-term funding, a bank's solvency may then be called into question, especially if it has to liquidate assets at substantial discounts in so-called 'fire sales'. Potential panic could also lead to a run on the bank, and liquidity crises can swiftly become solvency crises.

The typical response is to establish a 'lender of last resort' (LOLR) that can provide discretionary liquidity to financial institutions against good collateral (Bagehot, 1873). Given their role at the heart of the banking and payments systems and ability to 'create' money, the LOLR is typically the central bank. These can even offer unlimited funding to a large number of banks, as in the European Central Bank's long-term refinancing operations (LTROs).

Concerns remain about central banks injecting liquidity to support institutions, as this backstop could encourage banks to take excessive risks, engendering moral hazard. (A similar argument can be made about government-funded bailouts.) Typically, the costs of not supporting solvent institutions are thought to be greater than the costs of intervening; but distinguishing between solvent and insolvent institutions can be difficult within short time-frames (Goodhart, 1999). Hopefully, higher capital buffers should make this distinction easier.



Figure 2: Cross-currency basis swap spread (a)
(a) Three-month euro vs US dollar. Source: Bloomberg

Another liquidity risk is currency mismatch; European banks recently had to pay a premium to borrow in US dollars (Figure 2). In response, central banks in advanced economies set up a network of bilateral currency swap lines, to ensure that banking systems would not face particular currency needs. These were subsequently converted into standing arrangements, to mitigate the impact of future cross-border funding strains. However, thus far little emphasis has been placed on the role of liquidity management to contain nascent credit bubbles. Given the critical role of central bank operations in the wider system of banking and credit, this is likely to be an oversight.

Meanwhile, central banks' appetite for becoming 'market makers of last resort' (Buiter and Sibert, 2007) has varied. In the recent financial crisis, liquidity in specific securities markets declined sharply or dried up completely. Faced with the ensuing uncertainties around the value of these illiquid assets, no private market maker may be able to buy and sell them.

In these circumstances, central banks could intervene to re-start these markets, either by accepting the illiquid securities as collateral in regular financing operations or by making outright purchases (and sales) of the securities themselves. However, central banks' appetite for holding private securities has varied markedly. In the US, around half of the Federal Reserve's new asset purchases has comprised of mortgage-backed securities (and related agency debt). But in the UK, the Bank of England's net purchases of private securities are zero, despite it being indemnified for up to £50bn; its diminutive initial purchases were replaced with gilts as they matured. Given current discussions around (re)developing specific securitisation markets, central banks' roles in this area may continue to evolve.

IMPLICATIONS FOR INVESTORS

The wide range of new MPP tools has the potential to significantly affect the financial landscape. However, it is clear that MPP will not eliminate asset bubbles or unusual swings in financial market prices. In the absence of wider external capital controls limiting cross-border and currency flows, the potential for financial market prices to diverge from fundamentals is likely to remain little changed from prior to the crisis. One caveat here relates to leverage-fuelled asset prices. While MPP will not aim to control asset prices, policymakers are still likely to try to limit increases in leverage. As such, those asset prices that are closely related to developments in credit markets – in particular, residential and commercial property prices – may experience declines in value, over the long term, relative to the prices of other assets. But equity investors should not expect to see reduced volatility in stock markets as a consequence of MPPs.

A second development will be the further shift of activities from the increasingly regulated banking sector to the less fettered shadow banking sector. This reflects a continued desire by banks to shrink and de-risk their balance sheets, and by businesses to diversify their funding sources. European companies are still highly dependent on bank funding, compared with US businesses, and policymakers are likely to encourage efforts to increase businesses' direct access to financial markets (or indirect access via securitisation). The ultimate implication of activities shifting to the shadow banking sector is that the inherent risks associated with them will no longer be visible in the banking sector, but will still be present in the wider economy. As such, if investors want to maintain exposures to the same implicit risks (and returns) that bank investments offered prior to the financial crisis, then they will need to change and/or broaden their portfolio allocations accordingly.

The shift of these activities outside of the banking sector is consistent with MPP not preventing bubbles or large swings in asset prices. However, it also suggests that MPP may struggle to curtail increases in whole-economy leverage, unless new tools are also applied to regulate the shadow banking sector.

Given the limited access of many borrowers to non-bank finance, the shift in the provision of finance will also result in increased credit rationing. This will pose challenges for monetary and fiscal policymakers, and will widen inequality among households. But rationing will also drive a further wedge between the performance of firms with good market access and those without it; the external finance premium for smaller and riskier firms is likely to rise. In principle, this could lead to higher returns for providers of alternative finance, such as private equity and venture capital (VC) firms. However, the performance of VC funds, in particular, has been poor for many years (British Private Equity & Venture Capital Association, 2013), which should temper any optimism.

Stricter regulatory enforcement regimes are also likely, which could increase the incidence of broader corporate default. Apart from an increased likelihood of banks being allowed to fail as implicit state support declines, regulators are also less likely to allow widespread forbearance on bad debts. Under regulatory stress-testing frameworks, banks are typically forced to recognise losses up front, thereby limiting the scope for sequential write-downs. In turn, that could result in underlying borrowers facing greater financial distress; companies will be less able to negotiate an extension or non-payment period for a troubled loan. This may be partly offset by political pressures, where governments want to keep credit flowing for other reasons.

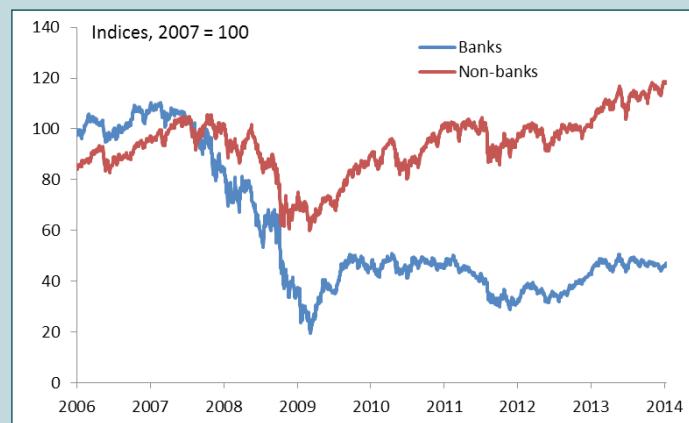


Figure 3: FTSE All-Share equity indices
Source: Bloomberg and author's calculations

For bank investors themselves, the implications are likely to be more direct. Ordinarily, more capital and less leverage will lower the return on equity that a bank can deliver, for a given return on assets. For this reason, bank equity prices are unlikely to return to their previous relative standing against non-bank companies (Figure 3).

At the same time, this might seem to imply that banks' debt securities will become more attractive. Holding higher levels of capital will reduce the risk of bank failure and creditor losses. And – if counter-cyclical MPP works – dampened credit cycles will also be positive for creditors, in the sense that losses on defaulted portfolios will be smaller.

However, there are important qualifications to this analysis. First, there is no guarantee that MPP will effectively dampen credit cycles, or indeed be applied consistently over time; as memories of the crisis fade, in particular, policymakers are likely to come under more pressure to regard past events as exceptional. Second, the underlying bias of bank managers towards risk-taking remains unchanged even in the event of distress, as noted by Myers (1977). As such, banks will tend to fix damaged capital ratios by shrinking assets and credit rationing rather than by raising new capital, which would be better for creditors.

Third, a key aim of MPP is to end – or at least limit – government-led bailouts. This means that the implicit state support for banks and SIFIs, in particular, should end if MPP is successful; and in the event of distress, bank bondholders may have significant losses imposed on them, particularly if a large portion of deposits is insured by the government (which ultimately controls bank resolutions). Exhibit 4 presents an illustrative example of two banks, where one is heavily deposit funded, and the other is more reliant on debt. If the total asset losses faced in the event of failure are the same, then bondholders of the deposit-funded institution could see higher write-downs, because the total loss is spread among a smaller pool of wholesale debt. From the point of view of bondholders, a high deposit ratio may be undesirable, even if deposits provide a stable funding base.

Implied loss rate for 15% fall in total assets				
Balance sheet liabilities	Bank A	Bank B	Bank A	Bank B
Equity	5	5	-100%	-100%
Subordinated debt	5	5	-100%	-100%
Senior debt	45	15	-11%	-33%
Deposits (guaranteed)	45	75	0%	0%
Total	100	100	-15%	-15%

Figure 4: Illustrative effects of bank losses on balance sheets

Source: Author's calculations. For simplicity, losses are assumed to run through liabilities sequentially.

A key indicator of investors' appetite for bank debt will be the evolving market for CoCos and other hybrid securities. Against a recent backdrop of tight spreads and strong issuance in high-yield corporate markets, banks have increasingly been issuing these securities. However, a sudden deterioration in market conditions could significantly hit investor demand.

Policymakers are also likely to influence banks' strategies. In the short term, many institutions are focusing on meeting the new 'rules', building up capital and reducing risk as swiftly as possible. Over the longer term, there is likely to be a strong focus on once again delivering a high return on equity, given the continued alignment of bank managers' incentives with shareholders rather than creditors.

New MPPs could also have a perverse impact on banks' risk management. In recent decades, many banks have increasingly devoted more resources to developing their own risk measurement and monitoring frameworks. But if regulators are increasingly prescriptive about risk measurement, the need for complex internal systems may diminish; for instance, if there is no scope for debating the risk weights associated with different lending categories, and the regulator's word is final, then banks may have little need for complex internal capital models.

The regular US stress tests that the Federal Reserve conducts in its Comprehensive Capital Analysis and Review (CCAR; see Federal Reserve, 2014) are already moving in this direction. Each of the reporting banks currently conducts its own stress test, prior to the Federal Reserve conducting its centralised tests. However, the market focus is already skewed towards the Fed's tests, rather than those of the banks, as these are the results that drive regulatory requirements and banks' remedial actions. Although the banks will still have to conduct their own tests, the relevance and impact of these internal exercises are greatly diminished.

CONCLUSION

The range of macroprudential policies currently being developed and implemented will have a profound impact on financial markets and investors. While swings in asset prices are still likely, credit cycles may be dampened. Bank investors will face a new constellation of risks, with some activities shifting into the shadow banking sector, but bail-in regimes increasing the likelihood of credit losses in distress. In addition to the likely effects outlined above, however, there will undoubtedly also be unintended consequences arising from policy. Apart from the recent acceleration of the shadow banking sector, the application of MPPs is likely to lead to other changes in the financial landscape that are as yet unpredictable. In part, this is the necessary consequence of putting new rules into operation. However, it also implies that the final impact of macroprudential regulation is likely to remain unclear for some time.

References cited in this paper are listed at cisi.org/rofmjune2014

ACADEMIC JOURNAL PANEL MEMBERS

Prof Moorad Choudhry FCSI	Brunel University
Prof Carol Alexander	University of Sussex
Dr Edward Bace, Chartered MCSI	CISI, Middlesex University
Dr Paul Cox	University of Birmingham
Scott Dobbie FCSI(Hon)	Deutsche Bank
Peter Land, Chartered FCSI	Brewin Dolphin
Gino Landuyt	Luxembourg Financial Group
Prof Donald Lawrence MCSI	University College London
Sian Lloyd, Chartered FCSI	CISI
Gregor Logan MCSI	Family Investment, Nutmeg
David Moskovic	Royal Bank of Scotland
Prof Jim Steeley	Aston Business School
Nigel Sydenham, Chartered FCSI	BPP Professional Education

PÉTANQUE IS A GAME MANY OF US WILL HAVE PLAYED ON HOLIDAY. BUT IT IS A YEAR-ROUND PASSION FOR BRIGITTE IBITSON, CHARTERED MCSI, A KEEN PLAYER IN HER HOMETOWN OF ST HELIER, JERSEY

◆ LORA BENSON

Pétanque perfection

Born and educated in Jersey and employed in the financial services industry for over 20 years, Brigitte Ibitson currently works with Kleinwort Benson as a member of the compliance team. Her job is likely to become ever more demanding, as the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) is now responsible for assessing Jersey's compliance with relevant international standards.

When not grappling with international compliance issues, Brigitte unwinds on the local terrains with a game of pétanque, which she plays weekly: "In 2008, the Jersey Pétanque Association (JPA) looked at ways of increasing its membership and the idea for a lunchtime league in St Helier was hatched.

"The league now boasts more than 30 teams in four divisions, playing weekly matches in summer and winter competitions. The teams are representative of the wider business community within St Helier but primarily within the finance industry."

The Liberation Pétanque Club (LPC) was formed in 2011 with close to 70 members,

many of whom come from the lunchtime league in which Brigitte and her daughter play.

The LPC now contributes more players to the Jersey team than any other island club: "I am hopeful of being selected to play in the 2014 annual Inter Insular against local neighbours Guernsey," says Brigitte.

Brigitte has collected several medals during her time playing pétanque and was part of the first ever doubles league and cup winning side in the senior competition played in Jersey:

"My daughter Alice and I are the highest placed women in the LPC Singles and Doubles League, which has led to us being invited to try out for this year's European Ladies Triples Competition, which will be held in Sweden.

"Unfortunately, due to work commitments, I am unable to attend this year."

The introduction of the business league and the LPC has meant that the average age of the island's players has been dramatically reduced. As the JPA has affiliated with the international governing body, the profile of Jersey as a playing nation has gained international recognition. The game itself

could also be set for a breakthrough on to the biggest sporting stage of all. The Fédération Internationale de Pétanque et Jeu Provençal, which the JPA is affiliated to, is in the process of applying for Olympic status.

Brigitte's message for islanders interested in trying pétanque is encouraging: "Come along on our regular Wednesday evening club night and give it a go. You will find the friendliest club in Jersey – and it will not cost you anything to try."

Do you combine your day job with an unusual activity or hobby?

Over the past six years we've featured articles about some amazing CISI members in the *Securities & Investment Review* and we are now looking for more.

Profiles have included a boxing second, an ex-Olympic cyclist, an ice climber, a watchmaker, a soldier who served in Afghanistan, a martial arts expert, a photographer of celebrities and a sky diver.

Contact lora.benson@cisi.org if you have a story you think will interest other CISI members. We'll give you a £25 shopping voucher as a thank you if we publish it.

FACT FILE

Pétanque is a version of an older game, Jeu Provençal, the current form of the pastime originating in 1907 in Provence in southern France.

The name derives from 'pes tancats', meaning 'feet anchored'. The aim is to throw hollow metal balls as close as possible to a 'jack' or small wooden ball called a cochonnet (literally 'piglet'), while standing inside a starting circle with both feet on the ground.

Each of two teams consists of one, two or three players. In the singles and doubles games, each player has three boules; in triples, each player has

only two. A coin is tossed to decide which side goes first. The starting team then draws a circle on the ground that is 35–50 centimetres in diameter. All players must throw their boules from within this circle, with both feet remaining on the ground. The first player throws the jack six to ten metres.

Play ends and points may be scored when both teams have no more boules, or when the jack is knocked out of play. The winning team receives one point for each boule that it has closer to the jack than the best-placed boule of the opposition.



BRIGITTE IBITSON IS A CHAMPION PÉTANQUE PLAYER

A puff of smoke

A CHIEF EXECUTIVE FACES A DIFFICULT RECRUITMENT DECISION IN RESPECT OF AN URGENT HIRE. IF HE DISREGARDS THE APPLICANT'S PAST, CAN HE JUSTIFY HIS DECISION – AND WHO SHOULD HE TELL?

George is the Chief Executive of a well-respected investment advisory firm, Haveago, which trades on its good, if unspectacular, reputation. It has a long-unfilled vacancy for an experienced senior investment analyst that is proving to be a problem for the firm. This is exacerbated by the imminent departure of a contractor who has been filling the position, although hiring a contractor for this role has not been felt to be a satisfactory solution to the firm's difficulties.

Haveago sets out to recruit a suitable candidate to fill the position. Stacey, the Head of HR and the only senior female employee in the firm, informs George that, after a lengthy search that revealed a dearth of suitable candidates, she has shortlisted two applicants for his consideration. The first applicant, Emma, is a postgraduate with comparatively brief but relevant experience from a respected competitor firm where she has progressed rapidly. Stacey reminds George that the board of Haveago has mandated that the firm must increase the number of female employees in senior positions since, apart from Stacey herself, there are no women in the firm other than junior administrative staff. Achievement of this goal is a key objective of both Stacey and George.

SO FAR, SO GOOD

The second candidate whom Stacey mentions to George is an older man, Thomas. He has greater experience than Emma and has worked for the past ten years

as an analyst at one of the leading investment houses, where he is currently employed.

Stacey arranges for George to interview the two candidates. Emma proves to be a bright, presentable prospect with valuable, albeit relatively brief, experience and she makes an immediate positive impact on George. He considers that she appears to fit the bill and that her sharp intellect more than makes up for her limited experience. The fact that she has progressed rapidly in a successful competitor firm strikes George as a positive point in her favour.

George is minded to hire Emma on the basis that she will be able to do the job and also, importantly, improve Haveago's female staffing ratio. As an added bonus, she appears to be connected to a number of high-profile families, which might have additional benefits for the firm.

Emma reveals that a few years ago she received a 'cannabis warning' from the police

Emma would be available shortly, because she reveals that she is likely to be made redundant following a reorganisation at her present employer, which has recently announced that it is merging with another firm.

Later the same day, George interviews Thomas, who comes across quite positively, with his greater experience being evident, although he has a rather restrained manner. In reflection of his greater years in the industry, Thomas is likely to be significantly

more expensive to hire than Emma and he would not be available until the end of a three-month notice period.

Having weighed the relative pros and cons of these two different candidates, both of whom would be suitable, George discusses the matter with Stacey and says that he is likely to offer Emma a job, but would like to see her one more time before making up his mind.

A POSSIBLE 'FLY IN THE OINTMENT'

As the second, less formal interview with Emma draws to a close, George asks whether there is anything further that she wishes to ask or to raise. Somewhat hesitantly, Emma says there is a matter she feels it is only fair she should mention.

Emma reveals that a few years ago she received a 'cannabis warning' from the police when she was found to be smoking the drug at a well-known music festival. George is somewhat taken aback by this unexpected revelation and asks Emma why she did not mention this potentially significant point either in her application form or to Stacey at her first interview. Is her previous employer aware of it?

Rather sheepishly, Emma replies that if she had mentioned this event when originally applying for the job, she seriously doubts that she would have been invited for even a first, let alone a second, interview. She apologises to George and says that it was a one-off occasion in the heat of the moment in the particular environment. Emma adds that a 'cannabis warning' is not a recordable criminal offence and she only mentioned

it because she felt she ought to be completely open and honest with George. He is not sure how to respond and tells Emma that he wishes to consider carefully what he has just learned and that he will let her know his decision in due course.

WHAT TO DO NOW?

George discusses with Stacey what he has just been told and she expresses surprise, but says that at least Emma has been honest, as she could have chosen to say nothing and it is unlikely that the firm would have found out. In any event, Emma has good experience, is available immediately and is well connected. Stacey adds that, in a similar vein to Emma's offence, would the firm take a strong line if an employee failed a breath test but was not significantly over the drink-drive limit? In any event, Haveago does not have a specific drugs policy, relying instead on Disclosure and Barring Service (DBS) checks to reveal any criminal

George is troubled by these conflicting views and decides to consider the position overnight

convictions against new hires. George is in two minds and decides to speak to his Senior Independent Director, Giles, who has considerable experience over many years within the industry.

Giles is clear in expressing his view that there is no room in the firm for anyone with a criminal record, but he too is unsure of how to respond in this situation. He says to George that there is still a difference between drinking, which is legal, and taking drugs, which is not, even if the penalty for the latter may, in some circumstances, be the equivalent of a slap on the wrist.

George is troubled by these various, conflicting views and decides to consider the position overnight, telling Stacey that they should meet first thing in the morning to resolve the matter. As a result, Stacey reviews the various options, which she sets out as follows:

- Hire Emma, although this possibly represents something of a risk in that she has less experience than Thomas. She does have an acceptable level of experience, is available immediately and meets the firm's need to hire more women. Against that is her admission of

her brush with the police over smoking cannabis. But should that be a deciding factor? She did, after all, own up to it when she need not have done so.

- Hire Thomas. This is the safer option as he meets the experience criteria, although he is not available for another three months. However, this will do nothing to meet the firm's diversity targets and, realistically, he may have been judged as the second-best choice if Emma had not mentioned her cannabis caution.
- Hire neither of them and carry on looking. However, the search has already been

going on for some time, resulting in the present position.

- Consider alternative options, such as hiring someone on contract, or possibly outsourcing or buying in research, while continuing the search for a permanent replacement.

What would you advise George and Stacey to do?

Visit cisi.org/smoke and let us know your favoured option. The results of this survey and the opinion of the CISI will be published on cisi.org/smoke



Getty

ONLY WHEN THEY FULLY UNDERSTAND CONDUCT RISK CAN FIRMS EFFECTIVELY MANAGE IT, AS JEANNETTE LICHNER MCSI EXPLAINS



Managing CONDUCT RISK

The financial services industry is slowly emerging from its most serious crisis in living memory. It is doing so against a hostile environment of public, political and regulatory mistrust, rising business costs, significantly increased regulation, and high levels of customer dissatisfaction. There is no doubt that the industry has changed forever, although what the industry will look like post this period of change is unclear. There has been an abrupt change of expectations on the part of the principal industry stakeholders: governments, consumers and regulators. Whether shareholders will be satisfied with the financial impact of the more conservative, less aggressive revenue focus is not clear. Right now, regulators are driving the agenda on behalf of retail and wholesale customers. The UK Financial Conduct Authority (FCA) has led the way on industry expectations, and has encapsulated in its name the somewhat awkward term ‘conduct risk’. In the FCA’s 2014/15 Risk

Outlook, ‘conduct risk’ has been replaced by ‘business conduct’, which is a small but helpful change. While differing terminology is used around the world for what is in

Firms must prove to regulators that they put the customer at the heart of every decision they make

essence conduct, the implications are the same – greater senior executive and board accountability, greater regulatory pressure and fines, and customer dominance.

WHAT IS CONDUCT RISK?

The biggest challenge for many firms is to define the beast. Until the board and senior management can clearly articulate what it means to their firm, they will be unable to make meaningful progress in figuring out how they will manage ‘it’. Firms look

longingly at the regulator to provide a definition or guidance but the regulator has refrained from doing so.

The perspective is not unreasonable, made clear in the often-heard comment: “You don’t need to tell a doctor what to do for his patients.”

How to explain what it is? Try this simplified working definition: “Conduct risk is the risk that the conduct, acts or omissions of the firm, or individuals within the firm, will either deliver poor or unfair outcomes for the customer (retail or wholesale) – or, particularly in the case of wholesale markets, will (or could) adversely affect market integrity.”

Firms are required to support the FCA in meeting its statutory obligation “to ensure that the markets within its remit function effectively”.

Its specific operational goals are:

- to secure an appropriate degree of protection for consumers (including wholesale consumers)

- to protect and enhance the integrity of the UK financial system (including market abuse and financial crime)
- to promote effective competition in the interests of consumers.

What this means in practice:

- Firms must be able to demonstrate, and provide evidence, to regulators that they put the customer at the heart of every decision they make. This means putting the desire to generate revenues second to providing products customers need; ensuring the customer understands the transaction or product; and delivering the promised outcomes. Retail firms will recognise the previous ‘treating customers fairly’ regime. Wealth management firms will reflect on the Retail Distribution Review. And wholesale firms need to say goodbye to *caveat emptor*. The burden of proof to demonstrate you have ‘done the right thing’ for your customers rests with you and your firm.
- At the same time, firms need to protect the integrity of the markets and industry. This means protecting the industry from facilitating financial crimes such as money laundering, violations of sanctions and fraud; managing conflicts of interest across all parties; and managing the flow of information within the firm and into the market (this includes benchmarks).

These two statements are big ones that get translated by the regulator into specific areas of inquiry. The FCA’s areas of concern are detailed in its *Risk Outlook* document. A selection of areas to consider are: viability of business model; clarity of customer strategy and offering; suitability; evidence of putting the customer ‘at the heart of all that they do’; identification of client needs to drive product design; managing information walls effectively, recognising that all private side information should not be treated equally; protecting consumers from fraud and the cost of fraud conducted by others; managing the risks of financial crime; and supporting local and global authorities in pursuing criminals.

Delivering the conduct agenda also extends to work performed for your firm under outsourced and offshored arrangements, business introducers and agents, and other third parties. It even encompasses the robustness and resiliency of your technology, as RBS and Lloyds recently learned.

In short, every aspect of a firm’s business has a conduct risk element to it.

We often have discussions about the conduct agenda and state of the industry which lead to the question of: “How did we get into this situation?”

THE CULTURE ISSUE

The industry and regulators’ answer is the need to change ‘culture’. This has caused a flurry of activity across the industry including: measuring culture; providing values and culture training; embedding values in job descriptions and performance reviews; and placing value banners in lobbies and on bulletin boards. A great deal of attention has also been given to remuneration structures, including greater long-term incentives; reduction in bonus levels (the verdict is out on the EU Directive’s impact); and claw-backs.

Culture is best described as “the way we do things around here” or “how we act when no one is looking”. Firms need to clarify what that means for them, from the board down to the most junior employee. Senior executives asking and getting consistent responses as to what is acceptable and unacceptable behaviour, in relation to the topics listed above and others, would provide a good sense of the real culture. Two other useful culture indicators are:

- 1) the relationship between revenue generators and infrastructure colleagues, including risk and compliance and
- 2) what decisions do individuals make when doing right by the customer means losing a deal that affects personal financial rewards? Despite the current culture hype, we continue to hear great cynicism about executive management’s commitment to driving a consistent culture when it means addressing the poor behaviour of big producers. The reason for that is quite simple. The desire for consistent behaviour is not as strong as the desire for financial results, driven by shareholder expectations. That is not an excuse, just an explanation.

Board members and senior executives need to consider how they will respond to culture-related questions from their regulators. Not an unreasonable request as leaders *de facto* set the ‘tone from the top’.

A SIMPLE IDEA

If you are struggling to get the conduct and culture message across at your firm, try this simple idea. Develop a behaviour pattern across the organisation where every decision made (by individual and committee) actively considers these questions:

- 1) Am I doing the right thing for my customer?
- 2) Do I know the customer’s needs well enough and the product well enough to be certain of my answer to 1)?
- 3) Is there any possibility that what I am doing could bring disrepute to the industry – today or sometime in the future?
- 4) Is there any possibility that it could bring my firm into disrepute now or in the future?

WHAT FIRMS SHOULD BE DOING

A brief summary of what good practice consists of:

- a clearly articulated description of conduct risk and the firm’s appetite for the risk
- a description of what the risks to your firm are and what could happen if the risk is not well managed
- ownership of conduct risk management by the first line of defence and management’s ability to articulate ‘how they know’ the risks are well managed
- a second line of defence which works with the first line and validates their work but does not take ownership
- a sensible, manageable level of management information, appropriate for various user groups
- demonstrations that the risks, and the management, or lack of management, of those risks are considered at the board and executive committee.

Conduct risk exists throughout any business; the onus is on senior management to understand the risks, to know where they are likely to pose the greatest threats within their own business and to put a plan in place to manage them effectively. Firms must take sensible and proportionate steps to prevent these risks crystallising and damaging the reputation of the firm – or the integrity and reputation of the industry.

To hear Jeannette speak on conduct risk, book your place at the CISI Financial Regulation Summit on 9 July 2014 in the City of London. For further details, see cisi.org/conferences or call +44 20 7645 0777.



Further information CPD training course: Conduct Risk: What Might we Expect in the FCA Environment? Practical issues, next date – 16 July; cisi.org/courses

Caveat vendor for financial innovation

THE LIST OF MISSSELLING SCANDALS IS TOO LONG. THE GULF IN KNOWLEDGE BETWEEN BUYERS AND SELLERS IS TOO GREAT. SOMETHING NEEDS TO CHANGE



ANDREW DAVIS JOHANNA WARD

Endowment mortgages, personal pensions, split capital investment trusts, payment protection insurance, interest rate swaps. The list of product innovations in financial services over the past few decades is long. Sadly, so is the list of misselling scandals that have befallen the industry, and the overlap between these two lists is unavoidable and conspicuous. It also presents a serious and growing challenge to the industry.

Some of these product innovations have hit trouble for reasons of simple misselling. Products were sold to people who did not understand them well enough to work out whether they needed them or not. A person eligible to join their employer's final salary pension scheme should not be advised to purchase a defined contribution personal pension, yet thousands were. Someone who is self-employed should not be sold an insurance product that pays out if they lose their job, but again, thousands were.

RIGHT AND WRONG

However, recent history also throws up examples of financial innovations where the question of right and wrong is rather less clear-cut. Take endowment mortgages. Early purchasers of these products in the 1980s had few complaints – the markets performed strongly and borrowers generally got back at least enough to clear their mortgage principal and sometimes more.

Or interest rate swaps. For years these provided peace of mind to borrowers facing the risk of higher outgoings. More recently, they have become another badge of shame for banks as rates fell and borrowers ended up on the losing end of the bet.

In both these cases, the products fell victim to a change in market conditions: they worked for a time and then they didn't. Whether

Innovation in financial services has become much riskier

bad outcomes resulted from misselling or a change in the weather, however, the results for the financial services industry were similar – and that similarity is likely to prove a bigger headache for the industry in future.

The switch from the Financial Services Authority to the Financial Conduct Authority (FCA) on 1 April 2013 has, as you might expect, placed greater emphasis on firms' conduct than under the previous regime: how they sell what they sell, how they decide who their customers should be and how they monitor their own performance and practices.

One major effect of this shift is that innovation in financial services has become much riskier because any remaining notion of *caveat emptor* has given way to a

recognition that there is simply too great a gulf of knowledge and information between sellers and buyers of financial products and this means that poor outcomes for consumers are just too likely. As a result, there is an unmistakably growing emphasis from the FCA on questions such as the suitability of products for individual customers, the level of understanding of the product both by those selling it and by the buyers, and the need to establish sales incentives schemes that do not produce damaging outcomes.

This will mean that financial innovators will have to demonstrate that they did enough to be sure that the product they sold was suitable for the individual they sold it to, that the buyer understood what they were buying and that the sales process was fair and transparent. This is very good in principle but it is fraught with practical difficulties. First, the legal documentation is often far too technical and voluminous to be intelligible to 99% of potential buyers, so it will remain very difficult to demonstrate conclusively that they understood what they were buying.

Second, the real profit in financial services comes from selling standardised products to large numbers of people – at some point this truth will come into direct collision with the question of individual suitability. Maintaining a wider range of products, each of

which is sold to a smaller group of customers, is more expensive and therefore less profitable.

FORECASTING NEEDS

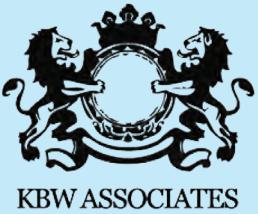
Third, even if a product looks suitable now, will it carry on looking that way? Every sale of a financial product involves some degree of forecasting of future needs and performance – will companies be liable to misconduct claims if conditions change and products that appeared suitable at one time no longer look that way, as happened with endowment mortgages or interest rate swaps? That's a big risk and demands an ongoing assessment of suitability.

The inescapable conclusion of all this is that both the costs and risks of product innovation are rising and that these burdens will be passed on to customers in higher costs and to shareholders in higher fines. It is probably prudent, therefore, to assume that henceforth there will be at least

Burdens will be passed on to customers in higher costs

four routine claims on the profits of financial services companies: taxes, dividends, remuneration and fines. Government, shareholders, staff and regulators will all take their share.

For financial services companies, the rule is now *caveat vendor*. For their shareholders, it remains *caveat emptor*.



We offer training in:

Derivatives

Financial derivatives

Financial derivatives module

We have *small classes*

We can offer *flexible hours*

We are based in the City of London,
but can offer you flexible *venues*

KBW Associates Ltd.
10 Furnival Street
London EC4A 1YH
020 3587 7742
keith@kbwassociates.co.uk

Invest in futures. Starting with your own.

Looking to make a wise investment?
Here's the best one of all: you.

BPP offers Europe's widest range of banking, insurance and financial short programmes, all led by experienced industry practitioners and designed to maximise your current performance and future employability.

To find out more call 020 3131 2901,
or visit bpp.com



BPP

PROFESSIONAL
EDUCATION

PROFESSIONAL
DEVELOPMENT