SECURITIES & INVESTMENT APRIL 2012

REVIEW

THE MEMBERS' MAGAZINE OF THE CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT cisi.org/s&ir

Border BARRIERS

How much attention should investors pay to country groupings such as the BRICs? *page 12*

Mission possible?

Why regulators are struggling to reform the rating agencies, p16

Turning the tables

Changing trends in outsourcing are good news for the UK, p20

REVIEW

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Yan Ling Angela Lua, a double winner at this year's CISI Annual Awards

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CISI OPINION

Four years after the crisis, there are signs that economies are looking up – at home and abroad

Reasons to be *cheerful*

"APRIL IS THE cruellest month," wrote the Lloyds banker (and poet) TS Eliot, 90 years ago. But does spring this year bring us reasons to be cheerful? In alphabetical order – as is appropriate when considering the best ideas – in the month running up to the UK Chancellor's Budget: Citigroup predicted that the FTSE 100 could double in value over the next decade, fuelling a boom in mergers and acquisitions; Jupiter reported net inflows of £700m into its funds ("We think that there has been a bit of a firming of the tone in February and March ... it is a change in trend to the positive," Chief Executive Edward Bonham Carter told the *Financial Times*); Manpower, the recruitment firm, identified, from a survey of more than 2,000 businesses, a new willingness by UK employers to hire; and Rathbone saw a 30% rise in pre-tax profits, driven by its highly successful wealth-management business.

There is also anecdotal evidence of an upturn. David Wighton, in *The Times*, writes that London's taxi drivers, those traditional fonts of economic wisdom, have reported more people asking for receipts – a suggestion, perhaps, that "the squeeze on expenses is loosening" and less-austere times lie ahead.

Global positivity

Beyond the London cabbie circuit, the US, the world's dominant economy, shows signs of robust economic recovery – its labour market has generated more than 200,000 new jobs each month since December. Ray Dalio, who last year overtook George Soros as the world's most successful hedge fund manager, describes America's economy as "the most beautiful deleveraging yet seen". His take is that the policy-makers have managed well the delicate balance between debt reduction and injecting cash to keep demand buoyant.

British economist Ian Harwood, of Redburn, is equally positive. The chances of a near-term American recession, he reckons, are pretty much zero – bar the unpredictable impact of a large-scale shock such as a war with Iran.

Across the world in Asia, optimism reigns. In markets on China's eastern seaboard in particular, Lehman's demise – still an open wound in the old world – is as distant in local memory as Barings' self-destruction last century is in London. China's supposedly new 7.5% target growth rate caused much hand-wringing when the outgoing government made the announcement in March. But it is consistent with the 2011–15 five-year plan. No economy has ever expanded at rates approaching 10% forever. Growing at 7.5% is still good by any standards.

> ***The banks are recovering, and the UK retains world-leading companies in aerospace, defence, pharmaceuticals and high-end cars***

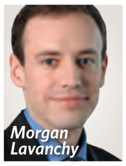
In the Middle East, Iran is a major worry. Added to that, the overdue reform process by conservative regimes will take time to creak into action and the humanitarian crisis in Syria is a disgrace. But there is much underlying good news. Young people in the wealthier pockets of the Middle East have never felt more empowered – or energetic. Their new-found optimism might just become infectious.

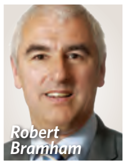
The British can be relied on to spot a cloud near the most gleamingly silver lining. But even as we enter Eliot's "cruellest month", the signs are promising. In the real economy, two other pieces of news cheered up in mid-March. Nissan announced that it would be investing £125m and creating 2,000 new jobs at its north-east England plant, to build its new small hatchback. Sunderland was chosen over Nissan's plant in Chennai (formerly known as Madras) because of the UK factory's strong productivity record. Tesco – Britain's largest private-sector employer – announced plans to hire 20,000 more staff over the next two years.

Brits have focused for decades on their country's perceived strengths in financial and other services, so the thumping taken by the financial world in recent years has knocked the stuffing out of many people's optimism. But the banks are recovering and the country retains world-leading companies in a number of non-service sectors, notably aerospace, defence, pharmaceuticals and high-end cars. A country that can sell ever-growing numbers of Bentleys, BMWs, Jaguars, Land Rovers, Lotuses, McLarens and Rolls-Royces to the wealthy of the BRIC countries and the Gulf should allow itself some springtime optimism, and share some of that with its global partners. ■

Got a story to tell or a view to share?
Email Richard Mitchell at richard.mitchell@cisi.org

QUALIFICATIONS





Principal event sponsor

BPP PROFESSIONAL EDUCATION

Annual awards have an international flavour

The global reach of the CISI was highlighted at its biggest-ever Annual Awards, where more than 100 top exam performers were recognised.

Of prizewinners honoured at a ceremony at London's Mansion House, 15 were from outside the UK, including four from India and three from Singapore. For the first time there were award recipients from Australia and Jordan.

It was the Institute's 19th Annual Awards ceremony and prizes were given in a record 56 categories. Winners were selected from takers of nearly 33,000 exams in more than 70 countries.

There was also a strong UK regional flavour, led by Scotland, which provided six winners.

CISI Managing Director Ruth Martin said: "Each year as we celebrate the success of outstanding individuals at the awards ceremony, we also celebrate the importance of continually encouraging entrants to our industry to aspire to achieve they very best they can in exams."

The principal sponsor of the awards was BPP Professional Education.

Award winners

Yan Ling Angela Lua became the first winner from outside the UK of an overall award for a globally established CISI qualification for administration and operations staff. Angela, Operations Officer at Deutsche Bank in Singapore, was placed joint top for the Investment Operations Certificate (IOC) from more than 5,700 candidates who gained the qualification. The other joint overall winner for the IOC, formerly known as the Investment Administration Qualification, was **Scott Sutherland**, Embedded Risk Manager – Markets, National Australia Bank, London. Angela said: "The IOC has helped me to gain an in-depth understanding of the financial services industry from an operations perspective. It has laid a strong foundation in building my career." Angela jointly secured the Operational Risk award with two other candidates, including **Maria Mathew**, Associate Manager, Accenture Services, Mumbai.

Diplomat **William Blomfield**, an Executive Officer in the Australian Department of Foreign Affairs and Trade, achieved the joint top score for the International Introduction to Securities & Investment. William, based in Canberra, said the qualification had been "important in gaining a better sense" of global financial difficulties.

Morgan Lavanchy, Head Legal & Compliance, Swissquote Bank Ltd, Gland, Switzerland won the the UAE Rules & Regulations award. He said Swissquote was developing its presence in Dubai and the exam provides "an excellent opportunity to delve into and gain an in-depth understanding of the Dubai regulations".

Other winners from around the world included: **Jamal Abdel Jabbar** ACSI from Jordan (International Certificate in Investment Management) and **Mark Elliott** ACSI, Director of Operations, QInvest, Qatar (Advanced Global Securities Operations). UK regional winners included **Sheila McIntyre**, Director, Corporate Banking, Clydesdale Bank, Aberdeen. She was joint winner of the Overall Certificate in Corporate Finance and Corporate Finance Regulation.

Tina Robinson MCSI, Investment Manager, Brewin Dolphin, Penrith, Cumbria, won the highest accolade, the Overall Masters in Wealth Management, and the Applied Wealth Management Award. **Robert Bramham** TD MCSI, Investment Manager at Brewin Dolphin's Leeds office, was the first winner of the new Compliance Institute Award for Regulation & Compliance. The Compliance Institute merged with the CISI last year.

Other new awards included a prize for the Investment Advice Diploma. It was won by **James Birch** ACSI, Dealing Floor Manager, City Equities, London, who also gained an award for FSA Regulation & Professional Integrity.

A prize was also introduced for the highest-scoring student in the Certificate for Introduction to Securities & Investment, a CISI qualification for schools. The winner was **Benjamin Hasan** from Langley Park School in Beckenham, Kent.

For a full list of award winners, see page 28.

LETTERS

Postbag

Letters to the *S&IR* can be sent by post to Richard Mitchell, Communications Editor, Chartered Institute for Securities & Investment, 8 Eastcheap, London EC3M 1AE, or to *richard.mitchell@cisi.org*

Dear *S&IR*,
I congratulate Hugo Cox on his excellent interview with Sharon Bowles, Chair of the European Parliament's Economic and Monetary Affairs Committee (*S&IR*, March).

Almost unknown in the UK, Sharon is a very famous figure in Brussels, where she does a critical job making sure that the UK tradition of free markets and competition is not overridden by some of our European partners' more interventionist preferences. She deserves greater recognition for her work and it is appropriate that the *S&IR* should have chosen to highlight it.

Jonathan Price FCSI, Partner, Variable Pitch Partners LLP, London

ONLINE

S&IR digital revamp

A new magazine format has been launched for the online *S&IR*.

From your computer you can read the current issue of the *S&IR* and previous editions as if you had the printed version in front of you. You can easily navigate around the magazine, zoom in on articles and be directed to websites of interest by clicking on live links. You may search each edition or the extensive archive for relevant terms, as well as download and print PDF copies.

The Institute is also redesigning the CISI mobile app to make it more suitable and user friendly for smartphones and tablets, such as the iPad. More information will be available soon.

Reading the *S&IR* counts as CPD for members. Anyone accessing the online edition or the app version has CPD hours automatically added to their CISI CPD log. ***If you prefer to read the S&IR online, you can opt out of receiving the hard copy of the magazine at cisi.org/mycisi***

View the online *S&IR* at *cisi.org/s&ir*. To download the latest version to your smartphone or tablet, use the CISI app installation instructions available at *cisi.org/app*

39 *The number of exclusive money-saving deals currently offered to members through the CISI Select Benefits scheme. These range from discounts on eye care to cut-price holidays. To see all the offers available, visit Select Benefits at cisi.org/mycisi*

MEMBERSHIP

New integrity requirement

Chris Harris-Deans, Chartered FCSI

The CISI is introducing new membership requirements for voting members. This is in line with its commitment to championing the highest standards of ethical behaviour within financial services.

Eventually, all members at MCSI and FCSI level must obtain a grade-A pass in the Institute's IntegrityMatters online ethics test. Nearly 5,800 members have already taken the test, which is based on ethical dilemmas in the workplace. It is already a requirement for personal Chartered status.

For existing MCSI and FCSI members who have not already passed IntegrityMatters at grade A, the following measures will apply.

As a first stage, as of 1 April 2012, they will be required to undertake and pass the Integrity & Ethics unit of the Institute's Professional Refresher elearning tool by 31 March 2013. Professional Refresher is provided free of charge to members and studying the module counts as CPD hours.

Subsequently, as of 1 April 2013, existing MCSIs and FCSIs will be required to take and pass with an A grade the IntegrityMatters test by the end of the 2013/14 subscription year.

There is a different requirement for new members entering at MCSI level, including those upgrading from ACSI. They need to pass IntegrityMatters at grade A before 31 March 2013. This will mean that new members meet the same ethics test entry requirements as entrants from universities accredited as CISI centres of excellence.

Chris Harris-Deans, Chartered FCSI, Chairman of the CISI Membership Committee and Senior Director of Charles Stanley's Exeter office, said: "The CISI requires all applicants for membership to declare that they will uphold the high standards of the Institute. The requirement that all MCSI and FCSI members must undertake ethics elearning and testing provides tangible support for that declaration."

For further information, see the Integrity & Ethics section at *cisi.org*

Francine Jackson ACSI, Operational Risk Analyst at an investment bank in the City, recently passed IntegrityMatters and highlighted the benefits of the test:

"With all the recent media attention around the financial services industry, maintaining high personal and professional standards of integrity is very important," she said. "The IntegrityMatters workshop and test provide realistic ethical dilemmas and have enhanced my moral reasoning and ethical decision-making skills."

CPD

China and India in the spotlight

John Adams

The CISI's London CPD programme will take a close look at the financial and economic centres of the future in twin events called 'The Rivals'.

China will be the first country put under the spotlight, on 10 May. The key speaker will be John Adams, a former senior Bank of England official, senior adviser on China at the CISI and fluent Chinese speaker.

Then, on 19 June, India will be put under the spotlight. Lord Desai, the eminent Anglo-Indian economist, and Deepak Lalwani, Chartered FCSI and close observer of India, will provide their insights into the world's biggest democracy.

The rest of the CPD programme from April to June is more varied than ever. It includes round table discussions on the changing face of exchange-traded funds, pitched at both intermediate and advanced levels; improving communications with clients; some radical transformations in back-office practice brought about by Dodd-Frank; and how to obtain UK residence visas (legitimately, as part of a UK Government programme) for overseas investment clients.

For further details of the London programme, see page 27 or visit *cisi.org/capitalcpd*

60-second interview

Douglas Croft, Chartered FCSI,

aged 62, has been issued by the CISI with a Statement of Professional Standing. This is the certificate of competence that retail investment advisers must attain by 31 December 2012 in order to continue in business. Douglas, a partner at Andrews Gwynne, a wealth management firm in Leeds, has worked in the sector for about 40 years.

Q *How did you feel about the need to obtain an SPS?*

To any time-served practitioner like me, with a string of qualifications that previously satisfied the FSA, the requirements of the Retail Distribution Review (RDR) looked, initially, like an insult. But burying my head in the sand was not the answer, and neither was walking away – meeting the challenge head on was the only solution.

Q *How challenging was it to obtain the SPS?*

The most demanding requirement was to attain an RDR-appropriate qualification, the CISI Certificate in Private Client Investment Advice & Management (PCIAM). When I got the PCIAM workbook, it landed with a resounding thud, my spirits sank and I wondered where on earth the study time would come from. Forward planning was needed, my workload was reorganised and I specified study periods, including evenings and weekends. Suddenly, not only did time appear for study but my work flowed more effectively and efficiently. I studied over the course of four months and this put my knowledge into context, added detail and jogged ancient memory. Although writing essays under exam conditions is not fun, the sense of achievement certainly is!

Q *What difference will the RDR make to the standing of the sector?*

The public has learned not to trust financial service providers, and rebuilding trust will take time and effort, so increasing professional standards is a good start. It's up to all of us to communicate these standards to our clients and provide reassurance.

Q *What advice would you give to help advisers to obtain an SPS?*

Above all, get started now. Sort out what you need to do, for example by considering any gaps you need to fill through structured learning between the content of an RDR-transitional qualification, such as PCIAM, and new exam standards. Then plan a programme – if you need to attend gap-fill study courses and workshops, get them booked – and stick to it.

An FSA Accredited Body, the CISI recommends that applications for an SPS are made to it by 31 October. It guarantees that all correctly completed applications lodged by that date will be processed before the end-of-year deadline. For further information, see *cisi.org/rdrsps*

EDUCATION

Links forged with business school

Aston Business School (ABS) in Birmingham has signed a memorandum of understanding with the CISI.

The memorandum commits ABS, part of Aston University, to future excellence in finance education in line with the mission of the CISI, putting it on course to be designated as an Institute centre of excellence.

ABS finance students are given student membership of the CISI upon enrolment, allowing them access to a range of professional networking and career development opportunities. In future, students will have the opportunity to complete professional qualifications, such as CISI Diplomas, while they are studying.

CISI Managing Director Ruth Martin said: "We are very much looking forward to working more closely with ABS and developing new initiatives to further advance finance education for the region and beyond."

Jim Steeley, Professor of Finance and Head of the Finance and Accounting Group at ABS, said: "This partnership will provide students with further opportunities to gain a professional qualification alongside a degree." He added that it could only enhance students' job prospects.

The CISI recognises seven UK universities as centres of excellence.

From left, CISI Managing Director Ruth Martin with Professor Patricia Chelley-Steeley, Senior Lecturer; Professor John Edwards, Executive Dean; Professor Jim Steeley; and Adele MacKinlay, Chief Operating Officer; all ABS

REGULATION

CISI gives input into Finance Bill

For the first time, the CISI has been invited to contribute directly to UK legislation.

The invitation followed the CISI featuring in a *Financial Times* article about the growing regulatory imbalance between the retail and wholesale markets. The article promoted greater professionalism for the wholesale sector, suggesting a return to compulsory exams and the introduction of continuing professional development, alongside the requirement for higher standards of integrity. This led to an approach from the Shadow Treasury team, which asked the Institute to submit an amendment to the forthcoming Finance Bill, currently in its third reading.

The CISI amendment, number 52, was debated by the Treasury Committee on 1 March, resulting in some heated debate before eventually being withdrawn following government opposition.

DINNERS

Branch events raise charity money

An expert from television hit *Antiques Roadshow* and a comedian were guest speakers as two CISI branches held their annual dinners. Cultural historian and broadcaster Lars Tharp provided an insight into *Antiques Roadshow* at the East Midlands & Lincoln event at Devonshire Place, Leicester, which was attended by nearly 70 guests. A collection for Derbyshire, Leicestershire and Rutland Air Ambulance raised £807, including Gift Aid.

East Midlands & Lincoln branch President Jonathan Wernick ACSI (left) with Lars Tharp

More than 80 guests at the Northern Ireland dinner, held at Belfast Harbour Commissioners, were entertained by funnyman Gene Fitzpatrick. Hilary Morrison MCSI, from Cunningham Coates, who has more than 60 years' experience in the industry, also spoke. More than £695, including Gift Aid, was raised for the Northern Ireland Cancer Fund for Children.

Adrian O'Neill, Chartered FCSI, President, CISI Northern Ireland branch; Derek Borthwick, Vice President Sales, J.P. Morgan; Gene Fitzpatrick, guest speaker; and Richard Bennett, CISI Regional Director

At the dinners, the branch Presidents, Jonathan Wernick ACSI (East Midlands & Lincoln) and Adrian O'Neill, Chartered FCSI (Northern Ireland), gave updates on local activities. CISI Regional Director Richard Bennett spoke at both events about developments within the Institute.

67 The percentage of financial services players that expect Greece to leave the euro within a year, a CISI survey shows. To take part in the latest survey, visit *cisi.org*

ONLINE

BEST OF THE BLOGS

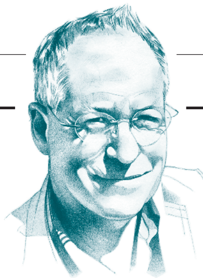
1 tinyurl.com/patrickkingsley
Do the three major rating agencies rule the financial world? Undoubtedly so, is the conclusion Patrick Kingsley reaches in a recent blog for *The Guardian*. He believes that, while there are more than 150 agencies worldwide, companies need Standard & Poor's (S&P), Moody's or Fitch Ratings onside for a credible rating. "The first two firms each control around 40% of the market," he said. "Fitch has about 15%, and is usually engaged when S&P and Moody's disagree significantly about the creditworthiness of a debt."

2 tinyurl.com/BBChughpym
Europe might be in the financial mire, but rating agencies should perhaps think twice before giving certain governments the thumbs down. Writing for BBC News, economics correspondent Hugh Pym notes Italy's reaction after S&P downgraded the country's sovereign debt last August – a move that many believed would push up the Italian Government's borrowing costs. In January this year, the Italian financial police carried out a dawn raid on the Milan office of S&P, taking away documents and files as "part of a wide-ranging and ongoing investigation into alleged market manipulation".

3 tinyurl.com/ianverrender
Credit-rating agencies command little respect from Ian Verrender, a senior business columnist for the *Sydney Morning Herald*, who criticises Fitch for downgrading three of Australia's four big banks. Pulling no punches, he insists that the rating agencies are hell-bent on proving themselves relevant despite failing to predict every major financial crisis or collapse in the past 20 years. Verrender also denounces as blindingly obvious S&P's claim that Australian banks would suffer greatly if the Chinese economy collapsed. "There's certain to be more than just our banks that will suffer," he says. "Try our resource companies for starters. Try the global economy for seconds."

See page 16 for more on rating agencies.

Do you have a blog recommendation?
Please send it to the Editor:
louise.reip@wardour.co.uk



CLAY *'MUDLARK'* HARRIS

Back story on Martin Watkins, Chartered FCSI, Euroclear Group

The world of technology in the securities industry can be a carousel. As it revolves, the same faces show up again and again, often in new arrangements.

That sums up the last two decades for Martin Watkins, Chartered FCSI, now Director, Global Sourcing, for Euroclear Group. There are few names – individual or corporate – in the sector with whom he has not worked in one way or another, often more than once.

It's enough to make your head spin, and vertigo of the literal sort was a hazard at his first job, as a management apprentice at PSC Freyssinet, a French civil-engineering firm.

Its projects included lowering huge seals into the Thames Barrier as it was being built. Martin had to climb down a ladder deep into the piles. A single electric cable supplied light and, being below the riverbed, there was inevitably some water seepage.

Martin had left grammar school at 16 and became an apprentice two years younger than the usual age. He was there for five years, but management prospects receded as Freyssinet reduced its UK presence in the recession of the early 1980s. "They got a good deal out of it; I got a good deal out of it; but it was time to move on," he says.

At Freyssinet he studied on day release and earned a Higher National Certificate in Business Studies, with distinction. "The 'distinction' was very important to me," he says. "I wanted to show that I could get the highest possible grade available." He also did ICSA chartered-secretary training courses, without intending to sit exams, in order to learn about business finance and business law.

His next job, found through a local advert, was as a UK representative for the computer-technology division of Kongsberg, the Norwegian defence contractor. Martin's work produced 16% of turnover at its UK subsidiary.

> "I wanted to demonstrate that I could get the highest possible grade available"

His boss in Norway employed an unusual technique to teach Martin to ski. His first lesson was in thick fog on, Martin learned only at the end, a 'black' slope for experts. Martin was no stranger to training methods. For nearly 20 years, as a sideline, he trained international athletes. His goal was to "take talent to its optimum". At 18, he had become the youngest qualified Assistant Coach in British athletics. His brightest star was Mark Richardson, once world number two in the 400m. "I always took the accountability for whether [the training] worked or not," he says.

In addition to trainer, he acted as agent, negotiating with sponsors and media. He took no money himself, reinvesting all proceeds into the athletes themselves – either for expenses or as salaries. He considered trying to make a business of it, but concluded that he would need at least six world-class athletes, all competing, to make it pay.

Martin moved from Kongsberg to Sysdeco, the Norwegian software group, which was introducing its products to the Lloyd's insurance market. He then went to CityMax, where he set up an insurance business unit and managed Cazenove's preparation for the introduction of CREST on an extremely tight schedule. "It went live, on time, to spec and on budget. It was a huge effort, but very satisfying," Martin says.

From then on, it was a whirl on the carousel. Martin worked at Cap Gemini, leading its technology partnership with Liffe, and then headed Atos Euronext's clearing division in Paris with 100 staff.

In 2006, he became Head of Operations at what is now Euroclear UK and Ireland. He now focuses on global sourcing for Euroclear and plays an active role in the CISI, as Deputy Chairman of the IT forum and a member of the Membership Committee.

Martin Watkins, Chartered FCSI

Director, Global Sourcing, Euroclear Group

Do you have a back-office story?

mudlarklives@hotmail.co.uk

Illustration: Luke Wilson

RECOGNITION

CISI honours high-profile industry figures

Three prominent figures within the financial services industry have each been awarded Honorary Fellowship of the CISI.

They are Xavier Rolet, Chief Executive of the London Stock Exchange (LSE); Andy Pomfret, Chief Executive of Rathbone Brothers, and Abdulla Al Turifi, Chief Executive Officer of the Securities and Commodities Authority (SCA), the United Arab Emirates (UAE) regulator.

CISI Chairman Alan Yarrow, Chartered FCSI(Hon), centre, with Andy Pomfret, Chartered FCSI(Hon), left, and Xavier Rolet FCSI(Hon) at an Institute lunch in London for its Honorary Fellows

Honorary Fellowship, which carries the designatory letters FCSI(Hon), is awarded by the Institute Board to those who have contributed with distinction to financial services and to the CISI. The Institute now has 48 Honorary Fellows out of a membership of more than 40,000 worldwide.

Xavier Rolet worked in investment banking for 24 years before taking up his current role at the LSE in 2009. The Stock Exchange was the birthplace of the Institute and Xavier has played a key part in keeping that unique relationship alive.

Andy Pomfret began his career as a chartered accountant. He then spent 13 years with Kleinwort Benson before joining Rathbone Brothers in 1999, rising to Chief Executive in 2004. Andy has been a strong supporter of the Institute and its values since becoming a member 15 years ago.

Abdulla Al Turifi's Honorary Fellowship was the first to be awarded outside the UK by the CISI. He joined SCA in 2003 and has played a key role in improving professional standards in the UAE's financial sector. The focus for these efforts is a mandatory licensing regime, drawn up and administered in co-operation with the CISI.

CISI Chairman Alan Yarrow, Chartered FCSI(Hon), left, awarding Abdulla Al Turifi FCSI(Hon) his Honorary Fellowship during a visit to the Gulf

Alderman Alan Yarrow, Chartered FCSI(Hon), CISI Chairman and Sheriff of the City of London, said that the Institute Board felt it was "entirely fitting" that it should give these three valued supporters its highest accolade.

"I am delighted to welcome them to our elite group of ambassadors," he said.

Ask the experts...

Chris Cummings
Chief Executive, TheCityUK

LONDON AS AN OFFSHORE RENMINBI TRADING CENTRE

In January, UK Chancellor George Osborne announced that the UK had agreed to partner with Hong Kong to develop the City of London as an offshore trading centre for the Chinese currency, the renminbi (RMB).

Why London?
As well as being the leading global financial services centre, London is also by far the largest foreign-exchange market in the world, accounting for 37%* of trading. The UK is therefore ideally placed to join Hong Kong as a major international offshore centre for the trading of China's currency.

The breadth of financial and professional services based in the UK supports this ambition and means that the expertise is already here to develop the market. Added to that are the 'natural' advantages of our time zone – which means that our trading day naturally follows on from that of the Asian markets – and English being the universal business language.

Why China?
China's GDP is £5,824bn, having grown at 11% a year, on average, over the past five years. What is more, China's growth is set to continue. The International Monetary Fund predicts that China will contribute more than one-third of global growth by 2015. The importance of mainland China to the global economic and financial system will increase accordingly.

Thus, China's economic growth and the internationalisation of the RMB offer real opportunities for London's financial and related professional services.

Settlement in RMB is growing and the currency will gradually internationalise, although it is hard to predict when it will become either fully convertible or a reserve currency. The Chinese authorities enforce strict controls on the RMB. However, as China's economy expands, it is expected that restrictions on the RMB's flows and value will continue to be gradually relaxed. This will benefit London, as trading will increasingly flow to the UK capital.

The Hong Kong Monetary Authority (HKMA) plans to extend the hours of the RMB payment system in June to give European-based trading firms more time to settle offshore RMB payments through Hong Kong. The move will keep the system open until 17:30 UK time, giving London another trading advantage.

In 2011, the Chinese authorities announced their support for the UK as the first offshore RMB trading hub in the western time zone. In January, following talks between George Osborne and the Chief Executive of the HKMA, the launch of a joint private-sector forum was announced. This forum, comprising major UK-based banks and the Bank of China, will enhance co-operation between the UK and Hong Kong. At its first meeting in May it will focus on settlement systems, market liquidity and the development of new RMB-denominated products and services in London.

This initiative will generate jobs and growth for the UK economy, and ensures that the UK is open for business with Asia.

*Source: TheCityUK's City Indicators Bulletin, February 2012

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

TheCityUK
partnering prosperity

PROFESSIONAL INTEREST FORUMS

Risk events look to the horizon

Trevor Williams

Martyn Brush

What is likely to happen in the financial services market, and what are the risks involved in an ever-changing industry?

Those are questions that will be considered as the CISI's risk professional interest forum (PIF) holds its annual Investment Horizons event on 17 May. At the event, a line-up of senior industry experts will make predictions for the investment sector for the coming year. Panellists will include Trevor Williams, Chief Economist, Lloyds Bank.

Forum Chairman Dennis Cox FCSI, Chief Executive Officer, Risk Reward Ltd, will chair the panel. Dennis said: "By having a panel of experts with differing perspectives, delegates will get a unique insight into the key drivers of performance and the uncertainties that will arise. I'm sure that anyone attending this event will find it both enjoyable and stimulating."

On 12 July, the risk forum will discuss tools and techniques for portfolio management, covering some practical issues and dilemmas faced by CISI members. Martyn Brush, Head of Market Risk at RBS Global Banking and Markets, will speak at the event.

To join the 400 members already signed up to the mailing list of the risk PIF, or to book a place at one of its events, please email *riskforum@cisi.org*

The risk forum is one of seven PIFs run by the CISI. The others cover corporate finance, Islamic finance, IT, operations, compliance and wealth management. Each of these discussion groups meets at least once a quarter in London to debate current issues and hear presentations from industry speakers. Fellows, Members, Associates and Affiliates of the Institute can attend meetings for free as a CPD benefit. Students may attend one event of each forum annually. For more information about forthcoming meetings, visit *cisi.org/pifs*

QUALIFICATIONS

Training boost for Cyprus

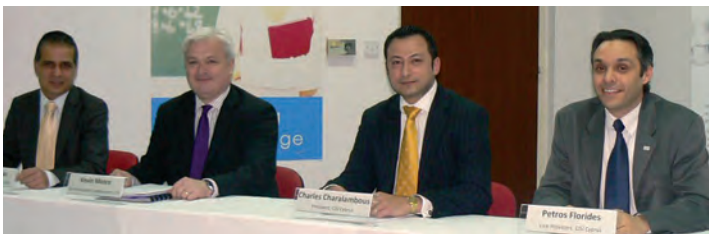
The CISI has officially launched its first exam centre and accredited training provider in Cyprus.

The training provider, the Cyprus International Institute of Management (CIIM), hosted an event at its Nicosia premises to mark it alliance with the Institute.

Guests from local financial services firms were given an introduction to the CISI, its range of qualifications now available in Cyprus and the training opportunities offered. There was also a question-and-answer session.

Speakers included Charles Charalambous, Chartered MCSI, President of the CISI's National Advisory Council in Cyprus; Kevin Moore, Chartered MCSI, CISI Director of Global Business Development; and Marios Siathas, Director Executive Education, CIIM.

Charles said: "This partnership is an important step in furthering professionalism within the financial services sector in Cyprus by enabling practitioners to train for and sit a range of CISI exams locally."



Pictured at the launch, from left, are: Marios Siathas, Director Executive Education, CIIM; Kevin Moore, Chartered MCSI, CISI Director, Global Business Development; Charles Charalambous, Chartered MCSI, President, CISI National Advisory Council (NAC) in Cyprus; and Petros Florides, Chartered FCSI, NAC Vice President

Future gazing

With a report predicting its ascent to the top of a list of world economies, can China live up to expectations?

I've always been a sucker for league tables, so a list of the world's top-100 economies in 2050, however fantastical, is guaranteed airtime.

In fact, the rather chunky report from HSBC, based on the work of Robert Barro, a Harvard economics professor, is hardly the stuff of fiction.

Here are the headline predictions. First, if you're not fluent in Mandarin, make sure that your children are. China will overtake the US to become the world's biggest economy within the next 40 years, its income per capita rising by an astonishing 800% in that time.

The US's status as sole economic superpower, already on the wane after the worst financial crisis since the 1930s, will be history, even though its economy is projected to double in size to $22,000bn in constant dollar terms.

By 2050, though, the US, will still be a long way ahead of India, the world's third-largest economy. In fourth place comes Japan, Germany follows in fifth and the UK ranks sixth, ahead of Brazil and Mexico.

France and Canada come next, while Italy, just behind, doesn't even make the theoretical new group of the ten richest nations.

China, of course, is the big story. Its GDP grew by 9.2% in 2011, down from 10.4% in 2010; in March it lowered its growth target for the first time in eight years (to 7.5%). Hedge-fund bears point to the huge proportion of Chinese gross domestic product that is accounted for by investment: the subtext being cityscapes full of empty tower blocks and a mountain of debt accumulated by local authorities under a flawed fiscal system.

HSBC's Karen Ward says that the bears have got it wrong. Critics, she argues, compare China's rate of investment with the rates seen during the expansion of the Asian 'tigers' in the 1970s, and claim that is it too rapid. Ward says that the starting point for these comparisons is wrong because China's level of development is so much lower than that of the tigers before their rapid expansion. Hence, all that investment is justified: it is providing China with essential infrastructure.

Yet the challenges facing China are considerable. HSBC itself admits that its report pays no attention to constraints on global resources and the upward pressure on commodity prices, for example.

Another report, by the World Bank, released in late February, spells out the downside for Beijing.

As well as the risk of a hard landing in the short term, China must contend with an ageing and shrinking workforce, rising inequality and growing environmental stresses. If it is to avoid a 'middle-income trap' and make the transition to a high-income country, Chinese leaders will have to shift their focus from the quantity of growth to the quality of growth, according to the report.

The constraints facing China extend well beyond the limits on physical resources – to the deadening hand of government interference in the economy, the weak rule of law and a lack of innovation.

All this means that, without sweeping economic and political reforms, the prospect of straight-line growth of 10% a year is slim.

The World Bank, for its part, projects a decline in China's growth rate, even if these reforms are implemented, to 5.9% by 2021 and to just 5% by 2026. While an enviable growth rate by more pedestrian western standards, this is hardly the grand march envisaged by Beijing.

> "There is fierce debate about how long China can sustain an annual growth rate of about 10%"

Moreover, the obstacles to reform, namely vested interests such as the state enterprises that enjoy monopolies in key markets and powerful individuals with special privileges, are significant. Whether the next generation of Chinese leaders will change that is open to debate.

The good news for China is that even at this lower rate of growth it will – probably – still replace the US as the world's biggest economy sometime before 2050.

As for league-table watchers, anyone wanting to hedge their bets could back promising outsiders for a top-20 finish; the Philippines, Malaysia and Egypt, notwithstanding current political turmoil, look like strong candidates. ■

***Christopher Adams** is the* Financial Times' *markets editor*

Illustration: Johanna Ward

Blurring the BOUNDARIES

BRICs, N-11, frontier markets – portfolio managers should not judge country categories simply by their titles, writes **Dan Barnes**

ON 31 JANUARY 2012, Brazil, Russia, India and China were all listed by Jim O'Neill, Goldman Sachs' Chief Economist and the originator of their 'BRIC' sobriquet, as constituent parts of a new group, one he calls 'growth markets'. In a note titled 'It is time to redefine emerging markets', he added Mexico, South Korea and Turkey to the list of countries "most likely to experience rising productivity coupled with favourable demographics and, therefore, a faster growth rate than the world average". O'Neill's pronouncement developed an idea proposed by Goldman in 2005 when it introduced the Next Eleven (N-11) grouping: 11 countries outside the BRICs, including Mexico, South Korea and Turkey, that were deemed to "potentially have a BRIC-like impact in rivalling the G7". Beyond Goldman's own investable N-11 index, investors showed little interest for this categorisation. It remains to be seen whether O'Neill's Growth Markets group will be more appealing. But the potency of terms such as 'BRICs' and 'emerging markets' in the investment community must not be underestimated: funds are sold that track stocks and bonds according to indices grouped under these names. The idea of building a fund too closely around these groupings is attracting increasing criticism, however. "The problem with having a BRICs fund is that it is four countries," says Mark Beveridge, Global Head of AXA Framlington, the specialist in equity investment management. "What if everyone recognises the growth in one country? Investors may overestimate how quickly companies will grow and stocks will become over-valued. "As far as regional investing goes, I think that less constrained and broader is better."

The background

The terms 'developed', 'emerging' and 'frontier' have become recognised classifications for index providers. Leading firms, which include FTSE, J.P. Morgan and MSCI, define a universe of countries for each category around which to base bonds or equities groupings in terms of the level of investment risk they pose. 'Emerging' and 'frontier' started out as marketing labels used by the International Finance Corporation (IFC), an independent, for-profit arm of the World Bank Group that arranges money lending and business advice for private sector firms in poor countries. "The name [emerging markets] was designed to give a more uplifting feel to what was originally called the 'Third World Fund'," says Antoine van Agtmael, who coined the term in 1981 while working at the IFC as an investment officer. Farida Khambata, currently head of the IFC's operations in East Asia, South Asia, the Pacific, Latin America and the Caribbean, first used the term 'frontier markets' to describe the smaller emerging markets on which the IFC was publishing data in the early 1990s.

Defining 'frontier markets'

Market definitions of this type vary with the user. The Goldman Sachs N-11 classification focused on the potential for growth,

Illustration: Clara Terne for Agency Rush

measuring macroeconomic stability, political maturity, openness of trade and investment policies, and quality of education. Its 2005 paper noted that South Korea, "although classified as an emerging market in financial terms, is in most respects a developed economy". South Korea and Mexico were then already members of the OECD; N-11 member Bangladesh, by contrast, remains one of the world's poorest countries.

Among index providers, classification differs from firm to firm and investors must be aware that commercial considerations may play a role here. For example, the inclusion of stocks from a more stable economy such as South Korea should reduce the volatility of an index and may make it easier to sell.

"It probably makes more money for an index provider to have South Korea as an emerging market than to include it as a developed market," says Beveridge.

Christopher Woods, FTSE Managing Director for Governance and Policy, explains the firm's selection process: "Criteria include: the market and the regulatory environment; custody and settlement; what the dealing landscape is; whether there is a derivatives market; the market capitalisation; and the number of companies in the market. Creditworthiness is assessed and gross national income per capita is also monitored."

Each country is assessed annually, through meetings of the FTSE Country Classification Committee, which then makes recommendations to the FTSE policy group, the firm's top-level committee for ratification.

For government debt, the J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM), launched in 2005, was the first comprehensive emerging markets index and is the market leader.

"Most investors follow the J.P. Morgan index," says Claudia Calich, Head of Emerging Markets and Senior Portfolio Manager for fixed-income asset manager Invesco. "It classifies countries according to their income levels, with a two-year waiting period for movement between categories, so a country would not move from emerging to developed market in the first year that it achieves a high-income status."

MSCI is dominant in much of the equity index world, especially in the US. Many funds there use MSCI classifications to define their investment mandates, with no investment allowed in equities that are listed in a country ranked below emerging-markets status. Two states in the Middle East, the United Arab Emirates and Qatar, have been working to achieve emerging-market status with MSCI for several years, so far with no success (see box).

Differences between providers

Categories are not interchangeable between index providers. South Korea, a

The Middle East

The Middle East is a challenging place for overseas investors. Under the MSCI classification, only Egypt is ranked above 'frontier market', a category considered off limits to many retail funds.

If that is not a barrier, foreign stock ownership is restricted; the degree varies by country and company. Qatar restricts ownership in a firm to 25%, the United Arab Emirates (UAE) to 49%.

Liquidity is low in most markets, and local authorities, supported by natural resources, do not have strong incentives to create capital markets infrastructure.

Against this backdrop, the UAE and Qatar are both trying to be reclassified by MSCI; the UAE is already considered a 'secondary emerging market' by FTSE. They will have to convince the index provider that irreversible measures are in place that will modernise the capital markets infrastructure. In total, 18 criteria are considered to judge a country, including securities lending and borrowing, short-selling and a delivery versus payment (DvP) structure, which involves a simultaneous transaction of cash and securities.

Originally due for review in May 2011, the deadline was extended to December 2011 and has now been pushed to June 2012 as the states make progress. DvP has been introduced and stock lending and short-selling are being considered by the authorities, but concerns remain.

Foreign-ownership limits are the barrier in Qatar. However, in the UAE, according to MSCI, "investors continue to stress significant concerns over [the DvP regime in the UAE] to fully ensure the safeguarding of their assets ... in particular, the case for failed trades where a forced sale of assets, without the owner's consent, remains a possibility."

Goldman growth market, has been listed as a developed market since September 2009 in the FTSE universe, but is still considered an emerging market by MSCI.

Indexes are typically rebalanced annually, but there are procedures to make changes more rapidly if needed. "In the case of Greece, we held a round-table meeting with clients to discuss what we might do," says Woods. "If anything were to happen to Greece, we would schedule emergency impromptu meetings of both the Country Classification Committee and the FTSE policy group to advise us on the appropriate course of action."

Creditworthiness, one of the FTSE's criteria, has clearly been severely tested in Greece, as well as other periphery eurozone countries. Indeed, many traders view the reissued Greek sovereign bonds of the March bailout as emerging-market debt. Prior to the completion of the deal, traders were operating a so-called grey market for the new bonds before their issue. The documentation guidelines they used for trading these was produced by the Emerging Markets Traders Association.

Many traders view the reissued Greek sovereign bonds of the March bailout as emerging-market debt

While there is no precedent for the downgrading of a developing country, this fact has not blinkered investors. When Portugal's debt was downgraded to 'junk' by Moody's last year, it forced widespread selling among many pension funds throughout Europe and beyond because they were prohibited from holding debt of this type. The downgrade similarly removed the sovereign from many investable debt indices. The fact that it remained a 'developed' country by the traditional classification was of little consequence to investors' appraisal of a country.

Downgrades from the emerging market category are more common. "In my career, Venezuela and Argentina have both been downgraded from emerging markets to frontier markets," says Beveridge.

Too much weight

That classification by an index provider can, by itself, have an enormous effect on investment flows into and out of a country, is a reason why investment managers caution its use.

A popular criticism of debt indices, for example, is that the most indebted countries can be given a larger weight in an index if there is no maximum cap on weighting. In autumn 2011, when Italian sovereign yields were increasing at an alarming rate, managers rebalanced their funds away from the indices – many of which gave Italy up to 25% of the total share.

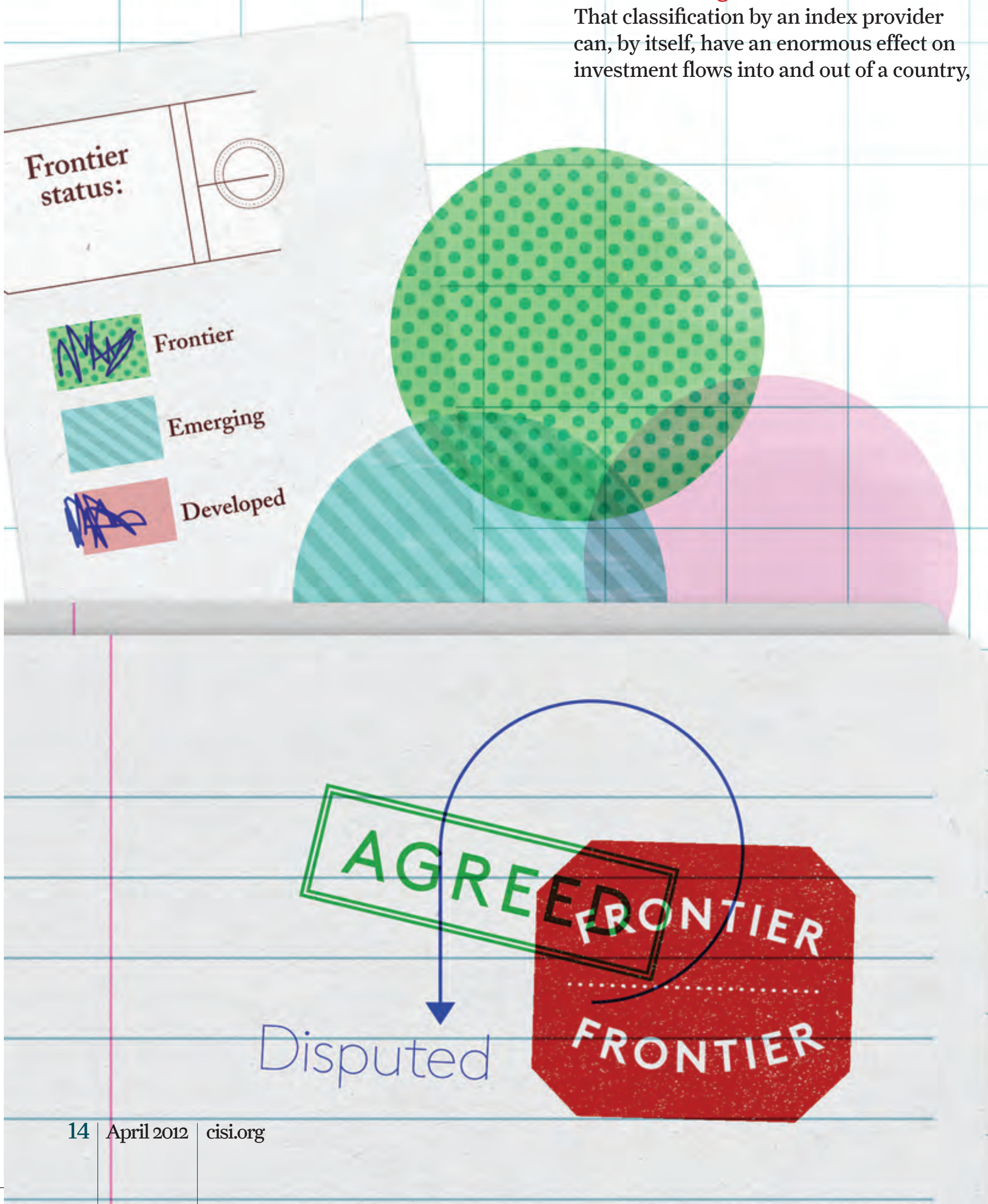
Where large companies dominate a country's stock or debt market, indices may not offer the diversification that investors assume.

"The MSCI Frontier Markets index has a huge exposure to the Gulf: Kuwait makes up 35% of that index," says Carlos Hardenberg, Senior Executive Director at Franklin Templeton Investments, who has responsibility for the Frontier Market Fund. "That 35% is heavily skewed towards two stocks – a bank and a telecommunications company – leaving investors disproportionately exposed in Kuwait." Hardenberg believes Kuwait is a country where corporate governance and prices are heavily influenced by speculative local investors.

Globalisation also challenges the assumption that indices provide exposure specific to the countries they cover.

"Is Nestlé a Swiss company? How much of its revenue is from Switzerland?" asks Beveridge. "If you invest in Vale, is that a Brazil play, or a China play? BHP Billiton is listed in Australia and the UK, but it is global. Fundamentally, your client needs to know about the risks involved in companies in which you invest."

Indices provide investors with a useful snapshot of a collection of countries with common risk features. Although a useful guide, they should not be a substitute for an investor's own due diligence. While their simplicity is a benefit, concludes Calich, "it is the job of the portfolio manager to determine what the best opportunities are". ■



The emerging markets leading the pack

Of the 22 countries designated emerging markets by the FTSE group, the following nine are graded 'advanced emerging'.

Brazil
Czech Republic
Hungary
Malaysia
Mexico
Poland
South Africa
Taiwan
Turkey

All of the nine are included in the MSCI and Standard & Poor's listings, which comprise 21 and 19 members respectively.

The credit CONUNDRUM

Hugo Cox learns that despite widespread acceptance of the need to reform credit-rating agencies, deciding how to go about it is testing regulators on both sides of the Atlantic

THE ROLE OF credit-rating agencies in contributing to the financial crisis is widely accepted. [redacted] In the US, the Government's Financial Crisis Inquiry Commission concluded that "the failures of credit-rating agencies were essential cogs in the wheels of financial destruction". The Dodd-Frank Act noted, more specifically, that "the ratings on structured financial products have proved to be inaccurate," which "contributed significantly to the mismanagement of risks by financial institutions and investors". To resolve this, it contained provision for "increased accountability on the part of credit-rating agencies". [redacted] The European sovereign crisis has reinvigorated the campaign. Leaders across Europe have bristled as their sovereign debt has been downgraded by the major rating agencies (see chart), prompting sniping at neighbours and criticism of agencies' competence. [redacted] Prior to France's January downgrade by Standard & Poor's (S&P), Christian Noyer, Chairman of the French central bank, said that rating agencies should pick on the UK before France for re-rating. Earlier, the European Commission President José Manuel Barroso dismissed the downgrading by Moody's of Ireland as "incomprehensible" and Portugal's 2011 Moody's re-rating as 'junk' in 2011 as unhelpful and unnecessary. The daggers appeared to be out for the big three agencies – S&P, Moody's and Fitch Ratings. [redacted] So, how far have regulators on each side of the Atlantic got towards increasing the accountability of rating firms?

Ratings and outlook actions

		2004	2005	2006	2007	2008	2009	2010	2011	2012
USA	AA+/Negative/A-1+								↓ Negative outlook	Negative outlook
Canada	AAA/Stable/A-1+									
Japan	AA-/Negative/A-1+			Positive outlook	↑			Negative outlook	↓ Negative outlook	Negative outlook
France	AA+/Negative/A-1+								Negative outlook	↓ Negative outlook
Germany	AAA/Stable/A-1+								Negative outlook	
UK	AAA/Stable/A-1+						Negative outlook			
Italy	BBB+/Negative/A-2	↓	Negative outlook	↓					↓ Negative outlook	↓↓ Negative outlook
Brazil	BBB/StableA-3	↑	Positive outlook	↑ Positive outlook	↑ Positive outlook	↑			↑	
Russia	BBB/StableA-3	↑	↑↑	↑		↓ Negative outlook				
India	BBB-/StableA-3	Positive outlook	↑	Positive outlook	↑		Negative outlook			
China	AA-/Stable/A-1+	↑ Positive outlook	↑ Positive outlook	↑	Positive outlook	↑		↑		
Spain	A/Negative/A-1	↑					↓ Negative outlook	↓ Negative outlook	↓ Negative outlook	↓↓ Negative outlook
Korea	A/Stable/A-1		↑							
Mexico	BBB/Stable/A-3		↑		↑		↓			

↑ Upgrade action ↓ Downgrade action Positive outlook Negative outlook

Source: Standard & Poor's

Europe

Prior to the crisis, European agencies were not even regulated. If any of the big three agencies were sued by investors, they tended to argue that claims had to be pursued through the US parent. "This was a useful get-out: in the US, rating agencies enjoyed the same level of protection from prosecution as journalists, under the Constitution's first amendment protecting free speech," says Hubert de Vauplane, partner at Kramer Levin Naftalis & Frankel LLP and professor at the Paris Law University. [redacted] In Europe, registration and regulation was the first step. From 2009, rating agencies required regulatory registration; the European Securities and Markets Authority (ESMA), is now responsible for their oversight. [redacted] The second measure addressed the considerable conflict of interest in the way that rating agencies rate the instruments of issuers. This derived from the switch in the fee model that rating agencies adopted from the 1970s – which precipitated their huge commercial success – when issuers, rather than investors, started paying for ratings. [redacted] The conflict was most visible in the ratings of collateralised debt obligations (CDOs), which caused such damage during the crisis. Banks needed AAA ratings to sell these products. So, rather than create a CDO before sending it to the agencies for a rating, the banks employed those agencies to help them build the products. [redacted] The conflict was clear. "How can you give an independent opinion if you come from within the team that structures the deal from beginning to the end?" asks de Vauplane.

After a delay in further reform, subsequent amendments were proposed by the European Commission last November. They have caused considerable concern.

Internal Markets Commissioner Michel Barnier has abandoned his most drastic suggestion: to impose a temporary ban on the release of sovereign credit ratings in 'exceptional' circumstances – such as in Greece recently – where ESMA felt that such a ban would prevent disorder. The problem was that the ESMA's judgment of the threat would be highly subjective and vulnerable to political pressure.

Forcing issuers to rotate rating agencies is another measure that is still being considered. Specifically, the Commission is suggesting that issuers rotate rating agencies every three years or ten successive debt issuances, not using the same agency again for at least four years. This would open up the industry to smaller players, such as US-based Egan Jones, and – it is suggested – encourage independence on the part of agencies.

There are at least two problems with this. The first is that most banks are already paying for ratings from two different agencies on many debt instruments. In a heavy patch of issuance, they could easily release ten instruments in less than a year. Smaller players will become involved, but major investors are likely to insist on ratings from the big three, meaning that many instruments would have to go unrated and therefore unsold.

The second problem is the huge workload and cost for issuers, some of which would appear to be pointless. "If you issue a 30-year bond, every four years you would have to re-rate it by a different agency," says Barbara Ridpath, Chief Executive of the International Centre for Financial Regulation, who, until 2008, was Head of Ratings Services, Europe, for S&P. "It would end up that banks would have to be constantly training rating agencies. The quality of the ratings would decline."

"If I were starting a rating-agency industry, the easiest solution would be tearing it all down and starting again"

In addition to rotation, the Commission is also looking at mandating that all rating agencies' methodologies are approved by ESMA. But, if European governments are looking to reduce the market impact of negative ratings, this seems an odd way to go about it: if the rating methodology is endorsed by the regulator, a downgrade would appear to be more serious.

It will also make ratings more homogeneous, explains Ridpath. "It would mean that investors need to use only one rating," she explains, "whereas, ideally, rating agencies should focus on different elements, so that their ratings mean different things and investors can choose the rating that best suits their risk appetite."

The combined effect of the proposed changes, believes S&P's Director of European Communications Mark Tierney, will be to make life harder for corporate issuers at a time when they are desperate to raise money. "The proposals being considered by the European Commission – including mandatory rating agency rotation for corporate debt issuers – will deny European companies the ability over time to use globally recognised credit ratings, and will severely hinder their access to capital markets."

The US

In the US, efforts at reform have focused on abolishing the regulatory use of ratings and replacing them with "other standards of creditworthiness", according to the Dodd-Frank Act.

This is a move that the agencies themselves support. By obliging certain investors to observe ratings in what they hold, governments would give their debt a double blow in the case of downgrades. When Portugal was downgraded to 'junk', many investors faced government rules prohibiting them from owning junk debt. Bond indices also use ratings as a condition for inclusion, causing further sell-offs.

But downgrades do not cause the problems, believes David Butler, Head of Global Credit Research at fixed-income investors Rogge Global Partners; the disruption of ratings downgrades is exaggerated. "In a scenario like the sovereign crisis, while there is a small pulse of forced selling at the downgrade, generally the market is ahead of the rating change," he says.

Besides, abandoning regulatory endorsement of ratings is no easy task. The first problem is that it requires US regulators to unpick the Basel rules on capital adequacy for banks, which are leading attempts at reducing systemic risk after the crisis. These rely on ratings to calculate how risky many debt assets are.

In the absence of a clear alternative, the Securities and Exchange Commission (SEC) has instead imposed arbitrary rules around instruments, such as securitisations, whose creditworthiness would usually be measured with a rating. The effect is an increase to the cost of capital that US banks claim is making them uncompetitive. Banks are threatening to forgo securitisation, echoing an episode in 2010 when rating agencies forced the SEC to retract tighter regulation when they refused to rate securitised products, stalling issuance (see box).

The second problem is that the alternatives do not look very appealing. If each institution used its own formula, regulators would have a difficult job to police these to ensure that they were not too lenient.

If regulators themselves came up with solutions, these would likely be rigid and inflexible and a poor reflection of the risk of a given instrument at a specific time.

Again, the European example is illuminating. Could investors trust European sovereigns to provide an accurate picture of their own debt when they are desperate to raise money? A German-backed suggestion last year to form a European agency to battle the dominance of the big three was resisted by the UK Treasury, which pointed out that it would not be an independent arbiter of sovereign risk.

While regulators, and much of the market, agree that rating agencies failed to carry out effective due diligence in advance of the financial crisis, reforming them is proving very tough for both US and European regulators.

"If I were starting a rating-agency industry, I wouldn't start here. The easiest solution would be tearing it all down and starting again," says Ridpath. With global economic recovery creaking under the weight of the uncertain creditworthiness of its major sovereigns, this is a luxury that regulators can only dream of. ■

An impossible task?

The problem of reforming rating agencies in the face of their considerable influence is demonstrated by an episode in the US in 2010.

The Dodd-Frank Act repealed an exemption enjoyed by rating agencies from the 'expert' liability required of accountants, and other parties involved in bond sales, when issuing credit ratings on asset-backed securities (ABSs). Smarting at the legal ramifications, S&P, Moody's and Fitch all shut up shop, refusing to allow their ratings to appear in prospectuses and registration statements for new ABSs in the summer of 2010.

The result was that the ABS market dried up until the SEC issued a no-action letter – a pledge not to enforce the rule. Subsequently, the Asset-Backed Market Stabilisation Act of 2011 was passed to repeal this element of Dodd-Frank.

Social LENDER

Hugo Cox talks to Puranam H Ravikumar, Non-Executive Chairman of microfinance firm SKS, about his path to that sector and the challenges facing Indian banking

LAST NOVEMBER, Puranam H Ravikumar, President of the CISI's India Advisory Council, became one of India's most powerful microfinanciers as Non-Executive Chairman of SKS. He took over from Vikram Akula, the poster-boy of Indian microfinance, following the latter's surprise resignation from his position as Executive Chairman of the firm – the largest in India's fast-growing microfinance sector – which Akula had also founded.

Ravikumar's appointment came at the end of a period where the company's fortunes had charted the eventful and emotive modern history of Indian microfinance – where lending is provided to low-income customers who would otherwise be denied access to banking services.

A year earlier, politicians in Andhra Pradesh, the state where microfinance has had the greatest effect and where SKS has its headquarters, accused microlenders of responsibility for the suicides of 57 people. It was alleged that these individuals had been brought low by punitive interest rates and bullying debt collectors. State legislators threatened a cap on lending rates and SKS voluntarily shaved 2% from its rate.

The controversy polarised the debate between the two ideological camps that have divided the industry since its birth in the 1970s. One group claims that poor borrowers with uncertain creditworthiness should pay commercial rates. They say that lending should not be capped, lenders should be free to choose the type of lending structure, and the segment does not need subsidisation as part of a developmental agenda.

The other camp, which sees microfinance as fitting within a wider social project of lifting people out of poverty, houses Ravikumar. His own interest as a microfinancier developed in an earlier role at ICICI, India's second-largest full-service bank, where he witnessed the huge differences in prosperity that targeted lending could make to small borrowers in the Indian corporate market (see box).

"Until the market reaches a sufficient level of maturity, I think there

CV snapshot

2011 – Non-Executive Chairman (interim), SKS Microfinance

2011 – President of the CISI's Indian Advisory Council

2009 – Managing Director and Chief Executive Officer, Invent Assets Securitisation and Reconstruction Private Limited

2003 – Managing Director and CEO of India's National Commodity & Derivatives Exchange Limited

1994 – Head of Treasury, ICICI Bank, subsequently Head of Emerging Corporate Entities and Agri Business, ICICI

1972 – Line Function Official, Bank of India, Bihar

1970 – Bachelor's degree in Commerce from Osmania University, Hyderabad, India

Photo: Johanna Ward

The birth of a microfinancier

Puranam H Ravikumar's interest in microfinance, and particularly its social benefits, grew out of his final role at ICICI.

Before leaving India's second-largest financial services group he ran the strategic lending unit, targeting small- and medium-enterprise borrowers. "I believe our lending made a difference to these borrowers," he says. "They are largely in the 'subsistence league' and therefore constantly short of funds. The adequacy and timeliness of funding are very important to them."

He left ICICI in 2003 to set up the National Commodity & Derivatives Exchange Limited (NCDEX), India's online multi-commodity exchange, where he was Managing Director and CEO. Again, his work had an important social element. "We did a lot of work to bring the benefits of price discovery that exchange platforms can provide to farmers," he says.

Prior to 2003, about 80% of farmers would sell produce at the time of harvesting (once or twice per year), when supply was the greatest and prices were lowest. "Middlemen stored the harvested crops to make it available to the market throughout the year, charging a hefty fee," he explains.

Ravikumar wanted farmers to perform the storage function, which would give them more for their crops. By building a new exchange that provided clearly visible prices all year round, farmers could now see the substantial difference between prices reached for a crop at harvest time versus six months later.

The effect was particularly striking in the government market. Historically, the Government of India has been a big buyer of agricultural commodities for a social-aid scheme that distributes foodstuffs through a network of local shops, at heavily subsidised prices, to Indians below the poverty line.

As commodity prices grew during the last decade, so did the government subsidy – in order to keep food affordable for the poor. But much of the cost of this was passed on to the farmers from whom the Government was buying food grains at below commercial rates. Farmers were, in effect, cross-subsidising India's poor.

When farmers started seeing the prices offered by the rest of the market through the exchange, they stopped selling to the Government at depressed prices.

"Over the past six years we facilitated a major transformation: now a farmer can sell to where the price is best," says Ravikumar. The other benefit, he adds, is better farming practices: with a view of prices, farmers can rotate crops according to those that currently pay best.

is a need for some level of regulation," he says. India, he notes, has a poor record of self regulation: the profit motive typically overtakes the developmental programme. National regulation looks likely: during the current budget session of the Indian Parliament, the Government is pushing through a new microfinance bill that will move supervision of the industry from state to national-government level and appoint the Reserve Bank of India as regulator. Ravikumar is softly spoken and polite. But beneath this gentle disposition is a tenacity that, you sense, will equip him well in defending the sector through a challenging period ahead.

Troublemaker

This tenacity was shaped by two influential managers under whom he worked during his first job, where he spent eight years working for the Bank of India in Bihar, India's poorest state. Their influence developed in him a confrontational streak that is out of the national character, he explains. "Traditionally, in India, we are taught not to contradict an elder," he says. "But these bosses shaped me to think independently. They taught me not to hesitate in disagreeing with superiors when I firmly believe in my view. Sometimes this got me into trouble. It continues to get me into trouble." Despite the political challenge, Ravikumar may have picked a smart time to move into India's small-scale private-lending market. India's banking sector, dominated by lumbering public behemoths, is currently reshaping itself around the deregulation of the private savings market. India's banks have historically been bound to fix interest rates on personal savings accounts between 3.5% and 4%. But this provision was removed last October; providers must now compete with each other for personal savers' business by offering competitive rates. The larger public-owned institutions, in particular, which comprise three-quarters of India's banking industry, are being dragged into a more competitive modern age. The transition will not be easy either for the leading public firms or the wider economy, believes Ravikumar, because India's banks are forced to lend more than a quarter of their deposits to the Government.

> ***"I do not hesitate in disagreeing with superiors when I firmly believe in my view"***

Out of every 100 rupees of deposits at Indian banks, 28 must be lent to the Government of India via subscription to Treasury bills and Government of India bonds or through deposits with the Reserve Bank of India. The Government has made much of how this helped to insulate India's banking sector from the global banking crisis. But yields on government paper are much lower than those available in the private sector – current corporate-borrowing rates are about 13%. The sector is effectively financing India's government deficit. This increases the pressure on the rest of the sector's loans. Fixing interest rates on personal deposits was one way in which the Government helped banks to make up the difference. Now the shortfall must be covered by corporate lending, which will become more expensive, hurting Indian business. "Banks' higher costs will be loaded onto the private sector," says Ravikumar. "Lending costs will go up and this will affect the competitiveness of corporates in the global market." For more than 40 years, Ravikumar's career has given him a front-row seat in the rapid – and, recently, transformational – development of India's banking industry. As the sector grapples with the twin issues of deregulation of personal-savings rates and the role it wants for microfinance lenders, Ravikumar's will be a highly influential voice. Those with investments or markets in the subcontinent would do well to follow his pronouncements. ■

Dan Barnes finds that cheaper parts of the UK are set to benefit from a decline in offshore outsourcing, with companies reaping the benefits of homegrown workers and cultural consistency

Coming home

MIDWAY THROUGH THE last decade, many British banks outsourced their call centres to India along with a range of back-office operations, from technology development to processing and handling. By doing so, they took advantage of the extent to which English was spoken by a highly educated, relatively low-cost workforce. Unpopular with the tabloid press, 'outsourcing' became a term that gained political cachet as the British media painted pictures of underpaid, headset-wearing, Indian IT graduates talking to middle-Englanders about last night's episode of *EastEnders*. Now, there is evidence that this trend is reversing. While data specific to financial services outsourcing are scarce, a recent study shows that Asia-Pacific is losing ground to Europe, the Middle East and Africa (EMEA) in this area. The Information Services Group, a data provider, looked at global outsourcing deals worth more than €20m up until the end of last year (see table) in both business processes and IT. The value of outsourcing deals in EMEA increased by more than a quarter in 2011; Asia-Pacific deals were down 10% in value over the same period. This trend appears to be accelerating: the year-on-year drop in the value of Asia-Pacific business was 42% in the last three months of 2011, while EMEA saw 80% of all outsourcing contracts awarded during that period, as measured by value.

Regional hubs

It is not always clear what commentators mean when they talk about 'outsourcing' in financial services (see box), so in some cases the original trends were overstated. While many IT and call-centre support services for banks, for example, shifted to India, much back-office outsourcing moved out of London but remained in the UK in cheaper locations, as firms looked to reduce high costs while retaining the skills of homegrown workers. Northern Ireland, Scotland and Wales now host contact centres not only for UK-based financial services firms, such as Lloyds TSB, the Royal Bank of Scotland and Santander, but also for Indian companies, such as HCL and Firstsource, that are moving operations to the UK. "Morgan Stanley, the investment bank, has more than 1,000 people in Glasgow alone," says Mark McMullen from Scottish Development International, an organisation focused on attracting foreign direct investment (FDI). "When it looked at expanding the support for its sales and trading operations in London, it considered outsourcing, offshoring and nearshoring. It decided to stick with the UK because of the skills available, but realised that it didn't have to face the same costs that it would in London." For McMullen, the growing realisation of the importance of these skills has brought much of the business back to the UK. "At face value, one region might be more cost effective, but once you take into account language, culture, work ethic and attrition level, that face value may not tell the whole story," he says. "A company has to balance the issues of cost, risk and service quality in the long term." Kerry Quinn, Head of International Sales and Marketing at Invest Northern Ireland, the region's economic development agency, also challenges the suitability of offshore locations for skilled tasks. She notes that Northern Ireland remains a popular nearshoring choice for London-headquartered UK financial services – the *Financial Times*' fDi Intelligence service rates it the world's number-one location for investment in research and development. Even among core businesses such as call centres, high-profile offshoring failures have seen some firms bring back work

> ***Northern Ireland remains a popular nearshoring choice for London-headquartered UK financial services***

to the UK. In 2010, the FSA ordered retail banks to publish complaints data. Spanish retail bank Santander had the worst complaint-to-customer ratio, and as a consequence surveyed more than 200,000 of its UK customers in 2011. In response to this feedback, the bank moved its call centres back to the UK from India in 2011 "to improve customer satisfaction and the treatment of complaints". This reversed an offshore arrangement established by British bank Abbey National, which Santander acquired in 2004. Peter Ryan, Lead Analyst at research firm Ovum, said at the time of the retrenchment that Santander's decision pointed to "a growing trend among enterprises in English-speaking markets to move capacity from Indian delivery centres". The UK Government has also done its bit to bring back business to the UK. Last September, Cardiff became the UK's first dedicated enterprise zone for financial and professional services, with funding support and reduced business rates offered to firms operating in the area. For smaller firms, meanwhile, outsourcing to India and beyond was never the cheapest option. Mike Foley is Managing Director at peterevans, a Cardiff-based firm that provides outsourced IT development for full-service stockbrokers and execution-only brokers – firms that do not have the scale to make an offshore operation

Total value of outsourcing contracts, by region (2011)

	Contract value (€bn)	Year-on-year change
EMEA	44.2	27%
Asia-Pacific	7.1	-10%

Source: Information Services Group, 2012

worthwhile but want to cut high London costs. "There are significant advantages to being in the UK," he says. "Being closer to the market gives you a better chance of understanding what is happening. You have the same time zone and culture and, crucially, we keep our lines of communication short. We are in a low-cost centre and most of our competitors are in the same position – nobody's really based in the centre of London these days."

Fighting back?

Not everyone accepts that UK skills are superior. "UK retail banks outsourced a lot of software-application development on the basis of arbitraging labour costs," observes Nigel White, a senior executive in IBM's outsourcing business in financial services. Indeed, it is increasingly the more demanding tasks that banks are looking to move abroad today, believes Ian Alderton, Chief Information Officer of Corporate Banking at the Royal Bank of Scotland, speaking in a personal capacity. "Historically, what was taken overseas tended to be very process oriented – activities that could be scripted," he says. "What I am seeing now in the Indian market is based less on cost arbitrage and more on the maturity of skills in country." Both supply and demand for better skills in financial services in countries such as India is increasing. As the *S&IR* noted in its 'City view' column in January, the CISI has seen increased demand for certification as firms seek a global benchmark for initial competence; these organisations are becoming more concerned with ongoing training and continuous learning. But the shift may no longer be simply about saving money, since the economics of success in the subcontinent have created wage inflation. "When you could get staff with PhDs being paid 20% of the wages of their western European equivalent, the additional management costs and issues were balanced out," says Martyn Hart, Chairman of the UK's National Outsourcing Association. "As the market grew, competition for staff drove up wages. To bring more staff to a higher level also adds cost to the outsourcer."

A fine balance

Wage inflation is one of several factors encouraging UK financial service firms to look back to Britain when considering what and where to outsource. But the trend is more complex than a simple repatriation of high-skilled services, such as building investment algorithms, or customer-sensitive services, such at telephone banking. The data show a renaissance in the wider clawing back of business for EMEA outsourcing firms against their Asia-Pacific rivals. Certainly there is anecdotal evidence of financial services outsourcing closer to the UK, but detailed research would be valuable in evaluating how far the UK and Europe have reclaimed business in this sector.

Outsourcing: What's in a name?

Misrepresentation in the media means that the 'outsourcing' concept has become muddled.

Outsourcing can involve 'offshoring', with a workforce employed thousands of miles from the rest of a business; it might also refer to 'nearshoring', with service centres developed in the same region or country as the core business but at a cheaper site. It is also important to distinguish business-process outsourcing – such as call centres – from IT outsourcing.

Captive companies, which are fully owned by the firms they service, have long been offshored, but this is not outsourcing. French bank Société Générale, for example, has operated an offshore technology business in North Africa that functions as a supplier to the bank since the 1970s.

The confusion also obscures how far UK firms have benefited from financial services outsourcing within the UK. According to data provider the Information Services Group, which investigates large, private-sector global outsourcing deals, the value of contracts in the UK across all sectors alone rose from £7.8bn (€9.4bn) in 2002 to £13.1bn (€15.8bn) in 2008. Although the global financial crisis led to a collapse in value, in Q4 2011 they had recovered to £11.95bn (€14.4bn).

Recognising STANDARDS

The development of a universal way of identifying all parties to financial contracts will have major benefits for the industry, says **Gary Wright MCSI**

THE INTER-GOVERNMENTAL G20 summit in Cannes last November, fixated as it was on the euro crisis, nonetheless scored a securities and investment industry first. In its Final Declaration, it specifically endorsed a technology standards initiative – legal entity identifiers (LEIs) – and called for immediate action in the adoption of this system (see below).

LEIs sound reliable and dull. Reliable is just what our political leaders – and regulators – crave right now. These standard identifiers will give regulators the raw data they need to keep a keener eye on global, systemically important financial institutions – and other firms with regulatory reporting obligations – and their transactions with counterparties across all their products, markets and regions. Both risk managers and regulators will be able to use LEIs to leverage the effectiveness of tools aggregating global exposures.

More mature readers in London will remember the days when the London Stock Exchange issued a three-digit broker code. Firms' systems recognised these codes; indeed, many of us recognised organisations by their numbers. LEIs are the logical, if rather grander, extension of that system.

LEIs originated in the US as a direct consequence of the 2007/08 financial crisis. The Dodd-Frank Act gave birth to twins: the Financial Stability Oversight Council (FSOC) and the Office of Financial Research (OFR), its research and data arm. The OFR realised immediately that LEIs were critical to its mission. So along came the Financial Stability Board (FSB) LEI expert group of key stakeholders – global regulators – that will deliver recommendations to the next FSB plenary this month [April 2012], and will in turn report to the G20 summit in June 2012.

> *"We support the creation of a global LEI which uniquely identifies parties to financial transactions. We call on the FSB to take the lead in helping co-ordinate work among the regulatory community to prepare recommendations for the appropriate governance framework, representing the public interest, for such a global LEI by our next summit"*
>
> ***From the G20 Cannes Summit Final Declaration, November 2011***

In the absence of one global standard, firms have either been using different identification codes from the various organisations that maintain codes, such as SWIFT, or creating their own bespoke codes. The problem with firms developing their own monikers is obvious: they work internally, but are meaningless for both counterparties and regulators. So, the creation of internationally recognised LEIs will allow all firms to identify legal entities, such as counterparties or professional investing institutions. And the potential benefits go further.

Americans are the current leaders in the LEI field, initially focusing on potentially toxic derivatives products. But LEIs will soon break out into other financial products and become a global standard in all markets. The UK is certain to be an early adopter.

What will an LEI look like?

The LEI will be a unique 20-character alphanumeric code assigned to all entities that are counterparties to financial transactions. The identifiers will be neutral, with no embedded country code or other intelligence. Any legal entity – though not a natural person, or 'individual', as we used to call them – that enters into a transaction will be eligible for an LEI. That includes issuing entities, transacting entities, reference entities, reporting entities and ultimate parents.

Who will operate LEIs? Will it be SWIFT, as a registration authority, or will it be a new organisation that does not compete commercially? Will the system be run from a central base, possibly in the US, or will it have a spokes-and-wheel look, with each market issuing its own domestic LEIs? Will all firms have to join SWIFT, or will it be an open standard allowing, for example, BT and other network suppliers to provide services?

There are many questions, and plenty of fevered work – and lobbying – is under way worldwide to come up with answers.

The biggest obstacle that needs to be overcome is to build a consensus of international market requirements. This is far easier said than done and, like all standards, will have its fair share of protective organisation; some countries will have to be muscled into line. 'Consensus-building around key topics' is the refrain here. The initial benefit of LEIs is built around counterparty risk management, allowing a far more industry-integrated capability, which would extend to assisting regulators in the case of a default.

However, this is by no means the only benefit. LEIs will create an environment in which industry-wide straight-through processing (STP) becomes a real possibility. After decades of great effort and greater cost, industry-wide STP is still elusive.

Firms have invested in front-, middle- and back-office systems since the mid-1980s, at huge cost and with mixed results. In many cases, these systems have reached legacy status and have been creaking for some time. Some systems have been integrated via middleware, with others operating in a fragmented architecture where spreadsheets are universally used as a cheap option to plug the gaps. It is in this scenario of market firms that LEIs will be introduced. LEIs could become an integrating standard within firms' systems, enabling a consolidation of data for regulatory reporting, as well as a major advancement of internal management of counterparty risk.

Internationally, regulators would all be able to use a common LEI standard to enable cross-border regulatory efficiencies. The regulatory mesh will become closer, bringing about harmony of reporting and the ability to get a clearer picture of international cross-border trading and investment activity.

Post-trade matching of transactions should become far more efficient. Consider the time currently wasted in trying to get trade allocations details. Then introduce LEIs into the scene and imagine the identity of the investing fund accounts being assigned at the point of deal execution. The potential to create faster and more efficient settlement is matched by the capability of almost real-time risk management of counterparties and investing institutions.

So, LEIs can be the platform for managing risk exposures across multiple financial products on an international scale, bringing together professional investing institutions and the market. The benefits to international regulators will be huge, providing them with a systems capability to share cross-border business with domestic regulators. Investment trends and the securities activities of firms and their legal investing institutions could provide early warnings of potential problems in the market.

All this is possible, but is still a considerable way from implementation. This year, there is anticipation of further agreements and developments concerning the design of LEIs. SWIFT and the various industry-standards groups would welcome feedback and assistance from people and firms during this key phase.

The CISI, through its professional interest forums, is also aiming to increase awareness of LEIs and pushing to get as many firms as possible engaged, as early as possible, in the design and implementation issues. This is a major global industry development that will, in time, affect all types of firm across financial products, and it needs to be on every firm's development agenda. When implementation begins, it is likely to come from a regulatory push first. But make no mistake: this is an opportunity to reduce risks and cost in the business, while producing the potential for increased bargain throughput and positive revenue effects.

This is well worth the investment, and it cannot come too soon. ■

Want to know more? The CISI will run a CPD event in London on 28 May called 'The Coming LEI (Legal Entity Identifiers) Revolution' (see page 27)

Gary Wright MCSI
is Chief Executive of B.I.S.S. Research

When a non-executive director is asked to produce a report on a company's due-diligence process, he finds it leaves much to be desired. The company thanks him and he resigns, as his job is done – but he then receives an email from another party fishing for information. What is the best course of action?

Keeping mum

BOB, A SENIOR manager, has spent most of his working life in the securities industry, for many years being an approved person and holding board-level positions in FSA-regulated firms. He has always enjoyed good relationships with other industry practitioners, as well as serving on an FSA advisory panel regarding the Retail Distribution Review.

Bob is now semi-retired and is a non-executive director at Optimist, a small wealth manager. He has been asked to undertake an informal review of how the firm meets customer due-diligence obligations, such as 'Know Your Customer', when taking on board a new client and subsequently monitoring its transactions.

> ***Adam states that he does not intend to worry his clients over trifling administrative matters***

Bob's initial findings are that Optimist's processes are not of the standard suggested by the industry guidance and he reports his concerns to Kevin, the Non-Executive Chairman of the Audit Committee and Board Chairman.

Kevin is not surprised and explains that this confirms his beliefs, which is why he asked for the review. He mentions to Bob that he has discussed this matter informally at an industry dinner with a mutual colleague, Guy, who now works in the supervisory division of the FSA.

Trifling?

Bob is asked to present his findings to Adam, the Chief Executive, who angrily refutes the criticism. Adam says that Optimist's processes are in line with those of all the firms for which he has worked, and states that he does not intend to waste resources on this or to worry his clients over trifling administrative matters.

Bob accepts that no customers appear to have been disadvantaged, and he has no evidence of the firm being associated with financial crime, but says that there is not sufficient management information to confirm the issue either way. The report is then discussed by the firm's Audit Committee, where Kevin thanks Bob for his "excellent work, which has provided much food for thought". He adds that, in due course, it may be felt appropriate to look at some of the individual parts of the findings.

As a result of this decision, Bob tells Kevin that, since the main focus of his position on the board was the production of the report, he does not feel that it is in the interest of either party for him to remain on it. He tenders his resignation as a non-executive director of Optimist.

Shortly after that, Bob receives an email from Guy. It says that he understands that Bob has left Optimist and asks him whether he is "aware of anything that he would like to disclose". Bob is somewhat surprised by this and wonders whether it would be unethical for him to respond at all. Nevertheless, he considers various possibilities and writes them down so that he can mull over how best to proceed. The four courses of action he considers are:

- ignore the email and do nothing
- respond saying that he would be happy to meet to discuss anything specific that Guy may have in mind
- respond saying that he left Optimist as a result of a disagreement over policy
- respond saying that he had nothing specific to raise, but then phone the whistleblowing line to report Optimist's poor standards regarding basic compliance issues. ■

What would you do?

Visit cisi.org and let us know. The results, together with the opinion of the Chartered Institute for Securities & Investment, will be published in the June edition of the *S&IR*.

Hidden agenda?
THE VERDICT

When Cyclamen, a large investment management company, arranges the transfer of smaller company Freesia's outsourced work to a third party, Tulip, it fails to reveal that it is receiving a fee for its part in the negotiations. Is this a harmless oversight or a serious breach of duty? This was the Grey Matters dilemma posted in the February issue of the *S&IR*. Readers were invited to vote in a poll on the CISI website for the course of action they would take, choosing from the following four options:

- what Duncan, Cyclamen's Chief Operating Office, had intended was clearly wrong and he should be fired
- what Duncan had proposed was wrong, since Freesia was not being offered a similar fee
- the transfer process was flawed and should be restarted on a completely transparent basis
- Duncan's motivation was for the best, so Alex, Freesia's Chief Executive, should accept the explanation of Cyclamen's Chief Executive, Naz.

The CISI response

The great majority of the limited number of respondents to this dilemma felt that as the process was substantially flawed, it should be restarted on a completely transparent basis, and it would be difficult to argue against such a response.

There was a small degree of support for sacking Duncan, with the remaining votes being split evenly between the two other suggested courses of action.

What we have here is a situation in which one party was clearly being disadvantaged, and the proposed transaction certainly did not meet our test of being open, honest, transparent and fair. Consequently, an offer by Naz to reopen the proposed transfer via an open tender would meet that requirement – although this is not to say that the outcome would necessarily change.

It is worth bearing in mind that where it was proposed that a fee would be paid to Cyclamen by Tulip for introducing the business, this fee would ultimately have been at the expense of Tulip's clients – in this case, Freesia. Cyclamen's attempted justification that it was incurring expense in passing the business to Tulip is probably equally true of Freesia, and Duncan seems to have adopted a blinkered view of the impact of his actions. Whether this amounts to a 'sackable offence' remains debatable.

Need to read

The latest publications and study aids supporting CISI qualifications

NEW WORKBOOK AND ELEARNING EDITION

Financial Derivatives

A professional-level exam, Financial Derivatives is part of the CISI Certificate programme and covers the characteristics of derivatives including forwards, futures, swaps and others traded in the UK, their relationship with the underlying cash securities and their use in achieving investment objectives. A new edition of the *Financial Derivatives* workbook and corresponding elearning product (valid for exams from 11 July 2012 to 10 July 2013) is due out and will cover:

- an introduction to derivatives
- futures and options trading
- principles of exchange-traded futures and options
- principles of OTC derivatives.

Price: £100 for the link pack (combined workbook and elearning product).

NEW WORKBOOK AND ELEARNING EDITION

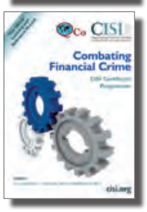
Derivatives

The aim of Derivatives, part of the CISI Certificate programme, is to ensure that individuals develop an understanding of the technical aspects of financial and commodity derivatives. This will enable candidates' employers to seek approved person status for them to advise and deal in the derivatives markets. A new edition of the *Derivatives* workbook and corresponding elearning product (covering exams from 11 July 2012 to 10 July 2013) is due out and will cover:

- an introduction to derivatives
- underlying markets
- principles of exchange-traded futures and options
- principles of over-the-counter derivatives.

Price: £100 for the link pack (combined workbook and elearning product).

TWO NEW WORKBOOKS



Global Financial Compliance and Combating Financial Crime

A new qualification, Global Financial Compliance gives candidates an introduction to international compliance. The *Global Financial Compliance* workbook covers areas including:

- the international regulatory environment
- the compliance function.

The objective of the new Combating Financial Crime qualification is to ensure that candidates have a basic knowledge of the regulations and practices related to combating financial crime. Topics covered in the qualification workbook include:

- the background and nature of financial crime
- predicate offences
- money laundering.

Price: £75 each

NEW WORKBOOK AND ELEARNING EDITION

International Investment Management

The International Certificate in Investment Management is the appropriate competence-based qualification targeted at investment professionals engaged around the world in managing investments, dealing in/advising on securities or derivatives and undertaking activities as a broker fund-adviser. A new edition of the *International Investment Management* workbook and corresponding elearning product (covering exams from 1 August 2012 to 31 July 2013) is due out shortly and will cover:

- economics
- financial mathematics and statistics
- industry regulation
- asset classes
- financial markets
- accounting.

Price: £100 for the link pack (combined workbook and elearning product).

NEW WORKBOOK AND ELEARNING EDITION

Introduction to Securities & Investment

A new edition of the CISI's *Introduction to Securities & Investment* workbook and corresponding elearning product (covering exams from 21 July 2012 to 20 July 2013) is due out in April. It will provide an ideal introduction to the world of financial services, with topics covered including:

- the economic environment
- financial assets and markets
- equities, bonds and derivatives
- investment funds.

This workbook and elearning product will fulfil the syllabus requirements of:

- the Introduction to Investment Award
- the Investment Operations Certificate (formerly known as the Investment Administration Qualification) programme, unit 1.

Price: £100 for the link pack (combined workbook and elearning product).

ONLINE TOOL

Professional Refresher

The CISI's Professional Refresher elearning tool enables you to remain up to date with regulatory issues and changes, maintain compliance and demonstrate continuing learning. The product now consists of more than 40 modules, including:

- anti-money laundering
- corporate actions
- investment principles and risk
- financial crime
- professional taxation
- training and competence.

Price: Free for all CISI members; otherwise it costs £150 per user. Visit cisi.org/refresher for further information.

ONLINE TOOL

CISI bookshop

The CISI online bookshop enables you to purchase workbooks, publications and elearning products quickly and efficiently.

The 'add to basket' facility allows you to see at a glance what you are buying, and there is information on what each product covers and the exams to which it applies. The 'checkout' facility is secure and easy to use.

Go to cisi.org/bookshop

External specialists

The CISI relies on industry practitioners to offer their knowledge and expertise to help create and maintain its exams, workbooks and elearning products. There are several types of specialist: authors and reviewers for workbooks and elearning products, item (question) writers, item editors and exam panel members. All of them receive a number of benefits to thank them for their involvement.

There are currently about 300 external specialists who have volunteered to assist the Institute's qualifications team, but more are required.

The CISI would particularly welcome applications from specialists to help with developing its regulatory titles, *Corporate Finance Regulation*, *FSA Regulation & Professional Integrity* and *FSA Financial Regulation.*

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

Diary

Events to attend over the coming months

CISI annual dinner

6 SEPTEMBER
Guildhall, Gresham Street, London, EC2
Bookings are now being taken for the CISI's premier social event of the year, its annual dinner, which will celebrate the Institute's 20th anniversary. To make an enquiry, please email *flagship@cisi.org*

Conferences

20 JUNE Annual Conference
Glaziers' Hall, 9 Montague Close, London, SE1

CISI members can attend this conference for just £200 (non-members £400). For further details, visit *cisi.org*, call +44 20 7645 0680 or email *clientservices@cisi.org*

CONFERENCE SPONSORSHIP
To consider taking up one of the sponsorship or exhibition opportunities at a conference, please contact Hannah Steele at *+44 20 7645 0648* or email *hannah.steele@cisi.org*

London CPD events

17 APRIL Vision and Values in a Volatile World
Gresham College, Barnard's Inn Hall, Holborn, EC1

30 APRIL Long Finance or Short Monetary Systems
McGraw-Hill, 20 Canada Square, Canary Wharf, E14

1 MAY FCSI Masterclass – Strategic View of Competence and Professionalism
Watermen's Hall, 16–18 St-Mary-at-Hill, EC3

9 MAY What Makes a Good Regulator?
Willis, 51 Lime Street, EC3

10 MAY The Rivals: Will China Rewrite the Rules of World Trade and Finance?
America Square Conference Centre, 1 America Square, 17 Crosswall, EC3

21 MAY Communication Skills for Client-Facing Managers
America Square Conference Centre, 1 America Square, 17 Crosswall, EC3

23 MAY Regulating the Regulators
Gresham College, Barnard's Inn Hall, Holborn, EC1

25 MAY ShareGift – Saving and Profiting from Charitable Donations
TBC

28 MAY The Coming LEI (Legal Entity Identifiers) Revolution
SWIFT, The Corn Exchange, 55 Mark Lane, EC3

30 MAY European Equities Update
Morningstar UK, 1 Oliver's Yard, 55–71 City Road, EC1

1 JUNE Futures Versus ETFs
BlackRock, Drapers Gardens, Throgmorton Avenue, EC2

8 JUNE Passive and Active: European Active Bond Fund Analysis
BlackRock, Drapers Gardens, Throgmorton Avenue, EC2

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

To book:
cisi.org/eventscal *clientservices@cisi.org* *+44 20 7645 0680*

Professional courses

Venue: London unless otherwise stated

19 APRIL Anti-Money Laundering and Terrorist Financing Introductory Workshop £500

23/24 APRIL Understanding Regulation & Compliance £900

25 APRIL Investment Principles & Risk (PCIAM)* (Leeds) £300

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		Praneil Doolabh	Goldman Sachs
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Investment Advice Diploma			
Derivatives		Andrew Rinker MCSI	Andrew Rinker
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		John Saunders	Barclays Bank
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CREST Settlement		Kathryn Woodley	Euroclear
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Global Securities Operations	Baillie Gifford	Elizabeth Aldridge ACSI	Morgan Stanley & Co International
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		John Pattie	Friends Provident International
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Financial Markets		Helen Sullivan ACSI	Quilter
Portfolio Construction Theory		Beth Pearson ACSI	Brewin Dolphin
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This list includes membership admissions and upgrades from 28 January to 21 February 2012

Community spirit

The contribution of John Garbutt FCSI to the 'Square Mile' extends far beyond his distinguished career in financial services. **Lora Benson** reports

John Garbutt FCSI in his Alderman's gown

AS AN ALDERMAN and Justice of the Peace (JP), John Garbutt plays a key role in the government and judicial system of the City of London. John became an Alderman, an elected member of the City of London Corporation, in 2009. The Corporation is effectively the local authority for the City, and John represents the most central of its wards, Walbrook. The ward is based around Bank underground station and encompasses the Mansion House – home of the Lord Mayor of the City of London – the Bank of England and many other landmarks within the world of financial services. On his election as an Alderman, a title that dates back 900 years, John transferred as a JP to City of London Magistrates' Court, having previously been on the bench at City of Westminster Court. "Being approved as a JP is a key prerequisite to becoming an Alderman," he says. "A second requirement is that the candidate should hold the Freedom of the City." John is very much at home in the City, having worked there for nearly 40 years with some of the leading names in international financial services. He is now Director, Global Head of Corporate Governance, at HSBC Global Asset Management (UK). He says that being an elected member of the City of London Corporation is unusual in a number of ways. First, the position is unpaid, unlike that of councillors in other UK local authorities. Second, City of London voters include business electors in addition to residents. Furthermore, candidates campaign for election as independents and not on any party-political platform. John's role as an Alderman extends beyond being a ward representative to giving support to the Lord Mayor as he promotes the City of London and its financial and professional services. John's duties include attending the Lord Mayor's Show and other functions, with guests ranging from visiting heads of state and ambassadors to captains of industry, government representatives and the clergy. Aldermen are expected to be actively involved in livery companies to which they belong. In John's case, this includes the Weavers, which is the oldest livery company, and the International Bankers, one of the newest. He says that there is no formal training as such for the role of Alderman, but that it is important for the individual to ensure his or her own continuing professional development in this capacity. "This includes learning about how the City of London Corporation and the numerous City-wide institutions operate in order to enhance one's contribution," he says.

> *"The panel interviews to become a Justice of the Peace were some of the most testing I've ever sat through"*

Charity work

Within the role, John is not only a member of two decision-making bodies – the Court of Aldermen and the Court of Common Council – but is also a trustee of the City Bridge Trust, London's largest charity; the Epping Forest Committee, administering the largest open space owned by the Corporation; and the Irish Society, which governs certain properties in Northern Ireland that are owned by the City. As for his role as a JP, John had to pass a rigorous selection process to be accepted for the position. "Completion of a penetrating application form is required, with extensive references taken up, followed by panel interviews that were some of the most testing I've ever sat through, and I've been through quite a number in my career!" he says. "Training is ongoing for a magistrate, and includes visits to prisons and community-service centres as well as numerous courses led by the probation service. You have to be approved as 'threshold competent' after the first 12 to 18 months of sitting in court, and again every three years thereafter. So you are constantly kept on your toes." His casework is "extremely varied". He explains: "You have no idea what might confront you at any particular sitting. All but the most serious crimes are dealt with by magistrates, from minor thefts and traffic offences to cases involving quite a high degree (though not the very highest) of fraud and violence. When a case is deemed too serious, it is referred to the Crown Court, which, in the case of the City of London Magistrates' Court, is the Old Bailey. As an extension of my involvement in this area, I'm also the City of London Magistrates' Court representative on the Inner London Magistrates' Association Executive Committee." John is a member of many other City-based entities and international charitable organisations. He is a Fellow of the Royal Society of Arts and a Governor of two City-related schools, as well as Deputy Chairman of the International Students Trust, President of Walbrook Ward Club and a Council Member of the City Livery Club. ■

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

UK REITs

Phil Nicklin
REAL ESTATE TAX PARTNER, DELOITTE

"It's worth noting that although a REIT, or the holding company of a REIT group, needs to be UK tax resident, it can be incorporated anywhere including the Channel Islands and can hold its properties using offshore structures."

REITs have been with us for five years now and the proposed changes to the REIT regime from this July are the most significant so far.

The changes should greatly increase the regime's attractiveness to a wider pool of property investors and providers of capital. The Government's hope is that these changes will encourage more capital to be invested in the built environment and, in particular, into residential property.

Just to recap, a REIT is a company that satisfies various conditions and in return is exempt from tax on its rental profits and capital gains of its property rental business. REITs are therefore tax efficient for shareholders because there is only a single layer of tax on those profits and capital gains i.e. at shareholder level. The conditions the company must satisfy include being listed, sufficiently diversely owned, having 75% of its profits and assets relating to its property rental business and distributing 90% of its rental profits. Currently, an entry charge of 2% is levied on the value of the company's property rental assets when joining the REIT regime.

It's worth noting that although a REIT, or the holding company of a REIT group, needs to be UK tax resident, it can be incorporated anywhere including the Channel Islands and can hold its properties using offshore structures. It can also be listed on the CISX, which has been the stock exchange of choice for three of the more recent new REITs.

The benefits of being a REIT include access to the global REIT 'brand' and to the significant sources of international capital allocated purely for investment in REITs. REIT status also gives enhanced shareholder returns through tax exempt rental income and capital gains, a competitive pricing advantage on corporate acquisitions and the ability to make divestment decisions in a tax free environment.

One of the most significant changes expected in July is the abolition of the 2% entry charge. From July this year, companies will no longer need to pay an entry charge to access the benefits of REIT status.

There is also a relaxation of the diverse ownership rule for institutional investors, which should greatly widen their investor appeal. Soon, a REIT could be owned by a small 'club' of institutional investors. For this purpose, 'institutional investor' includes pension schemes, insurance companies, unit trusts, open-ended investment companies, all of their overseas equivalents and sovereign wealth funds.

Furthermore, there is the proposed 3 year 'grace period' for new REITs to meet the diverse ownership requirement. This will enable start-up or closely held/family-owned REITs to build sufficient reputation to attract new shareholders, without prejudicing their ability to enjoy the benefits of the REIT regime whilst they do it.

The relaxation of the current requirement for a REIT to be listed on a 'recognised stock exchange' is also welcome. The proposals will enable companies traded on UK based markets other than the LSE (and their overseas equivalents) to obtain REIT status without requiring, for example, a full London listing. However, one major shortcoming of the proposals that the Government needs to address is that the REIT's shares will need to be 'traded' on the exchange each accounting period, even though it may be 100% owned by institutional investors or by a small number of investors during the '3 year grace period'.

Finally, there are a number of technical improvements to the REIT regime which includes redefinition of "financing costs" for the REIT interest cover test and for cash to be treated as a 'good' asset for the 'balance of business assets test', which will make the REIT regime that much more user-friendly.

The Government is also looking into proposals to introduce mortgage REITs and social housing REITs into the UK. Mortgage REITs are well developed in the US and the thought here is that they could take on existing bank loans, freeing up lending capacity and potentially providing a new source of capital to the mortgage market. Many of the difficulties faced by residential REITs, such as the need to 'churn' property (a 'bad' activity for REITs) and problems meeting the interest cover ratio because of low net rental yield, will also be faced by those wishing to form social housing REITs. The question of whether grant funding would need to be repaid on a transfer of housing association stock to a REIT also remains unanswered.

In conclusion, the Government's proposals should secure a healthy future for REITs, in which the Channel Islands can continue to play an important part.


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