FINANCIAL
SERVICES
FACULTY

ICAEW.COM/FSF

ISSUE 125
APRIL 2018

FSFocus

A BIT LOUDER
HOW TO CREATE AN OPEN AND HONEST WORK ENVIRONMENT

HERO TO XERO
GARY TURNER ON HOW TECH IS CHANGING FINANCIAL SERVICES

TECH SAVVY
SHOULD AUDIT FIRMS GIVE TECH ADVICE DURING TRANSACTIONS?

IN TRUMP WE TRUST

Examining Donald Trump's impact on financial and professional services this side of the Atlantic

April 2018 Issue 125

COVER PHOTOGRAPHY: GETTY

Tried and trusted

The themes of trust and technology run throughout April's issue of *FS Focus*. From speaking truth to power (page 14) and auditors taking over technology due diligence (page 9) to the way banks handled data (page 24). I will let you make your own minds up as to whether we should trust Trump based on his record (page 10).

Dominic Lindley points us to Professor Lo's assessment (page 21) that "whatever can go wrong will go wrong, faster and bigger than before". While we've spent countless hours learning from crises past, will the next (perhaps inevitable) crisis indeed be faster and bigger than before?

There has been work to reduce interconnectedness within the financial system and build up capital buffers (the performance of these under stress is discussed on page 6). Our savings are protected by the FSCS, so there is, in theory, no need to queue up outside the bank if things go wrong. But I wonder what would the run on Northern Rock have looked like in the age of Twitter? Rather than waiting to see Robert Peston on the evening TV news in front of people lining up in the street, how would a live stream and app alerts of the same (not fake) news have affected how we behave, particularly with our ability to instantly move our money around? Not just between our own accounts, but with services like Transferwise, for example. Would there have been more chaos and confusion than there already was? When does technology help us, and when does it cause more trouble? Fake news, the ability to make snap decisions and the power to execute them can be a dangerous combination. In our interview with Gary Turner (page 18), he points out that new digital banks are user experience "app first" with banking infrastructure coming second. While not systemic, how will these banks cope in a personal crisis of confidence?

It is undeniably true that technology allows us to do things with less friction than we have previously been able – transacting, producing and analysing information, and decision-making. It empowers us to do things for ourselves, which would have previously been brokered or intermediated. These activities can be done more securely and transparently, but not always more competently or purposefully. Taken together, these attributes can instil trust. Our role over the coming years will be to figure out where technology can help facilitate this trust, and where our professional knowledge, skills and scepticism will be needed even more acutely.

Philippa Kelly

Philippa Kelly
Head of Financial Services Faculty

Printed in the UK by Sterling Solutions ISSN 1759-9768 TECPLM15905

ICAEW

Financial Services Faculty

THE TEAM

Philippa Kelly
Head of Financial Services Faculty
philippa.kelly@icaew.com

John Mongelard
Technical manager, risk & regulation
john.mongelard@icaew.com

Zsuzsanna Schiff
Technical manager, auditing & reporting
zsuzsanna.schiff@icaew.com

Dipak Vashi
Manager, financial services assurance
dipak.vashi@icaew.com

Chris Evans
Commissioning editor
fsf@icaew.com

Elizabeth Price
Service manager
elizabeth.price@icaew.com

ADVERTISING
Advertising enquiries should be directed to:
+44(0)20 7936 6400
advertising@progressivecontent.com

FACULTY EVENTS
For enquiries about faculty events, contact
+44(0)1908 248 250

FINANCIAL SERVICES FACULTY
Chartered Accountants' Hall
Moorgate Place, London, EC2R 6EA
+44(0)20 7920 8685
fsf@icaew.com
icaew.com/fsf

FS Focus is produced by Progressive Content
71-73 Carter Lane
London EC4V 5EQ

PEFC Certified
This product is from sustainably managed forests and controlled sources
PEFC™
PEFC/16-33-1391
www.pefc.co.uk

NEWS & EVENTS

CHAIRMAN'S REPORT: BANKING COMMITTEE

Mike Lloyd explains how ICAEW is stimulating debate about the impact of IFRS 9 on the banking sector

One of the most significant changes to accounting by banks came into force on 1 January 2018, when the elements of IFRS 9 on expected credit losses became effective. Although IFRS 9 was issued in July 2014, a long lead time to implementation was allowed, in part, to give banks the time to implement what is a radical change to their accounting for loan losses.

The new standard also raises many challenges for preparers, regulators, auditors, analysts and other users of the financial statements of banks to understand the new requirements. The Banking Committee has been focused on considering, responding and providing help to the wide range of stakeholders on some of these challenges.

The Committee produced two briefing papers to assist stakeholders on understanding the changes to the new expected loss model. Both briefing papers are on ICAEW's website – one aimed at analysts and other market professionals and one targeted at the non-technical audience.

In December, we organised a seminar for those interested in finding out more on the changes brought in by the new expected loss model that was attended by preparers, auditors, analysts, banks' directors and regulators. The seminar was aimed at helping understand in greater detail the challenges the industry was facing immediately before implementation with preparations largely completed by that time. It was intended to stimulate debate about IFRS 9, allowing questions and any concerns to be raised. The presentations and discussion were thought-provoking with an open exchange of views.

The presentations and discussion were thought-provoking with an open exchange of views

The feedback was very positive and attendees appreciated the many viewpoints that were expressed. We are planning a follow-up for September 2018, when audited half-year results will be available for a closer look at the financial effect in the first six months, movements in the year to date, disclosures and comparisons across the industry. Further details will be available on the Financial Services Faculty website.

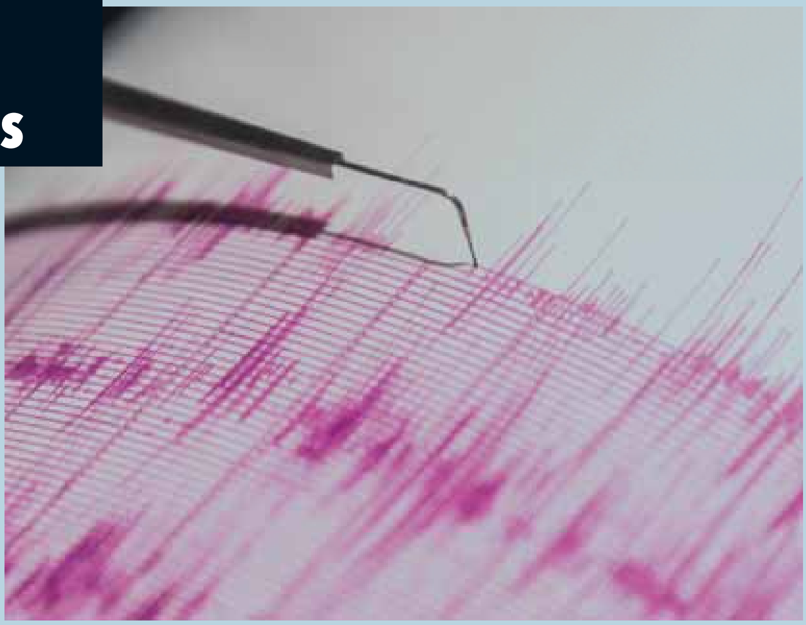
We have provided input to other parts of ICAEW where this very important new standard will have a major effect on other sectors of financial services in addition to banking.

The Banking Committee is participating in the Financial Reporting Council's (FRC's) project of the proposed update of *Practice Note 19 (Revised) The audit of banks and building societies in the United Kingdom*. Members have provided a group of volunteers who will assist the FRC with drafting and finalising the update to the new practice note. The expected completion date will depend on the finalisation of the revision of ISA 540, *Auditing accounting estimates and related disclosures* by the International Auditing and Assurance Standards Board later on this year.

A longer-term topic the Committee is looking at is how banks and bank audits are changing and what it can do to help banking professionals, as well as the wider public, understand, analyse and interpret the vast amount of financial information that banks produce. ●

Mike Lloyd, chairman, Banking Committee

NEWS ANALYSIS



STRESSED OUT

Peter Wilson assesses the adverse headline reactions to new accounting standards for the latest stress test of European banks

By definition, a stress test is never meant to be too easy, but the exercise that is now being conducted on major European banks has left much of the finance industry feeling more than a little tense.

"I think 'anxious' is the right adjective," says Adrian Docherty, the head of the financial institutions advisory team at BNP Paribas, and author of *Better Banking: Understanding and Addressing the Failures in Risk Management, Governance and Regulation*.

An expert in risk management and governance, Docherty says the test of how 48 large banks might cope with major financial shocks could produce "chaotic and confusing" results because it will encompass fundamental technical changes that have not yet been properly trialled or fully understood.

The stress test was launched by the European Banking Agency in January, and its conclusions are due to be released in November.

Much of the media attention has focussed on the fact that the biennial stress test will examine how the banks could cope with adverse results flowing from Brexit, including the bloc's economy shrinking cumulatively by over 8% by 2020. These are the first worst-case scenarios around Brexit modelled by an EU agency to be made public.

While the Bank of England has been vocal that Brexit could pose a risk to financial stability for the EU as much as for the UK, so far European authorities have been quiet as to what risks they are modelling for around Brexit.

But a much more important feature of the stress test is that it will be the first such exercise to adopt the new accounting standard International Financial Reporting Standard 9 (IFRS 9).

That standard, which came into force in January, is intended to make losses appear more quickly on lenders' balance sheets by shifting from a focus on incurred losses to expected losses, requiring banks to model what might happen to a loan in the future and provision for future losses as soon as there are signs that the borrower is less likely to repay the loan.

According to an EBA briefing note about the stress test, "banks are requested to account for credit impairments not only for a 12-month perspective but also based on the lifetime credit losses."

Given that such loss provisioning has a huge impact on the carrying values of loans, which are the largest component of banks' balance sheets, the change to IFRS 9 could have an enormous impact when regulators eventually use the results of the stress tests to decide whether banks need to increase their capital and change their business models, governance structures and management.

"The change in standards for loan provisioning has been slipped in without full consideration of the knock-on effects in many areas, including stress tests," says Docherty.

"IFRS 9 has been coming since 2009, but the understanding has been that any change like this would need to follow impact assessments and parallel runs. In fact, there has been no real impact assessment and zero parallel runs."

The EBA had planned to publish results by the middle of the year, but delayed its timeline to give banks more time to adjust to IFRS 9. Banks now have to submit their results in early June and then mid-July with final datasets due in late October. Laurent Birade, a senior risk

8.3%

The amount taken off the EU's GDP for EBA's 2018 stress test

GETTY

consultant at the business analytics firm SAS, agrees that many market players and regulators are still not prepared for the changes to accounting standards.

"Given that increased loss provisions represent the greatest impacts to balance sheets under stress scenarios, the effects of these accounting changes will likely ripple through future stress tests," he said, warning that IFRS 9 requires "a much deeper level of modelling, analysis and reporting than before."

"Firms may need to fundamentally adjust how they manage their loss allowance processes, including how they integrate their risk and financial data, design their analytics platforms and share information between departments," he said.

In practical terms, the tests will challenge not just a bank's risk and finance teams, but also its IT, audit and broader management teams because data, technology infrastructure, reporting, governance and control functions will all be in play.

The stress test will involve 48 banks, with 33 coming from nine eurozone countries, one from Norway – which is not a member of the EU – and 14 from EU nations which do not use the euro, including Britain's Barclays, HSBC, Lloyds and RBS.

Four Greek banks will also be put through their paces alongside the main stress test, although the deadline for their assessments has been brought forward to May to allow them to seek any fresh capital required before the end of Greece's bail-out programme in August.

The test is a "bottom-up" exercise, meaning that the EBA has set a common methodology which each bank then applies to its own balance sheet using its internal models. The banks' results will be checked and perhaps challenged by regulators to assess the reliability of banks' data, assumptions, estimates and results.

The test's worst-case scenario is more severe than the previous European stress tests in 2014 and 2016, but not as severe as that set by the Federal Reserve in its 2017 test of US banks.

The EBA's previous stress tests have been criticised for not being as rigorous as their counterparts in Britain and the US

The banks will be required to model how their balance sheets would look if a recession slashed 8.3% off the EU's GDP by 2020 compared to the baseline of the European Central Bank's December economic projections. That adverse scenario includes a 3.3 percentage point rise in unemployment and a fall in residential property prices to 27.7% below the baseline.

Banks must test credit risk including securitisations, market risk, counterparty credit risk and operational risk while projecting the impact on net interest income, profit and loss and capital items.

The EBA's previous stress tests have been criticised for not being as rigorous as their counterparts in Britain and the US, with sceptics noting that banks deemed reasonably healthy, such as Spain's Banco Popular, have collapsed within months of the process.

This time around, there are mutterings from some analysts that the scenarios set for Greek banks are too lenient. But the main worry is the uncertainty surrounding the impact of IFRS 9 and its reliance on complex internal modelling to produce inherently subjective projections of future losses.

Critics such as Docherty say the danger – indeed the likelihood – is that the results will vary so widely between banks or suggest such large provisions for losses that market players could misinterpret the results and regulators will struggle to find a coherent response to the test results. ●

EVENTS

FUNDS TRANSFER PRICING FOR BANKS

1 May

Understand how funds transfer pricing mechanisms are evolving; what is currently considered by the banking industry to be best practice. tinyurl.com/FS-FTP

CLIENT ASSETS FIRST

13 June

An overview of the client assets sourcebook with key industry and assurance provider speakers. tinyurl.com/FS-ProtectCA

E-BULLETIN

Look out for our monthly e-bulletin for faculty members, featuring exclusive news and events information.
To find it, select 'Edit my details', under 'My account', on the website. For help, call the service manager on +44 (0) 20 7920 8689.

BLOG AND PODCAST

The FS Faculty also now run a regular blog, which can be found at tinyurl.com/FS-TA-Blog and a podcast at tinyurl.com/FS-Podcasts

DAVID SMITH

TROUBLED TIMES

Market volatility is a reminder of the risks on both sides of the pond

This year has already seen more market volatility than most in recent times. In February, we had two daily falls of more than 1,000 points in the Dow Jones Industrial Average during a single week. While it was correct to point out that – in percentage terms – these falls were much smaller than crashes of the past, and as such, did not amount to one, they were a reminder that, as the old health warning had it, the value of investments can go down as well as up.

Stock market volatility has not been the only manifestation of uncertainty. The dollar has been blown about (usually downwards) over fears about what Donald Trump's tax cuts would mean for the US budget deficit. It certainly means a deficit in excess of $1trn a year for the foreseeable future. Tie that to market worries about the return of inflation and it is a recipe for rising government bond yields, particularly in the US, but also elsewhere. And when the bond market spell is broken it has implications for other markets; low yields supporting hefty equity market valuations.

The return of some volatility in markets was to be expected. As the Bank of England governor Mark Carney observed recently, extremely low volatility "didn't seem consistent with even just the normal range of volatility around fundamentals and underlying economic outcomes". So, while stopping short of saying that the return of volatility was welcome, Carney said it was "not an entirely surprising development".

TWO QUESTIONS TO BE ASKED

Nevertheless, there are two questions for markets and those whose job it is to supervise them. The first is whether inflation is on the way back. The second is whether markets can cope with upcoming changes in monetary policy as central banks move away from the exceptional stimulus approach they adopted in the wake of the global financial crisis.

On inflation, Wall Street's tremors were caused by the releases of data showing US wages growing by 2.9% – the fastest since 2009. The jitters were reinforced by figures showing higher than expected US consumer price inflation. As things stand, fears of significantly higher global inflation look overdone. Though Britain has been experiencing a bout of 3%-plus inflation thanks to the weak pound, across the advanced world there is no clear evidence of acceleration. OECD inflation is running at a little over 2%.

Markets, however, may have got used to ultra-low inflation. In 2015 global inflation was at its lowest for many decades, brought down by weak oil prices and threatening to tip into deflation. It does not, therefore, take much of a rise in inflation for it to be regarded by investors as an inflation shock. There is a high degree of sensitivity.

MONETARY POLICY

Monetary policy presents a bigger challenge, with the days of very easy money numbered. Official interest rates are set to rise at least a couple of times on both sides of the Atlantic this year. Perhaps more importantly, the great quantitative easing (QE) experiment is coming to an end. The Bank has stopped, and the European Central Bank is about to stop. The Federal Reserve in America has gone further, and is already running down the pool of assets it acquired under QE by the simple expedient of not reinvesting the proceeds of maturing bonds.

This has a big effect on market arithmetic. In America, for example, the budget deficit is rising from $519bn in 2017 to $1trn. As importantly, the Fed will no longer be absorbing some of that deficit through QE. Its unwinding will amount to some $450bn this year. That is a big increase in supply and implies higher bond yields and greater market volatility. Nobody said that reversing the great QE experiment would be easy, as we will discover. ●

The Financial Services Faculty now runs a podcast related to market volatility. You can find it at tinyurl.com/FS-Podcasts

David Smith, economics editor, *The Sunday Times*

TECH SUPPORT

Murray Falconer argues the case for audit firms over tech firms giving technology advice during transactions

For both private equity firms and corporate businesses, transaction diligence has traditionally been limited to financial, regulatory and legal advice. But in the past few years, technology has become just as important.

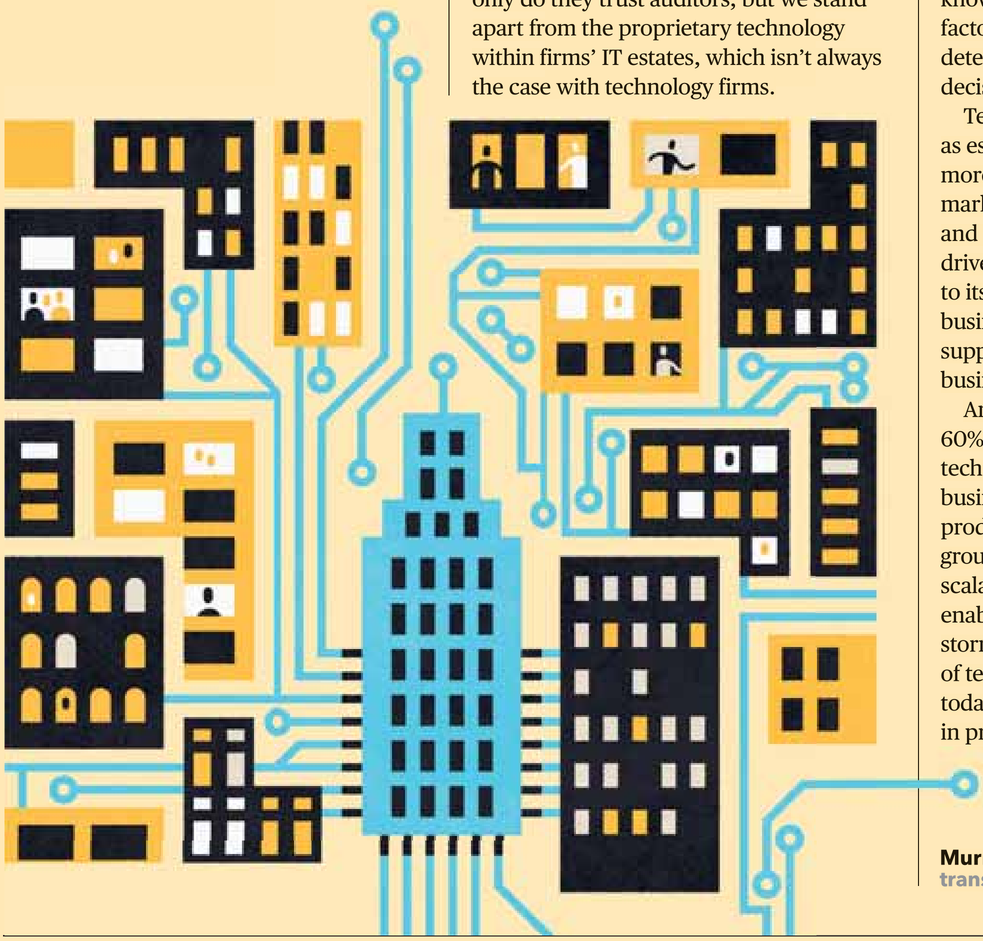
And it's not only technology providers and boutique consultancies providing this advice. Global audit firms have thrown their hat in the ring on both the buy and sell side, and it's proving a perfect fit for clients.

The scope of the advice has also widened. It is no longer just about examining the firm's applications and infrastructure architecture - it includes an in-depth look at service performance, risk management, the IT cost base, IT organisation and key suppliers.

PROVIDING KEY INSIGHTS

Global audit firms are perfectly placed to provide this. They have a vast deal of experience, deep business sector and technology expertise (many of whom have experience working for the technology providers), reputation for thoroughness, embedded disciplines and rigour.

But perhaps most important is the auditor's independence, which is key for corporates and private equity clients. Not only do they trust auditors, but we stand apart from the proprietary technology within firms' IT estates, which isn't always the case with technology firms.



ARON VELLEKOOP LEON/IKON

The scope of technology due diligence has rapidly evolved to include technology strategy (eg, build vs buy vs rent), digital readiness, use of emerging technologies, cyber-security frameworks and preparedness in the event of an attack.

At EY, we have qualified people who can engage with the client and conduct investigations, as well as regional hubs, which consist of highly specialised teams who can assess the target company's cyber security readiness.

Using the latest technology, audit firms can help companies establish their optimal deal price, provide a better view of what they're buying into and where cost savings and error reductions can be made with automation. It's even possible to help transform a company's entire digital operating model.

So, our truly independent diligence report provides key insights to the client and can be a critical element in their decision-making process.

TECH DEPENDENT

Financial service clients often comment on the need for a detailed technology due diligence in order to prevent value erosion. Including it in the pre-deal stage provides the buyer with a better view of the target business in terms of the current state, known issues, potential risks and other factors that will support their determination of valuation and the decision to acquire or not.

Technology diligence could even be seen as essential to business survival in an ever more competitive financial services marketplace, both locally on the high street and online across the globe. The ability to drive costs down, while scaling up offerings to its end customers and expanding business capabilities that the operation can support, speaks directly to the value of the business in any deal process.

An EY survey noted that as much as 60% of deal synergies may depend on technology, largely due to the dependency businesses have on technology to deliver products/services to their customers. By grouping risk mitigation, cost reduction, scalability, new growth and business enablement together, it creates a perfect storm for the emergence and prominence of technology diligence in deal processes today. And audit firms are at the forefront in providing all this necessary support. ●

Murray Falconer, partner, EMEIA transaction advisory services, EY

The Trump effect

The presidency of Donald Trump has brought about an eventful and controversial period in the US. Jon Bernstein assesses the fallout and effect on financial and professional services this side of the Atlantic

Tax, trade and regulation. For a ruling politician looking to stimulate growth, realign priorities and exert control, these are the sharpest tools in the box. As a candidate seeking office, Donald Trump happily wielded all three, promising to lower both the tax and regulatory burden while, under the banner of America First, to rethink and, if necessary, retrench on trade.

Just over a year on, not all of Trump's rhetoric has coalesced into action, but an outline is visible. For UK financial services firms, meanwhile, the scorecard remains mixed – the impact yet to be fully realised.

Taking a broad view of the changes during president Trump's first year, Dame Inga Beale, CEO, Lloyd's of London, says: "The US is Lloyd's biggest market by a long way [over 40% of business comes from the US] and we play in a very specialist arena there. That is a longstanding, strong relationship and I don't think any of the current uncertainty is going to damage that. But there might be some things that change the economics of it."

TAX

Let's start with tax, where president Trump has achieved his single biggest legislative achievement to date. His tax bill was passed less than a week before Christmas. The headline figure for business: the introduction of a 21% corporate income tax rate, down from 35%. The tax bill also changed the rules on overseas dividends, making the repatriation of money back to the US tax neutral. A progressive change for most organisations, it does, however, come with a one-time return tax.

Richard Milnes, banking tax partner at EY, describes the changes as "momentous". He says: "In the last 20 years, the US has been left behind as global corporate tax rates have been going down and tax systems have become more territorial, seeking only to tax income earned in the jurisdiction, not to tax worldwide income."

Taken together, these measures make the US a more attractive destination. "Looking at where to grow and book business is a live issue with Brexit, in any case, and this big change in tax [is something to throw] into the mix."

So far, so good. But there is a "wrinkle" in the US tax reform, says Milnes. It comes in the form of the base erosion and anti-abuse tax (BEAT). Designed to dissuade companies from shifting income to low-tax countries, the measure imposes a 10% (5% in the first year) levy on payments made outside the US to related parties.

For a multinational firm, Milnes says the results could be "punitive". So much so, EU finance ministers were prompted to write to US treasury secretary Steven Mnuchin warning him that the changes could have "a major distortive impact on international trade" and penalise non-US resident firms twice over, and were likely to contravene World Trade Organisation (WTO) principles. BEAT was at odds with existing double tax agreements, wrote the EU finance minister.

Overall, therefore, the tax bill provides an upside and downside for financial services firms with interests on either side of the Atlantic. On the upside, firms will now earn 79, rather than 65 cents, on the dollar. On the downside, they could be disadvantaged by the impact of BEAT.

"It depends on corporate structure and exposure but by and large there may be some short-term hits but some long-term gains," says Gary Campkin, director of policy and strategy at TheCityUK, which represents London-based firms from the financial and related professional services industry.

AMERICA FIRST

What concerns Campkin more than the tax changes are any potential threats to "outward-looking trade policies". Trump's position, first as candidate and subsequently asnpresident, suggests something more inward looking. In 2016, the UK exported £99.6bn worth of goods and services to the US and ran a trade surplus of £33.3bn.

TRUMP BY NUMBERS

21%

Headline US corporate income tax rate from 2018, down from 35%

2.3%

US economic growth in 2017, up from 1.5% in 2016

£33.3bn

UK surplus in trading with the US

"From this day forward, a new vision will govern," Trump declared during his inauguration address in January 2017. "It's going to be only America first, America first." His refrain was almost musical but hinted at a protectionism discordant with globalised financial services. His promised abandonment of the Trans-Pacific Partnership (TPP) and his desire to renegotiate or withdraw from the North America Free Trade Agreement (NAFTA), while not directly affecting UK firms, appear to further signal US retrenchment.

"In one sense, it's the job of any government to put their country first," acknowledges Campkin. "So there's a need to look beyond the rhetoric. What we need to see is continued US engagement in international fora. We do need to see the US continue to engage with the likes of the World Trade Organisation, making sure that multilateralism doesn't wither on the vine."

There's also concern that an anti-globalisation backlash could have a direct and detrimental impact on the re-insurance market. For example, when natural disasters happen, foreign money pours in. If you put up protectionist and restrictive measures to keep risks within one country this could cause problems. Last year's major hurricanes and fires cost the US a staggering $306bn. Without sufficient re-insurance cover and foreign aid, it would be impossible to cover that amount.

TRADE TALKS

When it comes to trade with the UK, Trump's language arguably has been more conciliatory than his predecessor. During the heat of the 2016 European Union referendum campaign, President Obama suggested the UK would move to the "back of the queue" when it came to trade deals if the country decided to exit the EU. By contrast, in an interview with *The Times* last year, Trump described that as a "bad statement", adding: "I'm a big fan of the UK, we're gonna work very hard to get it done quickly and done properly. Good for both sides."

Any concrete deal will have to wait until the UK leaves the EU in March 2019, or quite possibly, until the end of a transition period, which will take us to 2020 and beyond. Any negotiation will, in any case, be shaped by the final UK-EU27 deal, says Campkin. His organisation is lobbying hard for mutual regulatory recognition and regulatory co-operation. "It has to be a cornerstone of any UK/EU27 deal," he says. The cross-border transfer of trade and a services version of the Non-Agricultural Markets Access (NAMA) negotiations that emerge from the WTO's Doha Declaration in 2001 are among the multi-lateral trade solutions Campkin would like to see on the table when UK-US trade negotiations start in earnest.

Trump introduced the prosaically titled Executive Order 13771, which promised to remove two existing regulations for every new regulation introduced

26,000

Dow Jones hits record points high in January before a more recent stock market correction

$200bn

Of federal funds committed to infrastructure spending in hope of stimulating $1.5tr private investment in kind

1,579

Regulatory withdrawals and delays in Trump's first year. Fewer than in the first 12 months of Bill Clinton, George W Bush or Barack Obama's administrations

REGULATION

As with trade, so with regulation. In one of his first moves in power, president Trump introduced the prosaically titled Executive Order 13771, which promised to remove two existing regulations for every new regulation introduced.

Regardless, the reduction of compliance overhead is broadly welcomed by the business community as a whole and financial and professional services in particular. "The compliance burden that has been imposed since [the financial crisis in] 2008 is hugely costly on banks and financial services," says Liv Watson, senior director of strategic customer initiatives at Workiva, Chair of the Institute of Management Accountants and committee member at the ICAEW.

Trump has promised to look at the Dodd-Frank Act again, which was introduced in the wake of the financial crisis. Specifically, he has promised to look at the Volcker Rule, which prohibits banks from conducting certain investment activities with their own accounts, and tightens ownership rules with hedge funds and private equity funds. Today,

GETTY, REUTERS

however, the Financial Choice Act that would overhaul much of Dodd-Frank – and allow banks to opt out completely if they maintain a 10% ratio of capital to assets – is a long way from becoming law.

According to Watson, one of the best ways to ease the compliance burden on financial services firms is to continue the work on both sides of the Atlantic to harmonise data standards. She argues that one of the most important measures in reducing compliance burden is a harmonised data standard so companies don't have to keep multiple books. The European Commission's Regulatory Fitness and Performance programme aims to make implementation of EU laws simpler. Its next task is to finalise financial services definitions. The 2014 US Data Act aims to do something similar on the other side of the Atlantic. Watson welcomes both but makes clear: "I don't think Trump is the champion of this. He inherited it."

LOOKING FORWARD

There are other issues, beyond tax, trade and regulation, which UK institutions are watching closely. One is president Trump's approach to immigration. Last year's failed travel bans proved hugely disruptive while reform affecting L-1 and H-1B visa applications remains a live issue.

The other impact may come from increased spending. In February, President Trump committed to direct $200bn of federal funds towards infrastructure spending in the hope of stimulating a further $1.5tr in private investment over ten years. Additional spending will be inflationary, but is likely to offer additional financing opportunities.

Despite the frenetic nature of the first year of the Trump administration – a collision of rhetoric and reality – much remains undecided. Campkin characterises the first year as "a political glass half full, glass half empty". He welcomes the tax bill as a "positive step forward", but misgivings remain about broader engagement on trade. "Perhaps it balances out," he suggests.

There may soon be change. Until now, President Trump has had the luxury of a Republican majority in Congress. That may not be the case after November's mid-term elections. Should the Democrats win back either the House of Representatives or the Senate – possibly both – the President's room for manoeuvre will be restricted. The alignment that made last December's tax bill possible will disappear. "It's going to be a key bellwether," concludes Campkin. ●

SPEAK UP

Megan Reitz explains how managers can cultivate an open and honest environment in the workplace

Being able to speak the truth to those in power has never been more important, particularly with increased scrutiny of businesses and the need for cyber resilience. And this is without even mentioning GDPR, Brexit and the advent of open banking.

The news has provided plenty of examples where silence has not been golden and voices have been ignored. It is alleged that Oxfam workers repeatedly tried to tell managers about sexual misconduct, but their voices fell on deaf ears.

Back in 2015, when Volkswagen came under fire for its so-called "emissions dupe", it was revealed that some employees knew about the issue but had not spoken up or been listened to properly. That same year, Amazon's Jeff Bezos pleaded ignorance to the "bruising culture" portrayed by his staff in a *New York Times* article. Could these situations have been avoided had leaders understood just how difficult it is for employees to tell them the things they need to hear?

Our recent research report *Being Silenced and Silencing Others: Developing the Capacity to Speak Truth to Power* (Megan Reitz and John Higgins for Ashridge Executive Education, March 2017) explores the cultures of silence that are prevalent in so many organisations today, and what is behind them. We found that leaders are unaware of just how difficult it is for their employees to speak up. Managers will tell you (and indeed often genuinely believe) that they are very approachable. They use phrases like "my door is always open" and hold 'leadership lunches' that aim to show just how accessible the leadership team is.

But creating the right environment for people to speak up is about more than just propping the door open or sharing a lunchtime doughnut. If leaders are sincere in wanting to hear what others know, then they have to understand how

everything that is said to them is said through the lens of their relatively higher power. Truth and power are inextricably linked. For example, just the simple phrase “my door is always open” conveys the message that, first of all, you are important enough to have a door of your own, and that secondly, you expect people to come and speak to you on your territory.

CULTURAL CONSIDERATIONS

Leaders who want to create a more open environment need to consider what type of culture (or ‘rules’) currently exist within their organisation and how easy (or difficult) that prevailing culture makes it for people to share what they know. What pattern of behaviour has become the norm, what gets spoken about and what doesn’t; whose opinion counts and whose doesn’t. Being aware of these ‘rules’, questioning them and forming new ‘rules’ can be vital in terms of enabling people to speak up.

Our research identifies four archetypes of organisational culture: empowering, adjudicated, directive and dialogic. We use these archetypes to engage groups in conversation about their particular ways of working and how they may serve them or hinder them.

In an empowering culture, there is often a clearly identified leader who makes the big important decisions, while still allowing scope for employees to make contributions within set boundaries. Meanwhile, in an adjudicated culture, the leader takes on the persona of the ‘wise owl’ who listens to opposing points of view and then makes a decision about the way forward.

As you would expect, in a directive culture there is a single, all-powerful, ‘heroic’ leader who expects people to follow his or her lead without challenge. By contrast, in a dialogic culture, there is little formal hierarchy and often no obvious chain of command. The leader typically sees their role as bringing a group of people together to discuss issues and make decisions.

It is important to note that none of these “truth to power” cultures are right or wrong. Each presents its own challenges and opportunities. The key for managers is to understand the cultural backdrop they are working in and how to influence the conversations they are part of in a way that develops the most conducive and productive culture, given the priorities of the organisation at the time.

GILLIAN BLEASE/IKON

There are ways to make it easier for people to speak up, whether it’s a small idea or highlighting a serious wrongdoing

UNDERSTANDING THE BARRIERS

It’s a complex balancing act, which requires leaders to have a sophisticated understanding of the factors that can get in the way of speaking up. Our research uncovered five aspects of silencing self and silencing others:

- **Personal conviction:** How strongly people believe in their own and others’ opinion.
- **Risk awareness:** How well people understand the likely consequences of speaking up.
- **Political awareness:** How savvy they are about the internal politics that might get in the way of speaking and listening up.
- **Social awareness:** How aware they are of the labels that are attached to them and others (man, woman, young, old) and how this affects how they will be heard and how they listen.
- **Judgement:** How well they understand what to say and how to say it to give themselves the best chance of being listened to and to give others the best chance of being heard.

Being fully aware of these factors is an important first step for leaders who want to encourage a more open dialogue in their organisations. Key questions to ask yourself are: whose opinion counts to you (who do you prefer to listen to and who do you dismiss out of hand)?

When have you encouraged others to speak up to you and how have you treated those who have? To what extent do people challenge you currently and in what forums? How do you make others feel important, comfortable and significant?

There are also practical actions you can take to make it easier for people to speak up, whether they are putting forward a small idea about how to improve customer service or highlighting a serious issue of professional wrongdoing:

- **Meet people on their turf,** not yours, or find somewhere neutral.
- **Understand that your status creates distance.** Be aware, for example, that it may be intimidating for a young employee to speak honestly to a senior manager, or that some female employees may find a very vocal, opinionated male difficult to approach.
- **Appreciate how risky it is for others to speak up to you.** The personal stakes for an employee can be high if, for example, they decide to expose some kind of wrongdoing by people in the organisation more senior to them. Employees also worry that if they challenge the status quo, they will be perceived as someone who doesn’t ‘fit’ and could be managed out.
- **Make it a dialogue:** Be curious about what people have to say and accept that there are always multiple perspectives on how things should be done – none of which are necessarily right. Be open to discussion rather than shutting the conversation down immediately if you don’t agree with others’ ideas. Notice what you do in the conversation that allows others to open up, and equally what you do that shuts them down.

Our research suggests that if the executive team demands that people speak up or tell managers that they need to be better at listening it is unlikely, in isolation, to make a difference – it will probably be met with cynicism.

Instead, we have found that encouraging inquiry-based conversations and bringing a range of people together from across the organisation to discuss their experiences and work on ‘live’ issues is much more sustainable and productive. This may help you shift from a ‘shut up’ to a ‘speak up’ culture – one conversation at a time. ●

Megan Reitz, associate professor of leadership and dialogue at Ashridge Executive Education – Hult International Business School

KEEPING A HOLD ON TALENT

Today's graduates are turning away from banking and increasingly being tempted into the tech sector, argues Morgan McKinley's **Hakan Enver**

Headlines would have you believe that financial services are flocking from London to other EU finance hot spots such as Frankfurt, Paris and Brussels. But it's not a tidal wave just yet.

Firms in the City continue on their recruitment drive in order to meet the requirements and expectations of increased regulation and tackling technological advancements, according to our research at Morgan McKinley. We saw a 3% month-on-month rise in financial services jobs coming to the market in February; although this is tempered by a 14% year-on-year decrease. There were 10,000 fewer people looking for new financial service positions in February than in 2016, due to EU nationals returning home and uncertainty over potential Brexit relocations.

THE BREXIT EFFECT

In the meantime, there's been an all-hands-on-deck approach in 2018. With January's MiFID II roll out, the pending GDPR regulations due in May and other policy/legislative changes, many financial services businesses are in need of extra pairs of experienced hands. This will continue to be the case for much of this year. In addition, huge change programmes centred on consolidation, relocation projects, core IT infrastructure, applications, security, data and digital transformation work will increase recruitment needs.

Brexit has undoubtedly had an impact on the number of graduates moving into investment banking. Last year, applications slipped by 15.8% year-on-year for the banks' graduate programmes, according to new research from High Fliers, which surveyed over 20,000 final year students at the UK's top universities. Just 9.6% of graduates applied for roles in investment banking – the lowest proportion since 2009, when banks halted graduate recruitment in the aftermath of the crisis. As a result, some firms have had to increase the number of strategy-aligned temporary banking roles to fill these gaps.

Instead, many graduates and those already in the finance sectors are moving into the technology sector, where opportunities abound thanks to a combination of continued venture capital investment, the establishment of start-up businesses and new project initiatives within existing corporate firms.

Furthermore, Theresa May confirmed that an additional £21m will be invested into Tech City UK over the next four years. This level of investment suggests a positive move from the government to continue supporting the UK's fastest-growing industry and one of the more productive segments of the economy.

We have seen development among financial service firms in application and mobile security to tackle attacks on computers and mobile devices. Security systems are often put under immense pressure by the ever-evolving malwares and viruses feeding through the network.

Companies are constantly conducting tests in order to prevent such attacks; those that are not doing so appropriately become vulnerable and must adopt more stringent security. These threats will continue to fuel hiring activity, as an increasing number of institutions realise the potential cost and risks that come with being unprepared.

COMPLIANCY CHALLENGES

Within the wider financial services arena, the latter parts of 2017 brought about a different set of challenges in the form of organisations falling behind the curve on some regulatory programmes. The MiFID II deadline on 3 January 2018 resulted in many businesses frantically preparing to be compliant with the new rules. While much of the work has

9.6%

The proportion of top UK graduates applying for roles in investment banking in 2017

now been done, many businesses feel it is not quite complete and it is expected that any outstanding areas of uncertainty will require further guidance to ensure full compliance. During the lead up to the deadline, rates began to rise for MiFID II professionals. Individuals with more specific skills, namely within investor protection and product specific areas, were in demand and often commanded a premium. This will remain the case in the coming months.

INCREASING ENTICEMENTS

The market for skilled, high-performing accounting and finance professionals is competitive, and this is increasingly reflected in the salaries and benefits on offer. Junior to mid-level roles are seeing the biggest increase in demand as businesses look to hire and develop employees for the long term.

Skills shortages are very much the driving force for the financial services marketplace, with a majority of businesses believing demand is outstripping supply combined with a lack of experienced professionals readily available. Businesses are having to be more creative in their remuneration packages, and turning to more interim and contract employees.

As we head closer to March 2019, when an agreement on Brexit must be made, we expect to see organisations finalise and start executing their Brexit programmes. Compliance initiatives at major European banks have been, and will continue to be, of paramount importance. Any anti-financial crime skills will be widely desirable for the duration of this year.

Much of what was seen in 2017 with regards to reservations around investing in talent is expected to continue throughout 2018, or at least until there is more clarity on the environment of post-Brexit Britain. The banking industry will feel the most impact, with continued hesitation around making volume hires that could ultimately backfire amid the uncertainty. Despite this element of nervousness, a number of global institutions have already committed to new and larger real estate in London – a sign of their commitment to the region in these trying times.

Even asset managers are carefully considering their next strategic moves and how best to restructure their operations as a result. This is especially the case now that urgency has been ramped up further. The increased pressure comes as a result of a reminder from the European Commission highlighting the fact that UK fund managers would be locked out of selling products into the EU from next April if they are not appropriately prepared. ●

Hakan Enver,
managing director,
Morgan McKinley

MILLENNIAL FLEXIBILITY

Most millennials don't want to work all hours and place more emphasis on work-life balance than career progression, finds a recent Deloitte survey of the younger generation.

During the crisis, any financial services employer who received a request from a candidate for a 30-hour week or time off to do yoga would laugh and throw the CV in a bin. There were plenty of other desperate candidates. But things have changed. With the economy improving, qualified candidates can make demands.

The tech sector is already adjusting to meet these needs. For example, Amazon is piloting technical teams that work 30-hour weeks for the same benefits and three-quarters the pay of 40-hour employees. .

Shorter hours won't help the poorest-paid workers, who can't afford to work less, or elite workers, who generally love their work and can hire help for household tasks. But for the broad middle in rich countries, a new working life is emerging. The basic work week will shorten, and individual workers will scale down when they have kids or aged parents to look after.

MIND THE GENDER GAP

Thousands of financial service firms across the UK are being forced to reveal their gender pay gaps. But the disparities could be putting off many women from taking jobs.

Some organisations are still trying to establish what falls within the scope of reporting requirements. Legal advisers are recommending employers publish a narrative alongside figures to spell out the reasons behind gaps and any action they've taken, as TSB have done.

Remedies so far include offering better flexible working, setting aspirations targets for women in senior management, and catering better for women returning from career breaks.

AGENT XERO

Gary Turner, UK co-founder and managing director of accounting software company Xero, tells Chris Evans about the impact of technology on financial services

Gary Turner has spent his whole life immersed in technology. From building an entire banking system while still at school, to working alongside Bill Gates, and now running a successful accounting software company in the UK.

FORTUNE TELLING

"I have always been obsessed with what's round the corner," enthuses Turner. "When I joined Xero in 2009, they were a small company based in New Zealand with a team of just three in the UK and revenue of £50,000. People thought I was crazy to leave Microsoft, but I knew from my research and knowledge that cloud software was going to be the next dominant platform and therefore it was the safest bet on the planet."

Initially, Turner had no office in the UK, so he worked out of coffee shops. Furthermore, Xero had no brand or credibility, competing against the goliath of Sage. But nine years later, it has built a successful business and is projected to surpass £40m in revenue this year.

They've gone from working with 10 accounting firms and hundreds of small business customers to thousands of firms and millions of customers.

Turner believes the tide is turning towards digital and cloud in the notoriously slow-to-adapt financial services and SME businesses. "The conversion away from spreadsheets is happening. Using the cloud is becoming more accepted. Consumer technology has certainly helped with this. We're all now accustomed to Spotify, Apple Music and sharing our photos on iCloud. The puzzled looks have gone and firms are getting it."

Plus, small businesses and accountants are being forced to go digital by the government as HMRC continues its drive to digitise the tax system. Effectively, spreadsheets are going to be outlawed for accounting. Paperwork is going to be a thing of the past.

The same applies to businesses requiring loans from the banks. "They're no longer going to be able to turn up with half a spreadsheet and some receipts and ask for money," insists Turner. "There's a new world of financial services and digital transformation."

BANKING REVOLUTION

Turner believes the traditional banks also need to adapt to this new world and meet customers' changing needs in order to survive.

"If you look at the new digital banks like Monzo, Revolut and Starling, they are ostensibly apps on a smart phone, with a digital banking infrastructure in the background. The surface area that the customers experience most is the cool, funky, useful app, and the banking part is secondary. If you consider the traditional approach, they are first and foremost a bank, and at a secondary level an app. It is therefore not surprising that the experience of the app between the two is markedly different."

The concern is that traditional banks will be marginalised as simply "important utilities", well run and resilient for payment processes, but lacking in innovation and digital drive, and struggling to provide value.

"Look at BT and Netflix. The latter wouldn't exist without the BT backbone, but people have more of an emotional connection with Netflix," explains Turner. "This model could work for the traditional banks if they were to partner with more innovative and exciting fintechs."

This is, of course, already happening, and the onset of open banking is forcing banks to react. Turner believes this is a positive step.

"Customers and small businesses will be able to use these apps to control their funds better, and banks can offer additional third party products through their own channels and improve their digital offerings, thus giving customers more choice."

The rise of online consumer choice was something Turner had been prophesising and writing about since the turn of the century.

"I read the *Cluetrain Manifesto* back in 2000 while on my honeymoon, and it transformed my work life," explains Turner. "That foretold the rise of social media and consumer engagement online. It gave me a huge head-start on the impact of the web."

Indeed, Turner was one of the first people to write a blog at that time, while working at Pegasus Software. This proved popular and helped attract the interest of Microsoft. In 2007, he became product marketing manager for the UK.

"THE CONVERSION AWAY FROM SPREADSHEETS IS HAPPENING. USING THE CLOUD IS BECOMING MORE ACCEPTED"

"I was a huge fan. We all grew up in a Microsoft world and they were the pinnacle of quality and pioneering in technology," enthuses Turner.

"The discipline of such a large organisation was incredible and it was exciting to receive in-staff emails from Bill Gates. But after about six months to a year, the excitement wore off, and I realised that it was not really this new world of opportunity I was looking for. It actually taught me a valuable lesson that it's not just about 'why not join Microsoft', you actually need a 'why'."

Soon after, he was on the Xero journey. He left Microsoft on a Friday, jumped on a plane, and was in New Zealand by the start of the following week. He hasn't looked back since.

REGULATORY BURDEN

As for the future of financial services, Turner is positive that the regulatory clouds will lift in the coming years, allowing firms to get back to improving their core business practices and offerings.

"We work with some of the bigger banks and I spend a lot of time in that world, and the considered view is that 2017/18 marks a crescendo of regulatory change and disruption, and that the disruption will start to dissipate."

He is convinced that new technology like AI, machine learning and Big Data will certainly help as supportive tools, automating previously burdensome manual compliance requirements.

"However, I think there will be two competing forces of change. Alongside the adoption of these new technologies, there will be an equal improvement in the skills and importance of employees," Turner says. "Financial service firms are realising that if their staff are happy, engaged and motivated then the customer service will be better."

Turner practices what he preaches. Despite being the managing director, he doesn't have his own office or PA, dresses the same as everyone else, and does all he can to nurture a relaxed environment.

"My modus operandi is if we achieve success, the team gets the credit, and if we screw up it's my fault. There's no blame culture and hopefully people feel they can experiment and be creative." ●

TURNER ON...

The future of the accountancy profession

"There are currently about 20,000 accountancy firms, which reflects the inefficiencies of that world and the paper shuffling that still goes on. With digitisation, there'll inevitably be consolidation, the emergence of new digital-only firms, and a natural wastage of old firms that don't make the transition and fade away."

GDPR – data management

"Generally, I imagine most small businesses haven't got a clue about GDPR, which comes into effect in May. There's a lot more education and learning to be done by SMEs on data privacy, security etc. We've had the internet for 20 years, but only now are businesses learning to use it properly. Many of the old practices (sending out spam email, mail shots etc) still go on.

"Data privacy is very important. If my personal information is stored on a business computer somewhere, I'd like to know that it is being taken care of. I don't want it running on Windows 95, unsupported, and riddled with viruses and security compromises. Companies need to exercise greater controls. They're still working this out and it's going to be a bumpy ride."

CABA with you for life

CALLING ALL PAST AND PRESENT ICAEW MEMBERS

LET US STAY IN TOUCH

New data protection rules mean that after 25 May 2018, we'll only be able to send you information about the support we offer if you've given us your renewed consent.

How to give your consent

1. Go to **caba.org.uk/consent** and complete a short form online
2. Call us on **+44 (0) 1788 556 366**

5 REASONS TO STAY IN TOUCH WITH CABA

We offer tailored support to ACA students, past and present ICAEW members and ICAEW staff, **for life**

Your **family** can access our services too

We can help with **anything** from health and wellbeing, to career development, carer support and much more

All our services are strictly **confidential**

FREE It's all **FREE**

caba.org.uk

BIG DEAL

Dominic Lindley explores professor Andrew Lo's influential adaptive markets theories and how they relate to 'too-big-to-fail' banks and cultural change

In March 2007, Powys County Council had £14.5m invested in Goldman Sachs' Global Tactical Asset Allocation Fund. It had been attracted by the name and steady returns it was promised. But something went wrong. In August 2007, the fund lost 30% of its value in a week. By the time Powys came to review Goldman's performance in 2008, the fund had fallen by 45%. The council eventually sold the fund in 2009 after incurring around £9m in losses – costing each household in Powys more than £150. Staffordshire and Kent County Councils had also invested – losing £100m of their taxpayers' money between them.

How can hedge funds, which are supposed to be market neutral and profitable for years, suddenly suffer such big losses in one week? What was it about the market that those managing money at Goldman Sachs and Powys County Council failed to understand?

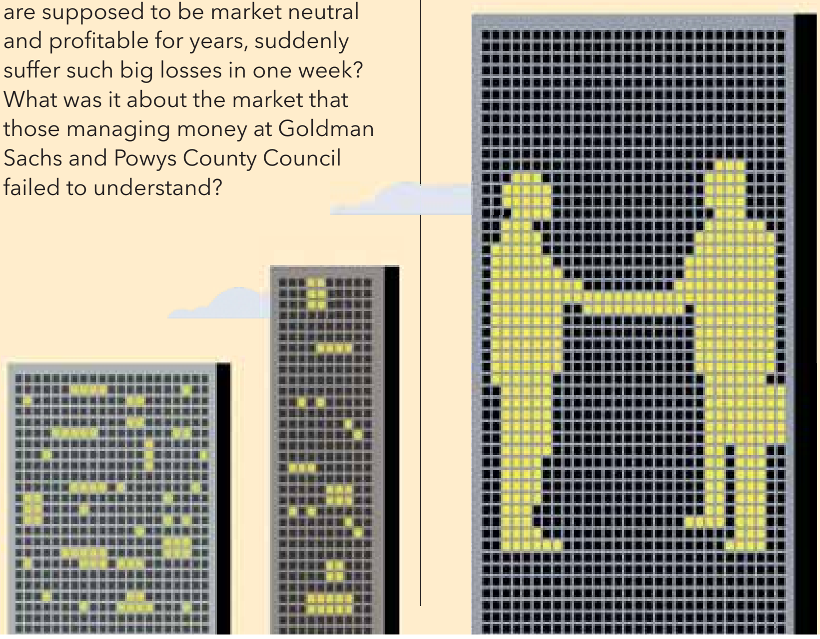
Professor Andrew Lo attempts to explain this in his new book *Adaptive Markets*. He highlights that advances in technology and complexity have created a combination of Moore's law and Murphy's law. This means that in financial markets, whatever can go wrong will go wrong, faster and bigger than before.

Professor Lo explains the adaptive markets hypothesis. "The idea is that financial interactions are governed not by the law of physics, but adaptation, selection and ultimately evolution."

Hedge fund managers had adapted to the environment up to 2007 by using computer models and rising amounts of leverage to search for returns. This worked for a while, but when one fund started selling in August 2007, it created losses for others that were outside the bounds of their models and caused them to sell. Hedge funds had adapted to the markets in new ways that created new risks, which those managing money for Goldman Sachs and Powys County Council failed to understand.

TOO BIG TO FAIL?

A similar evolutionary process has resulted in banks becoming too-big-to-fail. Professor Lo highlights that in many biological environments, size matters. The size animals grow to is determined by their environment and the processes of evolution and natural selection. Banks are no different. The environment in which they continue to operate favours size. Banks succeed not by being more efficient or by treating customers better, but by being big and complex and getting access to taxpayer support and bail-outs – a form of unnatural selection. Why have taxpayers allowed this to happen? Well, because politicians, regulators and auditors have also adapted to the environment and all promised that they are now much more competent and have 'ended' too-big-to-fail.



NICK LOWNDES/IKON

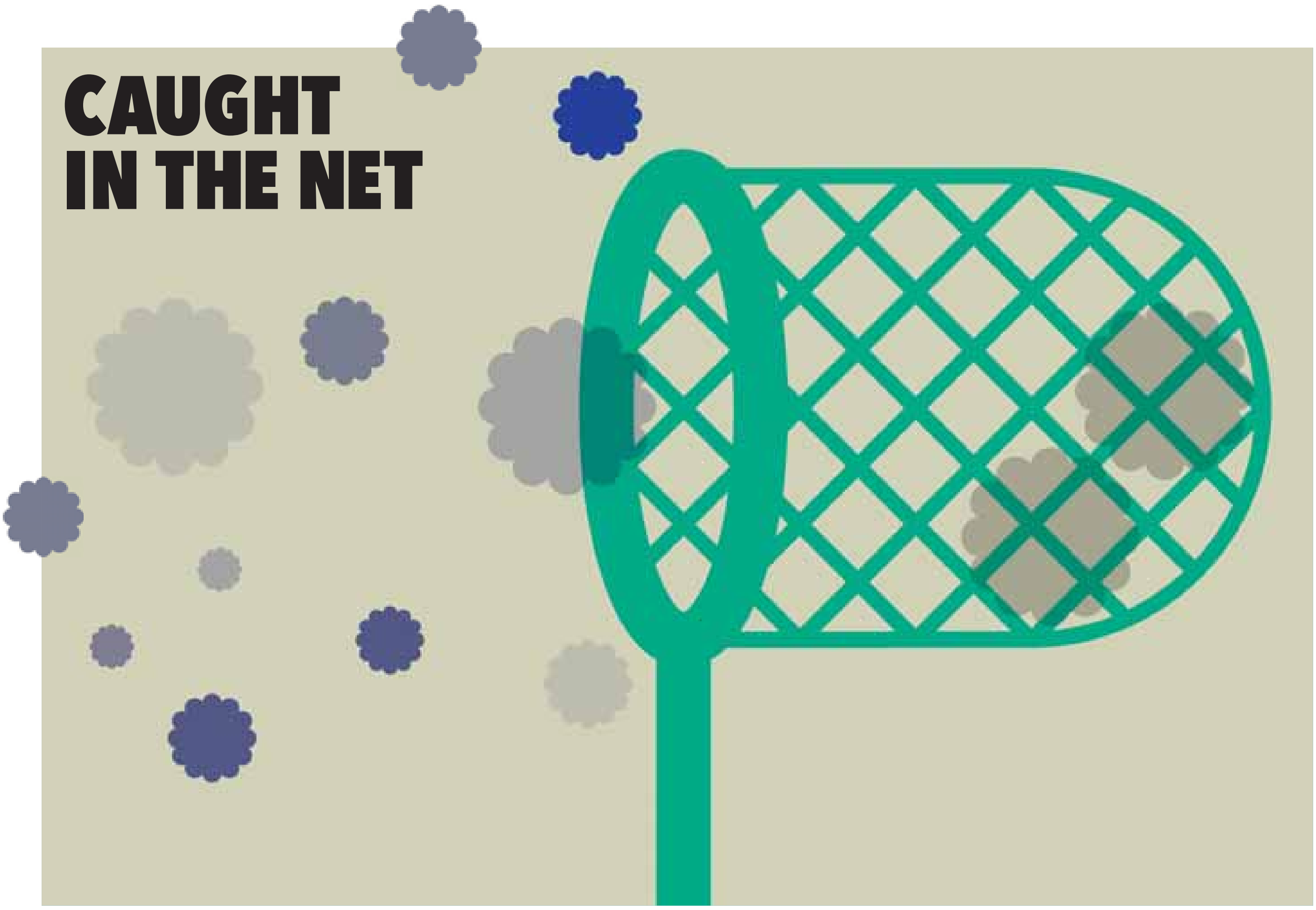
New City Agenda hosted an event called *Adaptive Markets: Financial Evolution at the Speed of Thought*, presented by Professor Andrew Lo on November 28 at the House of Commons. To receive a copy of the transcript from the event with Professor Andrew Lo, please email dominic.lindley@newcityagenda.co.uk

In the banking sector, some cultural values were positively correlated to individual success for bankers. Cultural values such as short-termism, risky behaviour and exploiting customers spread within banks and are taught to newcomers. Aggressive toxic cultures spread like a virus throughout the banks.

Professor Lo has advocated the introduction of a Capital Markets Safety Board, which would investigate what went wrong in a non-partisan way. When it comes to accountants and auditors, I have no idea why they missed the risk-taking at HBOS or sanctioned the misleading Repo 105, which Lehman Brothers used to disguise its risk. At the moment, we understand nothing about the behavioural or cultural motivations of the individuals involved.

Professor Lo's book is a fascinating introduction to a hypothesis which has implications for those working in the financial services sector and those overseeing it as auditors and regulators. As for Powys, they don't seem to have learned their lesson and still have over £25m invested in Goldman Sachs hedge funds. ●

Dominic Lindley,
director of policy,
New City Agenda



CAUGHT IN THE NET

Rebecca Walsh and **Carolina Samson** explain the impact of the SMCR extension for insurers – and how to prepare for it

The inevitable has happened. Insurers are being caught in the same net as their banking cousins. From 10 December this year, they too will have to comply with the Senior Managers and Certification Regime (SMCR), superseding the Senior Insurance Managers Regime (SIMR).

To soften the blow, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) issued a suite of consultation papers providing guidance on how they plan to transition firms and individuals to the SMCR. Insurance brokers and other smaller, solo FCA-regulated firms will not become subject to the SMCR until middle to late 2019.

The official line is that the extension aligns the accountability regimes for banking and insurance. It also continues to respect their different business models - and the requirements of Solvency II for insurers. The proposals also support improved governance and culture across all financial services.

But concerns have been raised about how easily firms will be able to implement the necessary changes in time. It's a huge task that includes updating employment contracts and HR policies, such as disciplinary procedures. All employees will need to be made aware of the new conduct rules and of the consequences of their failing to comply with them.

WHAT CHANGES ARE COMING?

The extension will introduce a number of new concepts to increase individual accountability within insurers. These include the introduction of new senior management functions (SMFs) to replace existing senior insurance manager functions. There will also be a revised set of prescribed responsibilities that must be allocated among a firm's SMF population.

Individuals in SMF roles will need PRA or FCA approval before they start. As part of the application process, large insurers will be required to submit a management responsibilities map (MRM) replacing the current governance map. Alongside this will be statements of responsibilities (SoRs) for individuals in SMF roles. This is intended to provide greater transparency, making it easier to identify those who are responsible for every business function and activity of the relevant firm.

It's important to note the extra-territorial implications of the regime - SoRs must be produced for senior managers working overseas. How overseas SMFs fit within the overall governance structure of an entity that falls within the scope of the new regime should be reflected in MRMs.

The FCA has proposed introducing new SMF classifications for: executive director (SMF3), compliance oversight (SMF16), money laundering reporting (SMF17), and other overall responsibility (SMF18). New PRA-proposed functions set out in CP8/17 include: head of key business area (SMF6) and chief operations function (SMF24).

The FCA highlighted that banks found SMF18 one of the more difficult areas to implement. It emphasised that firms need to consider carefully their business model in order to identify all relevant functions. The FCA has provided some general business areas as a guideline, but each firm will need to consider which areas are appropriate. This could trigger significant changes in documentation, particularly when it comes to the MRM.

As the 10 December deadline looms, we are beginning to see our insurance clients remobilising their SIMR project teams, assigning responsibility for implementation of the enhanced requirements under SMCR to an appropriate individual, and preparing their implementation plans.

As insurers make progress towards implementation we would expect them to carry out an assessment of the impact that the changes will have on a firm's functions and processes; starting to map changes that are needed to meet the enhanced SMCR requirements, particularly employee processes; and engaging senior management to make them familiar with the new SMCR requirements so that the transition process is a smooth one.

CERTIFICATION REGIME

A key challenge for insurers will be applying the certification regime, which puts the onus squarely on firms to certify annually that individuals in key roles are "fit and proper". This replaces regulatory pre-approval under APER principles. This element created significant challenges when first rolled out to banks in 2016 – and insurers should not underestimate this.

A firm's certification population is proposed to include material risk-takers (MRTs), key function holders (KFHs), and employees who are not SMFs but whose role means it is possible for them to cause significant harm to the firm or its customers. Identifying those employees who are MRTs or could cause "significant harm" requires judgement. Helpfully, an insurer's MRT population is defined under Solvency II requirements. Complying with

The implications of the extension of the SMCR are at the forefront of insurers' minds as they look to key 2018 regulatory changes

the proposed certification requirements will require firms to establish new processes and implement changes throughout the employee lifecycle.

Firms must also take account of the extra-territorial reach of the SMCR. It may bring overseas employees within the scope of the regime. Of particular note are individuals based outside the UK who deal with UK customers or have certified employees reporting directly to them.

Those banks that implemented the certification regime most effectively had active engagement throughout from both their HR and compliance functions.

CONDUCT RULE APPLICATION

The SMCR introduces a set of new conduct rules to replace existing APER principles and applies them to a broader population. These rules are currently in force for banking firms and apply to all employees, with the exception of those in ancillary roles. The extension of the conduct rules also introduces new regulatory notification requirements for firms in respect of breaches to these rules.

To comply with the proposals, insurers will need to determine what constitutes a conduct rule breach and have systems and processes for monitoring and reporting breaches. Banks have found developing and delivering training to be comparatively straightforward. The more complex area is calibration of existing material. Banks are still working through the definition of internal breaches versus regulatory disclosure breaches, particularly where overseas staff are concerned.

The desire for a transparent and well-governed process has led several banks to establish a conduct committee for management to review and consider potential conduct breaches and conduct management information requirements, reporting and governance arrangements.

Relevant employees will need to be aware of and trained on the new conduct rules, understand how they apply to their role, and know the consequences of failing to comply with them. Insurers will likely need to update relevant HR policies, including their disciplinary procedures.

A CONSISTENT APPROACH

The new duty of responsibility will enable the PRA and FCA to hold senior managers in insurance firms accountable if a breach of a regulatory requirement takes place in an area for which they have responsibility. To support senior managers and promote a consistent approach, many banks (to which this duty already applies) have set out the "reasonable steps" they expect of senior managers so they can provide evidence that demonstrates they are discharging their responsibilities.

The impact and implications of the extension of the SMCR are at the forefront of insurers' minds as they look to key regulatory changes taking place in 2018. A number of our insurance clients have responded formally to the transitional proposals outlined in FCA 17/41 and PRA CP28/17, sharing both experiences and perspectives following the initial implementation of the SIMR – but also highlighting their concerns and suggestions for possible improvements to the regulators' proposals. These consultations closed on 21 February 2018 and final rules are expected in the second half of 2018. ●


Managers **Rebecca Walsh** and **Carolina Samson,** FS Risk Advisory, Deloitte

GRUNDINI/IKON

DATA MANAGEMENT

Five years after data compliance requirement BCBS 239 was introduced, **Rob Konowalchuk** investigates what's changed and where banks are heading

Just over five years ago, a document hit our reading lists from the Basel Committee on Banking Supervision (BCBS), which triggered a renewed industry in data management programmes in banks.

By that point, we were used to reading new rules overhauling banks' capital and liquidity requirements. But this one was different. It began: "One of the most significant lessons learned from the global financial crisis that began in 2007 was that banks' information technology (IT) and data architectures were inadequate to support the broad management of financial risks." The document then defined 11 principles aimed at banks' governance over infrastructure supporting risk data, risk data aggregation capability and reporting practices.

Five years is typically sufficient to implement a new regulation, so it is reasonable to ask: are banks conforming and has BCBS 239 been a success? This is difficult to answer.

DIFFERENT APPROACH

Firstly, compliance with principles is harder to judge compared to more concrete rules. But also, success can be judged on multiple levels. If the question is whether all global systemically important banks (G-SIBs) meet the requirements fully, then the answer is no. As of the BCBS's last update (albeit a year ago now), only one G-SIB complied by the January 2016 deadline and many banks reported a good two or three years to run to be fully compliant.

But perhaps we should also ask the following questions: has BCBS 239 caused banks to dramatically rethink their approach to data management? Have the principles become the de facto standard for managing data across the whole bank - not just the risk organisation? Have banks begun to see more engagement with their data and between functional areas, between the business and IT, and with their regulators? Has BCBS 239 triggered a more prominent role for the chief data officer in banks? The answer is a resounding yes.

No other missive from the Basel Committee has become so universally known by its code name as BCBS 239 has. People outside the arcane world of banking regulation throw the term around in many different contexts. This is not just because it remains an area where banks are battling to comply, or because of the ever-heightening risk that IT resilience poses to banks (as cited by the European Banking Authority in its latest roundup of risks facing the sector in the EU). It is because it has become a trigger for large-scale, strategic investment in data architecture as a valuable asset to banks.

On its own, data is useless. So all the investment in high quality data (and data models) is futile if it is not organised correctly, understood and put to good use. By the same token, without getting the hygiene factors right, banks would not stand a chance of creating timely and insightful information with which to make important decisions.

BECOMING COMPLIANT

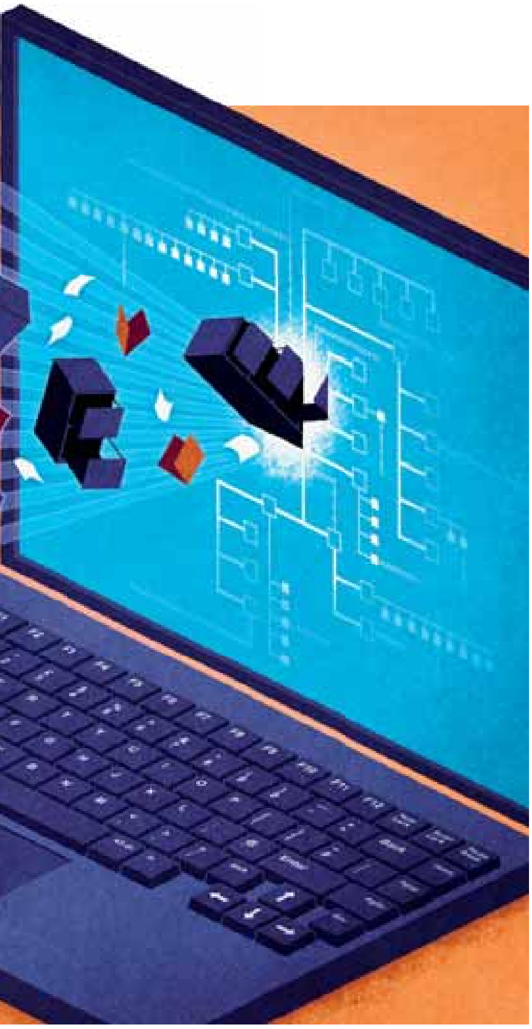
One of the trends that BCBS 239 sparked was the rise (or creation) of the chief data officer within banks. This C-level prominence reflects the strategic nature of the issues at hand. Most large banks have a well-defined data strategy. Executing such a strategy is not a one-off project, but an ongoing job. As the business changes (new products, new rules, new processes, new technology), data management must adapt.

Data strategies break down silos as data integration is a key aspect of the target architecture and therefore how disparate people and teams interact with data. The classic risk and finance divide features heavily here, but so does the integration of operational data and market data for example.

Beneath this, efforts are still ongoing to strengthen data governance. Data stewards are clearly identified all the way back in the lineage, data quality tooling is improving in robustness and usability, and upstream data owners have much more business context for their data.

Another finding of the BCBS report a year ago, which still rings true today, is an incomplete integration of data management with banks' wider business architecture and strategy. In this context, architecture refers to all of the systems, processes, policies and standards, as well as people and culture to support business capabilities. Data is the bloodline of the business but cannot run smoothly without all these other elements.

Banks are acutely aware of this, and are investing in tooling to form a more holistic view of how data management fits in with this wider context. The last item in the list above - people and culture - must not be overlooked. Systems and models can do so much with data. But it is people who



GETTY

Robotics is already a proven concept and widely put to use in banks – more in operational areas than in risk and finance

engage with it. Banks that have adopted a 'know your data' culture are maximising value from their investment in data management.

GAME CHANGING

As with most game-changing regulations, the first struggle is to comply on time – in whatever tactical way feasible. Once that is in a steady state, one can think about a more sustainable and strategic approach. At least, that has been the case for the vast amount of regulation unleashed in the past decade.

While many banks may not be officially classified as "fully BCBS 239 compliant", many have pressed ahead with more strategic and innovative methods of managing data.

This does not always involve the use of new technology still in proof-of-concept, but often better use of tried and tested technologies. Enterprise-wide information management programmes have been inspired by BCBS 239 concepts, involving the cataloguing and definition of key reporting metrics, their aggregation and calculation logic, their component data elements and corresponding lineage and ownership. Similarly, while BCBS 239 is ostensibly about risk data (and some finance data by extension), other critical banking functional areas are now investing in more robust and business-centric approaches to data. Treasury functions are redefining their logical data models and business architecture for critical aspects of liquidity and interest rate management.

Consolidated data layers for risk, finance and regulatory data are nothing new, and many banks have had this in development or in place for a while. However, many of these banks are now developing new, more automated reporting platforms to realise the benefits of having all their cleansed and standardised data in one place.

In parallel to this, there is large-scale investment in more exploratory and innovative ways of doing things.

The BCBS's 2017 progress report cites "over-reliance on manual processes" as a main finding. Process excellence teams have a refreshed mandate to drive efficiency and cut costs. Robotics solutions are emerging as a highly effective, yet practical approach. Robotic process automation enables repetitive tasks to be automated, while machine learning enabled intelligent process automation allows robots to take over complex and highly skilled tasks. These approaches will effect data management.

FINDING SOLUTIONS

Robotics is already a proven concept and widely put to use in banks – more in operational areas than in risk and finance. More experimental are the data innovation labs and data science teams in place at most large banks. These teams are identifying potential use cases for machine learning and natural language processing, for example, including the performance of critical risk data aggregation and reporting tasks.

Above all, banks are in business to serve customers. Banks' annual reports detail high amounts of investment in mandatory regulatory change and remediation; and improving the customer experience, typically through investing in new digital channels. This means that there is a risk that investment in risk and finance infrastructure may be de-emphasised. Leading banks recognise that, come budget time, these decisions are not mutually exclusive.

BCBS 239 has undoubtedly driven many demonstratable improvements in banks. But, there is much more to do on data integration, engaging the business around data, prioritising investment in infrastructure amid other firefighting or headline-grabbing initiatives, while investing in innovative solutions to future-proof the business.

Returning to the question of whether BCBS 239 has been a success: it is clear that managing data in banks is an evolving journey, bringing new challenges and innovation opportunities. Perhaps the question to address should be: when banks' use of data is undergoing such profound change, is 'fully compliant' really an end-state that will be realised anytime soon? Or should application of the principles and adapting practices to business and technological change be viewed as an on going process, with material benefits realised along the way? ●

Rob Konowalchuk,
partner, Avantage Reply

LET'S TALK ABOUT PRIIPS

With an industry at odds over PRIIPS, Steve Hardwick cuts through the noise

January's introduction of new European rules covering PRIIPs – packaged retail and insurance-based investment products – caused a huge storm, sparking a barrage of criticisms.

Trade bodies and senior fund industry veterans accused European regulators, including the UK's Financial Conduct Authority (FCA), of enforcing "the worst piece of financial regulation ever in Europe", and in the process committing an "absolute dereliction of the duty of care" to consumers.

The new regulation certainly presents the industry with significant challenges. However, now seems like an opportune moment to take a step back to revisit the reasons behind the introduction of the new PRIIPs Regulation, the role played by investment product providers themselves in the process, and how best to respond to an updated regulation that, while imperfect, is not going to go away any time soon.

WHAT ARE PRIIPS?

Despite their potential benefits for retail investors, PRIIPs are often complicated and lacking in transparency. The information that institutions make available to investors when selling these products can be overly complex. They often contain too much jargon and can be difficult to use for comparisons between different investment products. Since institutions selling these products also frequently play a role in advising investors, conflicts of interest may arise producing advice that may not be in the investor's best interests.

In order to tackle these shortcomings, the EU adopted a regulation on PRIIPs, which has applied since 1 January 2018 and is aimed at helping retail investors better understand and compare the key features, risks, performance scenarios and costs of different products through a short, standardised, consumer-friendly Key Information Document (KID). The KID is required to be accurate, fair, clear and not misleading. How information in the KID should be calculated is set out in the PRIIPs Regulatory Technical Standards (RTS).

In developing the draft RTS, the European Supervisory Authorities (ESAs) very specifically sought to reflect evidence from targeted consumer testing on the challenges faced by retail investors in using, understanding and comparing information on investment products, including in particular information on the risks, rewards (performance) and costs of these products.

A study was conducted with the European Commission, working in collaboration with the ESAs, which showed that simpler presentations of information (such as different ways of showing risks, rewards and costs) were in general terms more effective for retail investors. Notably, this included a simple risk indicator with a single risk scale with a limited number (seven) of discrete 'buckets', a tabular presentation of reward or performance information, and tabular presentations of cost information.

CONTENTION

As part of the new regulation, fund managers are required to use their past performance data to compile a series of 'indications' of how their fund might perform in four different market scenarios – stressed, unfavourable, moderate and favourable.

The performance scenarios assume continued performance of a similar level to exceptionally strong returns of global markets in sterling terms seen over the past five years – with even unfavourable scenarios producing positive annualised returns for the next five years. In many cases, only the 'stress' scenario suggests investors may lose money after their recommended holding period, while calculations for a 'moderate' performance scenario often suggest returns greater than 10% per annum.

Investment managers, critical of the changes to disclosure rules, have said that they could increase the risk of fund mis-selling. Intended to make it easier for potential investors to compare like-with-like, they have warned that a move to risk rating and performance illustration based on recent market performance could badly mislead buyers on future prospects.

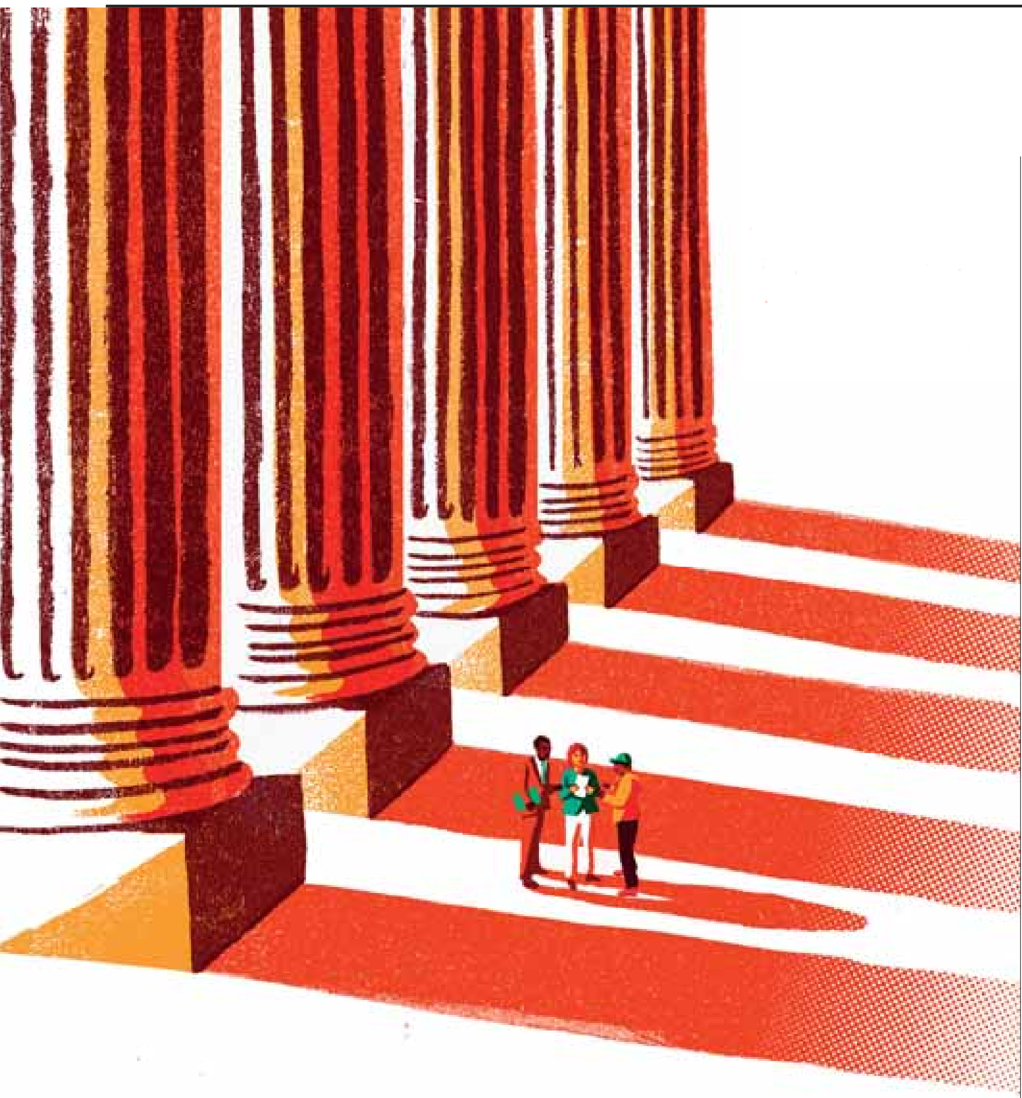
Retail investors have also highlighted the contradiction here, having been warned in the past not to rely on past performance. The FCA's own Conduct of Business handbook calls for investors to get "prominent warnings" to this effect. The disclaimer has been Lesson No.1 of mutual fund regulation since the early 2000s, when the US Securities and Exchange Commission enacted it in response to funds enthusiastically marketed on very good recent past performance during the first internet-stocks boom.

The issue of cost disclosure has also been flagged as an area of concern, as costs in the sector are calculated in an inconsistent way. While some trusts include stamp duty in the costs, others exclude finance costs or performance fees, and some estimates of transaction costs show significant differences.

CONCERNS

The FCA has intervened in the row over the use of performance scenarios in key information documents by publishing a statement a few days later expressing its understanding that some firms are concerned that the 'performance scenario' information required in the KID may appear too optimistic and so has the potential to mislead consumers. The FCA listed a number of reasons for this: the strong past performance of certain markets, the way the calculations in the RTS must be carried out, or calculation errors.

As a result, the regulator stated that, where a PRIIP manufacturer is concerned, performance scenarios in their KID are too optimistic, such that they mislead investors, they would be comfortable with them providing explanatory materials to put the calculation in context and to set out their concerns for investors to consider.



DANIEL HASKETT/IKON

In my view, the KID is very good at identifying differences in performance and differences in cost

The rapid turnaround and 'pragmatic approach to the industry's concerns' was welcomed by the Association of Investment Companies. However, the response from others has been more muted, with some critics expressing concern that investors could still be confused as accompanying explanations of misleading data may not be noticed or understood.

In defence of the PRIIPs rules, EU regulators might also argue exact forecasting is not the point. The purpose is to give an indication, so consumers can compare one fund's likely risks and rewards to another. In my view, the KID is very good at identifying differences in performance and differences in cost. And providing investors with such insight can never be a bad thing.

It is also worth highlighting that the majority of responders to an initial consultation on PRIIPs, especially those representing the investment fund or banking industries, actually expressed a preference for estimates of return distributions to be based upon the distribution of returns directly obtained from historical data, which are also shown in KIIDs for UCITS (mutual funds). Most respondents from the insurance industry, meanwhile, favoured the application of stochastic modelling based on parameters estimated from historical data.

IMPERFECT SOLUTION

In addition to the risk of legal action for mis-selling, the challenges of producing PRIIPs KIDs will be even greater than for UCITS KIIDs. Data issues, such as risks, returns and costs, being forward-looking rather than looking at just historical performance and additional disclosures at product and fund level will make life considerably more difficult for asset managers, while production is also a challenge.

Gathering such a huge set of data for an array of funds has put significant strain on firms, increased by the calculations needed and also by the design of some products. Most firms will benefit from automating their production and approvals process for marketing documents and financial promotions, which can make a huge difference when it comes to saving time, increasing efficiency, reducing costs and minimising potential compliance breaches. Given all these challenges, many more PRIIPs manufacturers are turning to third-party providers to take away this complex process from already stretched internal resources.

In spite of the efforts of the ESAs, there is no one-size-fits-all perfect solution and product manufacturers, consumer bodies and others were given plenty of opportunity to comment. And while any hopes Brexit might rescue UK funds from this EU rule are misplaced, some respite may come from a review, scheduled for 31 December 2018. This will see the European Commission investigate the practical impact of the new regulations and, crucially, may also offer the industry another opportunity to participate in and influence any related consultation process. ●

Steve Hardwick,
director at Willis Towers Watson

TECHNICAL DIRECTORY

A roundup of the latest regulatory news and bulletins of interest to the financial services sector

BANKING

PS18/5: POWERS IN RELATION TO LIBOR CONTRIBUTIONS

14 March 2018

This Policy Statement sets the approach, criteria and methodology that the Financial Conduct Authority (FCA) proposes to apply if it needed to use powers to compel banks to contribute to Libor. These are based on responses to the FCA's proposals in *CP17/15: Powers in relation to Libor contributors* (PDF), and on the results of the data gathering exercise it carried out in parallel. The policy statement provides feedback on the responses, and it describes the results of the data gathering.

tinyurl.com/FS-LIBC

INSURANCE

PS18/1: INSURANCE DISTRIBUTION DIRECTIVE IMPLEMENTATION – FEEDBACK AND NEAR-FINAL RULES TO CP17/33 AND OTHER IDD CONSULTATIONS

2 February 2018

This is the FCA's third policy statement setting out near-final rules for the implementation of the Insurance Distribution Directive (IDD).

This policy statement responds to the feedback the FCA received to CP17/33, as well as feedback on certain matters deferred from CP17/23 (the second CP), and feedback to the IDD-related aspects of two quarterly consultation papers (CP17/32 and CP17/39).

tinyurl.com/FS-FCAPS1

SS35/15: STRENGTHENING INDIVIDUAL ACCOUNTABILITY IN INSURANCE (UPDATE)

7 February 2018

The Prudential Regulation Authority (PRA) has issued an update to SS35/15, aimed at UK Solvency II insurance firms, third country insurance branches within the scope of the PRA rules on Solvency II, and the Society of Lloyd's and managing agents.

The statement takes effect from 10 December 2018, when the extension of the Senior Managers and Certification Regime for insurers commences.

tinyurl.com/FS-BOE3

GENERAL

FCA SETS OUT APPROACH TO SUPERVISION AND ENFORCEMENT

21 March 2018

The *Approach to Supervision* shows how the FCA aims to be more forward-looking and pre-emptive in its supervision of firms. Firms' strategies and cultures are at the root cause of most major failings. *Supervision's* proactive engagement with firms will focus on business models and the drivers of behaviour in firms.

The *Approach to Enforcement* outlines how the FCA conducts investigations and its powers. It also shows how enforcement sets out to achieve fair and just outcomes in response to misconduct and to ensure FCA rules and requirements are obeyed.

Both approach documents are open for consultation until 21 June 2018. The final approach documents will be published later this year.

tinyurl.com/FS-FCASUEN

PS18/4: CREDIT CARD MARKET STUDY: PERSISTENT DEBT AND EARLIER INTERVENTION – FEEDBACK TO CP17/43 AND FINAL RULES

28 March 2018

This policy statement responds to the feedback the FCA received to CP17/43, which sought views on measures to address persistent credit card debt and to require credit card firms to use the data available to them to identify customers at risk of financial difficulties and take appropriate steps.

tinyurl.com/FS-FCACMS

FCA PUBLISHES DISCUSSION PAPER ON TRANSFORMING CULTURE IN FINANCIAL SERVICES

19 March 2018

The FCA has published a discussion paper on transforming culture in financial services, which presents views from academics and industry thought leaders.

The paper is intended to provide a basis for stimulating further debate on transforming culture in the sector. The paper is a set of essays that discuss what a good culture might look like, the role of regulation and regulators, how firms might go beyond incentives, and how to change behaviour for the better.

tinyurl.com/FS-FCAESSAYS

TPR AND FCA JOINT STRATEGY CONSULTATION

19 March 2018

The FCA and The Pensions Regulator are working in tandem to address risks and harms in the pensions and retirement income sector.

They have been working jointly on their pensions strategies, which aim to clarify how they work together generally. They also outline how they will work over the next five to 10 years to tackle the risks they see facing the pensions industry.

Further information, including details on how to respond, can be found in the document below.

tinyurl.com/FS-PENS1 ●


RENAULT
Passion for life
Renault KADJAR
Crossover by Renault
KADJAR
Panoramic sunroof*
Leather upholstery with front heated seats‡
Hands free parking with rear parking camera†
To book your test drive, call the
Renault Business Hub on 0800 731 7066
The official fuel consumption figures in mpg (l/100km) for the Renault KADJAR Signature S Nav dCi 110 are: Urban 67.3 (4.2); Extra Urban 74.3 (3.8); Combined 72.4 (3.9). The official CO_2 emissions are 103g/km. Figures are obtained for comparative purposes in accordance with EU Legislation and may not reflect real life driving results.
*Standard from Signature Nav. ‡Standard on Signature S Nav. Part leather, synthetic leather on the sides. †Standard on Signature S Nav.

PEOPLE IN FOCUS

NEW CHAIRMAN FOR BROKERS' ASSOCIATION

Roy White has been appointed as chairman of the London & International Insurance Brokers' Association. White is also chairman of UK specialties at Marsh. During his chairmanship, he expects to focus on the increasing digitalisation of insurance and Brexit.

RISK COMMITTEE APPOINTMENT FOR NEW NOMURA NED

Asia global investment bank Nomura has appointed Neeta Atkar as non-executive chairman for Nomura Europe. She will also become chair of Nomura's risk committees, pending regulatory approval. Ms Aktar holds other NED positions with the likes of the British Bank Board Risk Committee and Yorkshire Building Society. She will be giving oversight on "risk appetite, management and exposure, and advising on the firm's current and future potential risk tolerance". This brings women's representation on the Nomura board up to 30% for the first time.

NEW BOSS FOR HSBC PROPERTY

HSBC Alternative Investments Limited (HAIL) has appointed Tim Williams as its new head of real estate investment. Williams joins to strengthen direct property investment capabilities. He was previously at CBRE, the world's largest real estate adviser.

KIMBER IS NEW CHIEF RISK OFFICER AT AON

Former JLT head of risk and compliance Matt Kimber has joined Aon UK as its new chief risk officer. Subject to regulatory approval, Kimber replaces interim CRO John Nicholson, who held the post for 11 months. Kimber has 20 years' experience, and has worked for the likes of Marsh, HBOS and Lloyds Plc. He reports to Julie Page, Aon UK CEO.

HSB ENGINEERING INSURANCE

Two new non-executive directors have joined the board of HSB Engineering Insurance, part of Munich Re.

Jeff Herdman is the new chairman of the board. He is former managing director at Oval Group, with 35 years' experience, and also has a non-executive role with Swansea Building Society. Craig Scarr, who has 32 years' experience, has responsibility for the finance, audit and risk committee.

5 MINUTES WITH...

HAGER JEMEL, ASSOCIATE PROFESSOR AT BUSINESS SCHOOL EDHEC

WHY DID YOU CONDUCT A DIVERSITY AND INCLUSION STUDY, AND WHO PARTICIPATED?

Our aims were to evaluate how employees judge their organisations in terms of diversity, gender equality and climate of inclusion, and to identify the links between diversity, inclusion, leadership and performance.

There were 767 participants online, the majority of whom were in management and worked for large companies across Europe.

WHAT ARE THE KEY FINDINGS?

The overall finding is that in order to improve diversity and inclusion, companies

WHO'S WHO?

After an explosive election and months of political wrangling, Germany's Christian Democrats (CDU) and Social Democrats (SPD) have cobbled together a grand coalition.

Angela Merkel takes the reins in her fourth term as chancellor. But with a worse than expected election result and radical outsiders gaining ground, commentators expect this to be her last. The CDU remains Germany's dominant party, but who will lead it come the next election in 2021 is less certain.

As Angela Merkel's possible successors jostle for pole position, *FS Focus* profiles the runners and riders.

ANNEGRET KRAMP-KARRENBAUER

Promoted to general secretary of the CDU at the beginning of 2018, the former minister-president of Saarland is now in prime position to succeed Merkel as chancellor. Kramp-Karrenbauer has carved out a career as a firm centrist; appeasing the left of her party with a labour-friendly approach to economics, while at the same time endearing herself to the right by adopting socially conservative stances on issues like gay marriage. Dubbed "mini-Merkel" by the German press, Kramp-Karrenbauer would be a continuity choice for Germany and Europe.

URSULA VON DER LEYEN

Also tipped for the top in CDU circles is long-serving minister Von der Leyen (pictured, left). Having headed up departments for family, labour and, since 2013, defence (where she was the first female minister to hold the post), need to put leadership at the heart of their diversity policies because it is not simply matters of gender, age or background, but about how power is represented and practised.

The research also uncovered an interesting dichotomy. Although there is a positive relationship between leadership, diversity, inclusion and performance, the overall image that people have of a good leader is quite traditional and not very open to the traits of a diverse leader.

Organisations that overcome stereotypes about leadership and have leaders who behave inclusively are also likely to fuel better performance from staff.

HOW WOULD CHANGING THE BEHAVIOUR OF LEADERS IMPROVE DIVERSITY IN THE WORKPLACE?

It's important to note that in order to improve diversity and inclusion, we need to have both a change in leadership representation and also behaviour.

Our study shows that the attributes of a good leader remain closely associated with "masculinity", and therefore excludes women and minority groups. This issue clearly needs to be addressed.

By adopting inclusive behaviours – caring for individuals and valuing their uniqueness and differences, being fair and building a sense of community – it would foster diversity and a climate of inclusion.

WHAT CHARACTERISTICS SHOULD THE IDEAL LEADER HAVE?

In the collective imagination, the leader figure continues to be perceived as a hero who makes decisions with authority, is willing to take risks, and can save the day and convince everyone, thanks to his or her charisma alone.

However, the effective leader is someone who has the ability to motivate and rally a group of people without having to rely on his or her status or hierarchical position and without having to use means such as constraint or authority.

Generally, among the most effective leadership behaviours are: valuing differences, participative decision-making and sensitivity to other's needs.

The effective leader has the ability to motivate and rally people without having to rely on his or her status

WHAT MORE CAN COMPANIES DO TO IMPROVE DIVERSITY?

Our results show that female respondents judged their companies as being less egalitarian than their male counterparts, with scores, on average of 4.1/10 and 6.8/10, respectively.

The highest levels of progress on diversity are observed when managers become directly involved in problem-solving, work directly with diverse teams and are encouraged to be transparent about decisions made.

WHAT ARE YOUR THOUGHTS ON THE GENDER PAY GAP?

Obviously, it's totally unacceptable that men still earn more than women at most companies. It's essential to highlight and condemn it.

More importantly, the gender pay gap seems to be narrowing very slowly, and if no significant action is taken by companies, this situation will persist for a long time ahead.

If companies really want to progress in terms of equality and diversity, they have to put the gender pay gap at the top of their priorities for ethical and performance reasons.

WHAT ADVICE WOULD YOU GIVE TO SMALLER FIRMS AND START-UPS ON DIVERSITY IN THE WORKPLACE?

Prevention is better than cure. So we recommend that start-ups move quickly to establish an inclusive leadership model and culture in the company.

We believe that to do this it's very important that the CEO demonstrates an important commitment and exemplarity.

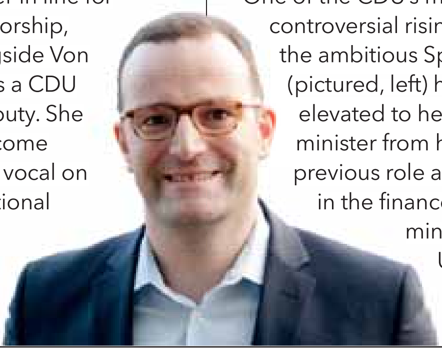
---

the former doctor was a long-time leadership favourite until the turbulence of 2017's election heralded a flood of new contenders. Contrasting with Merkel's caution, Von der Leyen is more outspoken – she has been bullish on Brexit and appears to favour more European integration – but she remains a popular figure and a party frontrunner.

JULIA KLÖCKNER

A former journalist and Wine Queen, Klöckner has been appointed the new minister for agriculture. She lacks the national profile of other candidates for CDU leader, having headed up the party in Rhineland-Palatinate in the last two elections.

However, Klöckner's behind the scenes manoeuvring could put her in line for the chancellorship, sitting alongside Von der Leyen as a CDU national deputy. She has also become increasingly vocal on issues of national policy like asylum for refugees and balancing the budget. Now, membership of Merkel's inner circle may provide her with a springboard onto the global stage.



JENS SPAHN

One of the CDU's more controversial rising stars, the ambitious Spahn (pictured, left) has been elevated to health minister from his previous role as deputy in the finance ministry. Unlike other favourites, Spahn's surge to prominence marks a break from the past. He favours a tighter monetary policy and has set himself up as a standard-bearer of the CDU right, with attacks on Merkel over Germany's stance on refugees. Spahn is also openly gay and a Catholic, thus marking a substantial shift in personnel for the CDU.

Nevertheless, his growing profile and support from certain sections within the party could set up a climactic succession battle with more moderate rivals.

CPD

APP-ROPRIATE OFFICE SPACE

From in-office apps to standup desks, Thomas Lawrence assesses how firms can manage their office space better

The modern office is changing. Characterless cubicles are out while fun and flexibility are in. But is the trajectory quite so simple?

Gone are the days when employees would slouch into a chair, grind through emails and paperwork then slope off after a day of sedentary submissiveness. Giuseppe Boscherini, a partner at Knight Frank Strategic Consulting, says a new understanding of office design is required, "tailored to suit employees' real-time changing needs."

Employees and employers alike are recognising the value of a multifaceted approach, allowing workers to combine conventional ways of working with dynamic new methods.

At a time when British workers are some of the least productive in Europe, rejuvenating office space could hold the key to competitiveness. According to a 2015 Gallup survey, 70% of office workers considered themselves disengaged and uninspired. Meanwhile, the What Workers Want survey revealed 53% of employees believed an "ideal" office environment would boost their workrate.

However, businesses have to be careful not to go too far. Abolishing desks and installing a slide won't instantaneously create that elusive ideal, and may well end up taking things too far the other way.

The What Workers Want Study also found 60% of employees wanted a dedicated workspace, while the percentage that prefer working from home is falling. Meanwhile, hot-desking was favoured by only 4% of those surveyed. Data from Gensler suggests adequate privacy provisions are actually crucial to business success.

Staff seen as "innovators" are five times more likely to have access to a private space than their less creative colleagues. Though, a similar YouGov sample showed only 30% were satisfied with provisions for this space in their companies.

Wendy Spreenberg is founder and president of workspace consultancy YES! Your Exceptional Space, advising firms across North America on how to optimise their office environment. She argues that communication is crucial to ensure you're meeting workers' needs rather than getting suckered into the latest fad. "Involve potential users from the very beginning of the redesign process. It reduces anxiety, increases acceptance and you'll avoid costly 'cool stuff' that never gets used."

There's a lot of baseless hype around office tech, but some of the trends are undeniably exciting. These could completely revolutionise the way

THE BIG IDEA

MORTGAGE TIME BOMB

Dipak Vashi assesses the risks of interest only mortgages

What is the easiest way to take advantage of a property market that (you believe) is certain to continue to rise? Well, if you asked this question in the mid-late 1990s, the answer would almost certainly be an interest-only mortgage.

However, as the world so painfully discovered in 2007, the party often does not continue and house prices came crashing down, leaving the most indebted and at-risk borrowers vulnerable to being evicted from their homes if they did not find a method of paying off the loan.

Interest-only mortgages allow the borrower to pay off the interest element of their mortgage only, rather than any of the loan amount borrowed, before paying off the entire loan amount at the end of the mortgage term. This allowed borrowers to maximise their borrowing capacity to buy that dream home, with some borrowing up to 120% of the purchased home's value.

New issuance of the products has now become extremely rare, with only 2.8% of new mortgages approved in 2017 being interest-only (compared with 30% in 2007), and with these mortgages normally being extended to the wealthy. This is due to lenders clamping down on the form of borrowing after the financial crisis as they tightened their belts after years of generous lending.

The Financial Conduct Authority (FCA) described the current situation in the

There is a wider concern that borrowers are burying their head in the sand regarding the issue

There's a lot of baseless hype around office tech, but some of the trends are undeniably exciting

employees work. "Specific workplace experience apps have recently emerged to record, manage and provide feedback on the availability of amenities and services, within and beyond the office environment, that afford employees a better workplace experience," says Boscherini.

From room-booking to food-ordering, Spreenberg echoes this anticipation of an app-based future. "Robust AI allowing for auto check-in capabilities via smartphone is really helpful. This trend will continue to grow, enabling seamless use and management of shared workspaces." With co-working giant WeWork's app encompassing everything from community manager appointments to food ordering, world-class offices are as much concerned with digital presence as physical layout.

Nevertheless, companies shouldn't run before they can walk where office design is concerned. Getting the basics right can go a long way. Boscherini says air and light are two of the most important (yet overlooked) factors in designing a productivity-friendly office and Spreenberg urges options be made available for sitting, standing and soft relaxed seating.

Above all, the modern world means throwing out the rulebook as far as office design is concerned. "Workplace has broken away from rigid codified behavioural models and is adopting a more casual model," says Boscherini. Social media and coffee culture are giving offices a more "social character", making collective achievement the order of the day. Innovations like apps and private working can help, but don't let these means become ends in themselves. ●

market as a 'ticking time bomb' as hundreds of thousands of borrowers' loans come up for repayment in the next 14 years. Lenders will be worried about their interest-only loan books going into maturity as 20% of UK mortgages are interest-only, constituting a potentially huge part of lenders' balance sheets.

There is a wider concern that borrowers are burying their head in the sand regarding the issue, and have not made appropriate repayment plans. Lenders have, on the whole, attempted to contact interest-only borrowers to work with them on formulating a repayment plan, but report a 'significant number' are not responding to enquiries. This lack of engagement may be for a variety of reasons including naivety over the consequences of the lack of repayment, procrastination and a lack of understanding of the issue at hand.

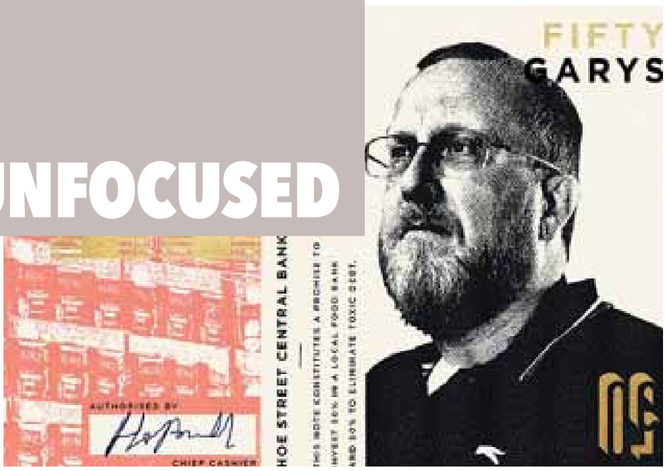
It has been highlighted that lenders have had some success in contacting borrowers, and many have converted interest-only loans to capital repayment products, but more can still be done. Lenders should begin contacting borrowers well in advance of the end of the term, for example up to 10 years before, to assess the borrower's intentions for repayment and whether moving them onto a different product may be more suitable. It is unreasonable to think all borrowers will have a repayment plan, or be able to stump up the loan amount at the end of term.

This is especially important due to the risks prevalent to the borrower if they fail in end-of-term repayment. There is a risk borrowers' homes could be repossessed to settle the outstanding debt if they do not engage with the lender, however this is a last resort in many cases. The FCA would prefer lenders explored forbearance options before moving into repossession measures.

Undoubtedly, lenders must carry some of the blame in the end of term process, with often lazy and chaotic processes in place. This includes lenders not communicating with borrowers as end of term approaches, or beginning litigation against them while both parties are still in repayment discussions.

However, it would be unfair to blame a possible impending disaster on the lenders. As mentioned, many borrowers are choosing to ignore attempted communication. To work through this, lenders should communicate in ways that are personal and relevant, engaging the borrower and working together on repayment options. By working together, this potentially explosive ticking time bomb can be safely diffused. ●

UNFOCUSED



THEY SAID IT... DO IT LIKE BANKSY

You've heard of HSBC... now there's HSCB. The Hoe Street Central Bank, to be precise, occupied a former bank in Walthamstow, north-east London, and was described by *The Guardian* as, "part art installation, part stunt and part charitable endeavour".

HSCB was set up by Hilary Powell and Dan Edelstyn to participate in the debt buy-back movement. The month-long project saw the "rebel bank" print its own money, which people exchanged for real cash to donate to four local causes.

The team also aimed to raise £1m to buy out the debts of people living in the E17 postcode area, which has a high poverty rate.

You can buy banknotes and see the project unfold online at bankjob.pictures

"In place of the Queen, leaders of the local food bank [such as Gary Nash, pictured left], homeless kitchen, youth project and primary school grace HSCB banknotes"
Says HSCB of its tender

"We are the forerunners of what we hope will be a bigger movement for debt abolition"
Hilary Powell explained HSCB to *The Guardian*

"Some talk. Some do! Proud to be associated with these 'crazy dancers' @BankJobPictures"
Supporters Indycube Community issue their praise on Twitter – where there was confusion over the acronym...

@jolataxi17
It's HSBC

@APHPaterson
Well, HSBC does indeed print the $HK and it depends how you define "rebel bank" – any views @n_wnicholas?

@n_wnicholas?
It's not HSBC!

@APHPaterson
indeed

PETER SEARLE

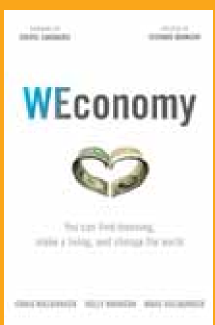
BOOK REVIEW

WEconomy: You Can Find Meaning, Make a Living, and Change the World

Craig Kielburger, Holly Branson, Marc Kielburger

Wiley
£28.99 in print

FS Focus rating:
★★★☆☆



BETTER TOGETHER

Doing good in society doesn't have to be restricted to high-net-worth individuals. As the authors of this book explain, anyone who has a purpose has the power to affect change, and even profit from the better world they help create.

Craig and Marc Kielburger and Holly Branson call this the "WEconomy", and were inspired by three prominent innovators – Oprah Winfrey, Richard Branson (Holly's father) and Jeff Skoll – who all founded companies for financial success and social impact on a massive scale. Sheryl Sandberg has written the foreword.

To help readers forge their own path, they share their advice on building new products, how to differentiate, how to inspire loyalty, how to break into new markets, boost the bottom line and move up the ranks in your company alongside the social cause you've identified. It is, as they say, a "roadmap for doing good and getting paid for it".

Three sections further split into bite-size chunks make for an easy read – although the opening section focuses a bit too much on the authors' personal motivations and could have put across the philosophy more succinctly. Parts two and three are where the really useful tips, 'how to', and step-by-step guides kick in.

There are crib sheets on understanding the differences between baby boomer, Generation X and Millennial motivations, and plenty of information aimed at corporate social responsibility teams/departments for really drilling into how to become even more purposeful.

For businesses and firms that are used to doing things in a traditional way but who are finding this approach has grown stale, this book offers a shot in the arm.

It would have had an extra star had it not largely focused on high-profile company examples. The book could have benefited from having more inspiring case studies like that of Sharmadean Reid's WAH Nails.

That said, the book is very persuasive, particularly in explaining how purpose appeals within HR, marketing and product team departments as well as for customers. Anyone sold on the idea will find an extensive list of ways to get started here.