Safety costs

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House prices, the FTSE and interest rates: 2011 predictions, p11

Yield search
Seeking returns in a low-interest environment, p20
REACH for the SKY!!!

The principals behind the 162 Group have a long record in creating shareholder value in over a dozen start up resource companies.

THE COMING MONTHS WILL SEE THREE NEW LISTINGS

A. Clontarf Energy, focused on oil in Africa and South America, AIM - Jan/Feb 2011
B. Botswana Diamonds, advanced stage diamond exploration in Botswana, Zimbabwe and Cameroon, AIM January 2011
C. Swala Resources, gold exploration, listing in Toronto, TSX-V - June 2011

The existing stable includes Connemara Mining (CON.L), with a zinc discovery in Ireland, Petrel Resources (PET.L) focused on Iraq, and African Diamonds (AFD.L) being sold to the Lundin Group.

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or email info@162group.com

www.connemaramining.com
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Essential Compliance Updates for 2011

Friday 28th January 2011
10:00 - 15:00
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Goodacre UK announces the launch of a series of compliance seminars for the Securities Industry over the next 12 months. These seminars involve leading compliance and regulatory experts and are the best way of maintaining your understanding on developments.

Each seminar will provide attendees with a platform to consider relevant compliance and regulatory issues that impact all sections of the business. The first of the series takes place on Friday 28th January.

This seminar will cover the following:

- General FSA Update and 11 Things
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- The US Hire Act
- MiFID Review
- Section 166 of FSMA & Enforcement
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For full details of this seminar and other financial and personal development training that Goodacre runs, please visit goodacreuk.com, email events@goodacreuk.com or call +44 (0)20 7422 0063

This City based seminar is being held in partnership with Barlow Lyde & Gilbert LLP.
The city’s critics have accused the investment management industry of acting like absentee landlords and have demanded a much higher level of engagement between investment managers and investee companies. The UK Stewardship Code, which was launched last summer, is intended to provide a framework for increased engagement, but the tenor of its recommendations may leave some feeling that, although its aims are worthy, it does not represent a radical departure from existing practice.

Although the CISI supports the Code, which we believe represents an acceptable compromise between the desirable and the achievable, it is worth considering its aim. This is defined as “to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance”.

While this is a worthy goal, it is questionable if it will be possible to measure, in an objective manner, whether or not the Code achieves this aim. Therefore, its purpose might be described more appropriately as being “for the public good”, or at least “for the good of the investing public”, which is most of us. We believe that there is nothing wrong with such an aim, which is in accord with the objectives of the CISI, provided that its limitations are understood. These limitations include some significant issues, such as the fact that overseas holders, who may feel no obligation to the idea of a stewardship code, own some 40% of UK shares, a figure that is likely to increase if recent trends continue. Additionally, with the irreversible rise of share trading as an end in itself, as opposed to equity investment in a company as an indication of faith in its long-term prospects, many shareholdings are extremely transitory in nature. In such cases the holder feels no obligation to engage with the company, indeed quite the reverse. Again, we do not believe that these are sufficiently compelling reasons to dismiss the Stewardship Code in its published form.

**There is nothing wrong with the Code’s goals, providing its limitations are understood**

**Achievable aims**

Those who press for change should give the UK Stewardship Code a chance

**CISI OPINION**

**THE CITY’S CRITICS** have accused the investment management industry of acting like absentee landlords and have demanded a much higher level of engagement between investment managers and investee companies. The UK Stewardship Code, which was launched last summer, is intended to provide a framework for increased engagement, but the tenor of its recommendations may leave some feeling that, although its aims are worthy, it does not represent a radical departure from existing practice.

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**European angle**

One of the arguments advanced by supporters of the Code is that there exists a significant constituency in Brussels, and even within the UK, that sees the answer to every perceived problem in more legislation. Brussels has already fired a warning shot in its green paper published in June 2010: “More generally, it raises questions about the effectiveness of corporate governance rules based on the effective control by shareholders. As a result of this situation, the Commission will launch a broader review covering listed companies in general.” Experience to date has shown that once Brussels focuses on a particular issue, even if its initial proposals are subsequently amended, the outcome is invariably achieved only after the expenditure of an enormous amount of time and energy and with a result that satisfies almost no one other than politicians.

Consequently, proponents of even greater levels of shareholder involvement should be reminded that the fundamental purpose of investment is to produce a return to the owners of capital commensurate with the risk accepted by them. They should be required to demonstrate consistently improved corporate performance resulting specifically from their proposals. In the meantime, it is up to those of us who support the Code to make sure that arguments in its favour do not go by default.
As a result of publication of a Final Notice from the FSA against CISI Affiliate member Sudipto Chattopadhay, he was invited to appear before a disciplinary panel for breaching membership regulations relating to the imposition of a penalty upon him by a regulatory body.

The panel took into account the nature of the cause for action by the regulator and its penalty and ordered that the member be reprimanded.

Dear S&IR,

James Gavin’s article ‘Paper Chase’ (November/December S&IR) was generally good, but there was reference to the CREST compromise towards the end stating that it was settling both dematerialised and paper-held shares. The CREST system cannot settle paper-held shares.

The article also suggested that full dematerialisation would remove paper from the system. The reality is that paper in circulation would increase, with annual statements, balance statements and statements to show zero balances if you sold your entire holding in a particular issuer.

Derek Young, Chartered MCSI, Technical Specialist, Market Infrastructure, FSA

Dear S&IR,

Surely the example of Lehman and others is enough to secure the right to possess a share certificate. The centralisation of banking has proved disastrous for individual bank customers, and it could be the same for share ownership. A collapse in the electronic paperless system wouldn’t matter to a shareholder who has physical stock – maybe there is an argument for a broking firm to be set up exclusively to deal with clients who want to have their shares actually delivered.

Robert J. Head, Chartered FCSI, Independent Corporate Finance Adviser, Punta Gorda, Florida, USA
Congratulations to Jim Herbert MCSI, the CISI’s oldest member, who celebrates his 100th birthday this month. Jim worked in the City for 74 years, not retiring as a stockbroker until his 89th birthday. He began his career as a 15-year-old office boy with a stockbroking firm in 1926, three years before the Wall Street Crash.

“I was greatly shocked by the Crash,” he recalled. “At 18 I saw grainy photographs of American millionaires throwing themselves out of office block windows. Such was the frenzied atmosphere in the City at the time that lift attendants clubbed together to buy small stakes in American companies.”

Jim said: “I was very ambitious and made quick progress in my career. I switched to another firm as an under-manager at 21 and, following a further move, became a member of the London Stock Exchange in 1941 at the age of 30. That was my proudest moment, and I was ultimately appointed Senior Partner of my company.”

Aged 60, Jim relinquished the partnership and moved on again. He spent his last two years prior to retirement with Hichens Harrison.

Jim, who lives in Bristol, has no doubt about the biggest change that he witnessed in financial services: the growth of technology. “In my early days, I watched the partners of the firm getting prices from a tape machine,” he said. “Just before I retired, I could get the prices in Tokyo and Wall Street at the press of a button - fantastic!”

The fondest memories of his career include big company flotations, such as BP, prior to ‘Big Bang’ in 1986. “They created havoc on the floor and a magnificent day’s trading,” he said. “Big Bang’ was a very sad day. We retreated to our offices, losing the eyeball-to-eyeball contact we all thoroughly enjoyed.”

Jim also clearly recalls 1974, an all-time low for the FTSE Index. “Stock Exchange members spent their time tossing coins for three-penny pieces on the trading floor!”

Jim retains a close interest in financial services, being kept up to date by Tony Jenkins, a friend with a proud family history in the sector.

“‘We are still undergoing a bumpy ride and I think there are still one or two horror stories to be revealed,’’ he said. “However, I feel 2011 will see the beginning of a genuine but slow recovery.”

Jim, whose wife Ruth died last year, has six children and keeps himself busy by supporting charities and through his avid interest in sport. “I love to watch sport, whether it’s on TV or being played locally. I’m a member of Keynsham Cricket Club and have just been in correspondence with Arsenal Football Club manager Arsene Wenger - I’ve been a fan of the club for 83 years!”

60-second interview

with: Hassan A. Jawad, Chartered FCSI, Chairman of the Muscat Securities Market (MSM), the Oman stock exchange

How important has the securities market become to Oman?

It has played a major role in Oman’s economy in recent years. Between 2002 and 2009, investor numbers increased from 17,000 to 320,000 and foreign participation within the sector rose from 14.4% to 22.7%. During that period, the ratio of market capitalisation to GDP jumped from 25.7% to 51.2%.

Can the market help reduce Oman’s reliance on oil revenues?

The majority of companies listed on the MSM are from non-oil sectors. The non-oil sectors’ contribution to revenue increased from 23.9% in 2006 to 32% in 2009.

What steps is Oman taking to improve transparency and disclosure?

Oman is considered the most transparent market in the Gulf region. Listed companies must publish quarterly financial statements, along with a report from the board of directors. Oman is the first country in the region that requires companies to publish a fully fledged corporate governance report, certified by the auditor, as part of its annual report. The capital markets regulator, the Capital Market Authority, has even instituted awards to recognise corporate governance excellence among Omani companies.

Will link-ups between Arab markets increase liquidity?

Companies can already list their shares in multiple markets. We are about to see a consolidation of exchanges in the United Arab Emirates, with the merger of the Dubai Financial Market and the Abu Dhabi Stock Exchange.
Top performers honoured

Twelve up-and-coming financial specialists have been recognised as Scotland’s top performers in CISI exams. They were honoured at the third Institute Scottish Awards Ceremony at Merchants’ Hall, Edinburgh. The awards were presented by Margaret Wallace FCSI, Managing Director and Head of Morgan Stanley’s Operations Division in Glasgow. The event was sponsored by SIX Telekurs UK. Last year, candidates in Scotland passed more than 1,500 CISI exams.

Roll of honour


1,611

The number of members of the CISI group on business networking site LinkedIn. To join, at linkedin.com, apply to the Chartered Institute for Securities & Investment (CISI) official members’ group, owner Richard Bennett

Support for spending review

Two-thirds of financial services players believe the Government Spending Review is good news for the UK economy, a CISI survey shows. Of respondents, 14% think that the impact of the review, which will cut £81bn from public spending over four years to tackle the UK budget deficit, will be strongly positive. A further 52% consider that the effect will, on balance, be positive. However, 34% say it will harm the country, with 10% of those concerned that the result will be strongly negative. One survey respondent said: “Interest payments of £120m per day? Whether the impact is positive or negative, failing to cut costs is not an option.” However, another warned: “It’s too little, too late.” Nearly 400 people took part in this CISI survey.

Survey

For details of how firms can support students taking the qualification, contact the CISI Educational Development team at educationdevelopment@cisi.org

Student Joe Hayes

Joe Hayes is among the first wave of candidates to take the Certificate for Introduction to Securities & Investment (Cert.ISI), a new CISI introductory qualification for school and college students. Here, Joe, a student at Chatham Grammar School for Boys in Chatham, Kent, gives his early impressions of the qualification:

“I had previously studied economics and am very interested in the financial services industry. I believe the Cert.ISI will give me a head start in the financial sector as City firms often ensure that graduates complete an element of this course on entering the industry. It will show that I am passionate about this industry and help to differentiate me from other applicants. In terms of classwork, I have enjoyed looking at the structure of the industry, considering such things as custodian banks and insurance companies.”

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Online

1 nakedcapitalism.com/2010

“This is Basel III?” bemoans Richard Smith. He notes that the new rules are silent on valuation – the capital ratios mean nothing if the assets are overvalued; there is still no harmonisation of shadow banking accounting practices; regulatory risk weightings remain a mess “with the ratings agencies still ensconced as the arbiters of credit quality”, and the rules dance around shadow banking.

2 baselinesenario.com

MIT Professor Simon Johnson notes a recent letter to the Financial Times by three leading Stanford University professors rubbing the claim that Basel III’s higher capital requirements, and the accompanying lower reliance on debt funding, will limit economic growth. He notes: “The most productive firms in our economy are financed with equity – shareholding is at the heart of the American economic model!” The widespread belief of the dangers of higher capital limits “is pretence and bad science, pure and simple”.

3 bbc.co.uk/blogs/thereporters/robertpeston

Robert Peston concentrates on the tricky business of regulating global systemically important financial institutions. The G20 has committed in principle, but the devil will be in the detail. Among several problems is the need for “supervisors from Beijing to Moscow to push intrusive and robust in their dealings” with the major investment banks.

4 huffingtonpost.com/2010

A leading US blog is one of many to pick up the Financial Times’ November story that quotes research from Barclays Capital: the biggest US banks will be short of between $100bn and $150bn in equity capital if they are to hold top-quality equity capital of 8% – including a 1% cushion against the Basel minimum.

See page 12 for a full discussion of Basel III.

Do you have a blog recommendation?

Please send it to the Editor: hugo.cox@wardour.co.uk

NEWS REVIEW

QUALIFICATIONS

Classroom view

Top performers honoured

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See page 12 for a full discussion of Basel III.

Do you have a blog recommendation?

Please send it to the Editor: hugo.cox@wardour.co.uk
When Sue Concannon retired last year after more than 13 years as Managing Director of Halifax Share Dealing Ltd (HSDL), staff tributes included a rewritten version of ‘The JCB Song’, the 2005 number one single written and recorded by her son Luke, one half of pop duos Nizlopi.

Steering one of Britain’s top three execution-only stockbrokers unscathed through two big changes of ownership also earned her a lifetime achievement award at the Daily Telegraph Wealth Management Awards.

Sue’s career has spanned huge changes in the technology used in financial services, and computers were her key to the door. She discovered an immediate interest in computing, following her A-levels, in her first job. Soon she got an installation and training job with a maintenance company.

By that time, she had married, having met her husband at school, and within a year their son was born.

In 1985, Sue was hired as Operations Manager of ShareLink, a share-dealing start-up based in Birmingham, near her Midlands home. “I was still working out my notice at the old job when Black Monday came,” she says, “and I wondered if I had made the right decision.” But a close working relationship with ShareLink founder David Jones allayed any fears. “He gave me lots of opportunities, which I took,” she says.

ShareLink was chosen to set up the share-dealing for Abbey National’s demutualisation and run its broking business afterwards. Sue spent her last four years at ShareLink as Development Director. ShareLink was subject to a management buy-out in 1992, was floated in 1993 and finally sold to Charles Schwab in 1995.

In 1997, Sue was headhunted to set up and run HSDL, as Britain’s then-largest building society converted and floated. Technology and share settlements had moved on by then, which was just as well considering the size of the conversion. At the time, Halifax had 7.6m members, of whom 2.1m wanted to sell their entitlements immediately. Some 468m shares were sold for £4.2bn in a single transaction.

HSDL has always been a separate entity, managed independently from its owner, which may have helped it endure the Halifax-Bank of Scotland merger and the HBOS combination with Lloyds TSB. Sue says she was always motivated to enable employees to develop and progress. She estimates that 70% of senior managers at HSDL were homegrown. “Their professional training [through the CISI] is an important part of that,” she says.

A cancer diagnosis and a desire to devote more time to the family business, FDM Records, prompted Sue to take early retirement last August. Much in the spirit of her son’s original ‘JCB Song’ lyrics, Sue says: “I’ve never seen myself as a highly ambitious person. All I really wanted was to do a good job.”

MEMBERSHIP

New personally Chartered span five decades

At the age of 78, John Sreeves is the oldest CISI member to become personally Chartered. Now a Chartered MCSI, John is an associate at WH Ireland in Birmingham, specialising in traded options for private clients.

John has worked in financial services for more than 25 years following an earlier career as an industrial chemist. He said: “Achieving the personal Charter is still relevant at my age. When you meet potential new clients, they are likely to be more impressed if you hold Chartered status – it proves your professionalism.”

At the other end of the age scale, 23-year-old Louis Coke has also become a Chartered MCSI. He is Investment Adviser at Charles Stanley in Guildford, a firm he has been with for five years. Louis said: “Having Chartered status gives you an extra edge. You have reached a high level of qualification and have something that has required extra effort. That adds integrity, which is essential when dealing with clients.”

Christopher McCleane, Director of Halifax Share Dealing Ltd

Christopher McCleane is the 3,000th member of the CISI to be personally Chartered. Christopher, Director at Cunningham Coates Stockbrokers in Belfast, has upgraded his category of membership with the Institute from ACSI to Chartered MCSI. Christopher was awarded the distinction after passing the initial criteria set by the CISI for Chartered upgrade. He passed IntegrityMatters, the CISI ethics test, with a grade A, met a requirement to have 12 months’ logged CPD under the CISI scheme and had five years’ experience as an Associate member.

Christopher said: “The Charter enforces the Institute’s objective of promoting the integrity and professionalism of individual members. I am honoured to become the 3,000th personally Chartered member.”

Christopher McCleane, Chartered MCSI

Turn to the centre pages for a special eight-page listing of newly Chartered members of the CISI.
Target Date funds provide an investment strategy for those savers expecting to retire around a particular date. Funds pursue a long-term investment strategy that becomes more conservative over time as the target date approaches.

While these funds have long been used by defined contribution (DC) pension schemes in the US, to date they have gained little traction in the UK, which is dominated by Lifestyle strategies. These rely on the administrator, rather than the fund manager, to perform asset allocation.

But there are strong indications that the National Employee Savings Trust (NEST), the pension system for UK workers who do not have access to a pension provided by their employer, will start using Target Date funds after 2012. NEST will become more important from 2012, when the Pensions Act introduces automatic enrolment for all employees. From this date, the default setting for new employees will be opting into the employer pension scheme, rather than opting out of it. If employers do not offer a qualifying pension plan of their own, employees must join NEST instead.

Should Target Date funds be selected as NEST’s default option, many UK investment managers will look to offer suitable solutions.

**What is the same?**
Target Date funds and Lifestyle funds within DC share similarities. Both progressively move pension members from higher return-higher risk funds/assets to lower return-lower risk ones as the member approaches retirement. Both approaches undertake asset allocation changes that are essential to retirement planning.

**What is different?**
The key difference is who carries out the switching. Under Lifestyleing, the plan’s administrator carries out the switches at a member level; under Target Date funds, the fund manager carries out the switching within the fund.

**What is the US experience?**
In the US, Target Date funds are the most popular means of helping less financially aware members make investment and savings decisions. Because there is no requirement to purchase a UK market-style annuity, typical strategies retain equity exposure for about 15 years after the retirement date. Typical US strategies start switching from growth to protection assets much earlier than UK Lifestyling (often 20 to 30 years before retirement, compared with five to ten in the UK). Target Date funds have been criticised in the US following falling values during recent market volatility. The investment strategies of Target Date funds do not vary significantly from provider to provider and the equity exposure is frequently in the region of 60% around retirement. However, investments in an insured product with a guaranteed return offer some protection.

**Target Date funds in the UK?**
While some lessons can be drawn from the US experience of Target Date funds, not all the features used in the US will work in the UK, and the UK market must develop its own version. Simply transporting the Target Date concept from the US to the UK is unlikely to succeed. Members will need some of the same flexibility that they currently enjoy with Lifestyle.

Target Date and Lifestyle are both de-risking tools, and it’s likely that Target Date funds, in some form, will become more prevalent in the UK. In this respect, NEST may become the catalyst for DC change in the UK.

Did you have a question on anything from tax to virtual trading? richard.mitchell@cisi.org
Happy new year?

In 2011, house prices will drop, the FTSE will climb and interest rates will remain stable. Probably

**FIRST, A WARNING:** crystal ball gazing is a mug’s game. Do not attempt it without a large sack to hold the letters sent later by people pointing out how wrong you were. Remember, too, that very little is predictable. As Nassim Nicholas Taleb says in *The Black Swan:* “What is surprising is not the magnitude of our forecast errors, but our absence of awareness of it.”

With that in mind, I will make three precise predictions about 2011: one on house prices, another on the stock market and a third on interest rates.

Over much of the last two decades, bricks and mortar became a badge of prosperity for many homeowners, rather than simply a place to live. Memories of the housing collapse of 20 years ago faded in a frenzy of cheap borrowing.

The reality, however, is that houses are an asset just like any other. The idea that people can simply get rich by buying and selling property works only if the good times last forever. The credit bubble that fuelled the last boom burst spectacularly in 2008 and Britain, like the US, has since had to learn that the housing market is not a one-way ticket to prosperity.

House prices fell nationally by 7.9% two years ago and by another 10.5% in 2009, according to Halifax data. In the three months to October 2010, they were 1.2% higher than the same period in 2009, softening after a spring rally.

Even so, property remains overvalued. It’s true that the worst of the financial crisis is over, but the recovery is going to be uneven. Mortgage arrears have been falling, but figures showing a jump in possession orders being sought suggest more pain to come.

As long as job creation and economic growth remain shaky – spending cuts are likely to lead to heavy public sector job losses – then confidence will also be in short supply.

All this adds up to a bleak 2011 for property, and even estate agents are finding it hard to talk up the market. The proportion of surveyors reporting house price increases is at its lowest in 18 months, with more than half saying prices are falling. It won’t be as bad as in early 2008, but a 5% decrease in prices in 2011 is realistic.

The stock market, thanks largely to the Federal Reserve in the US, is more enticing. Heavy buying of Treasury bonds and a flood of cheap dollars into financial markets should send long-term US interest rates even lower.

Never mind the risk of higher inflation later: if people save less and spend more, and companies pass on higher costs, there will be growth and boosted profits. The Fed’s first round of quantitative easing lifted shares, and a repeat prescription should do the same.

Much of the Fed effect has, of course, been priced in. But equity valuations are still attractive. The FTSE All-Share has recently been trading on a 2011 price to earnings ratio of between ten and 11 and offers a prospective dividend yield of 3-4%. In contrast, the yield on a ten-year gilt is just under 3%.

The dividend yield could prove illusory if profits disappoint, but share buybacks and corporate takeovers will be supportive. Expect the FTSE 100 to move past the 6,200 level. Record low interest rates in the UK will assist a recovery, but, throughout much of 2011, it won’t feel like a rebound.

Indeed, as the Government’s spending cuts start to bite, and with income tax and national insurance contributions rising from April, the Bank of England will be anxious not to do anything that jeopardises growth.

Yes, inflation is well above the Bank’s targeted level. But the bigger risks remain the fragility of the US and the real possibility of a sovereign debt default in Europe. For an open economy such as Britain, the effect of another international shock could be truly destabilising, so rates will stay at 0.5% for the whole year. Now I’ll get my coat and wait for those letters.

Christopher Adams is the Financial Times’ markets editor
The cost of safety

The new Basel III global banking rules promise to buttress bank balance sheets against future shocks. They make the sector safer, but shareholders should prepare for lower returns from banking stocks, says David Wigan.

IF THE RESPONSE of the banking community to global regulatory proposals to increase capital requirements and strengthen balance sheets has been muted, there is a good reason. Basel III could have been a lot worse. Following the financial crisis, the Basel Committee on Banking Supervision, which represents central banks and regulators in 27 countries, was charged by the G20 to deliver a reform agenda for the global financial system. Last September, it published higher capital requirements and a blueprint for liquidity and leverage rules, which represent a significant watering-down from its earlier drafts. “The rules are less tough than some might have expected, so banks are now content to get on with it,” says Dr Lawrence Galitz, Director of ACF Consultants. “But costs are higher and profitability is going to take a hit.”

The Basel III package includes an increase in capital requirements for common equity and Tier 1 capital (the safest forms of capital, see table), tighter limits on leverage (how much banks can borrow), more stringent liquidity controls and a resolution mechanism for systemically important firms.

The cost of safety
Banks deemed systemically important will need to take further measures (see box), and capital requirements for complex exposures and trading books will rise as much as fourfold.

**Capital**

“Taking everything into account, capital levels end up about 25% higher than previously, which will have a direct impact on return on equity (ROE),” Galitz says. The 18 largest global banks will have to hold $95bn more capital under the new capital requirements and recurrent earnings will decrease by 24% ($35bn), according to a J.P. Morgan report from July, when the Basel Committee released its final proposals. This compares with a projected 31% ($110bn) under the earlier version of the rules proposed in February 2010. According to analysts, regulators moved to lighten the February blueprint after banks claimed that the proposals would cut lending and slow economic growth. The requirements for capital to be held against securitisation were so onerous, analysts claimed, that banks would be forced to abandon this business altogether.

Meanwhile, the interests of various lobbying groups had been taken into account. Japanese banks were successful in their battle to include deferred tax assets in the definition of capital, enabling them to continue to offset past losses against future tax liabilities. US institutions won the right to keep limited mortgage-servicing rights (the right to collect mortgage payments for a fee) within the definition. The total capital requirement will remain at the existing level of 8%, but the quality of capital must increase significantly. Currently, Tier 1 capital must account for 4% of risk-weighted assets, with half of that in common equity, the most secure type of capital. The remainder is made up by Tier 2 and Tier 3 capital. The revised guidelines require a Tier 1 ratio of 6%, of which 4.5% must be common equity. The remaining Tier 1 capital must also be stronger, with the more speculative financial instruments excluded. The definition of Tier 2 capital has also been tightened and Tier 3 capital will be phased out. In addition to these requirements, banks will be required to hold a capital conservation buffer of 2.5% of common equity to withstand future periods of stress, bringing total common equity requirements to 7%. An additional countercyclical buffer, of up to 2.5% common equity, can be added at national regulators’ discretion, to protect their banking sectors from growing too quickly during periods of financial and economic stress.

**Capital requirements summarised**

As well as raising the amount of capital that banks must keep, the Basel requirements have increased the quality of that capital. In addition to common equity, the safest type of capital, the Basel requirements have always included rules about Tier 1 capital. But the range of financial instruments that qualify as Tier 1 is now much narrower, limited largely to equity and retained profits. In addition, capital requirements for complex exposures, such as those created by securitisation and trading activities, have increased significantly, some as much as fourfold.

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<td>Tier 1 Capital</td>
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<td>Additional Common Equity Capital Conservation Buffer</td>
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1 Common equity plus other qualifying financial instruments
2 To absorb losses during periods of financial and economic stress. Banks are entitled to draw on the buffer but will face constraints on earnings distributions, such as pay.
The regulation will bring return on equity across major global banks to 9.7% in 2011, says J.P. Morgan

good times. The two buffers are not obligatory, but banks face restrictions on the distribution of earnings if they are not met. The Basel Committee has also agreed to test a minimum Tier 1 leverage ratio of 3%. This will mean a bank’s total assets cannot be more than 33 times its Tier 1 capital; it is designed to limit on- and off-balance sheet exposures and offset the hugely leveraged gambles in credit markets seen at banks such as Lehman Brothers. The ratio will be tested from 2013 until 2017, with a view to making it part of the core requirement in 2018. Banks must start publishing their individual leverage figures from 2015.

Liquidity

One of the biggest and least foreseen issues at the height of the credit crisis was the evaporation of liquidity from the banking system, as banks stopped lending to one another. The Basel Committee has attempted to address this through the introduction of two standards: the Liquidity Coverage Ratio (LCR), requiring that banks hold funds to cover major shocks over a one-month period, and the Net Stable Funding Ratio (NSFR), aimed at preserving liquidity over one year. After considerable debate about the extent to which liquidity ratios may increase the cost of short-term funding, and concern about the definition of high-quality assets, the committee has agreed to make the LCR observational until 2015 and delay implementation of the NSFR until 2018. The precise levels of each ratio have not yet been set.

Gradual implementation

To soften the blow of Basel III, the committee set a long transition period for adoption, with full compliance required by as late as January 2019. A number of banks have already published their adherence to the proposed requirements, several years before they must comply. “Banks are supportive of the rules and have taken steps significantly to increase capital and liquidity,” says Simon Hills, Executive Director of the Prudential Capital and Risk Team at the British Bankers’ Association. “The transition period, however, is very good news because it means that, if the Basel Committee has got any of the levels wrong, the appropriate changes can be made.” The net impact of Basel III on global banking should not be underestimated. The rules will make banks safer, but at the cost of reduced earnings. US banks alone are set to earn $22.3bn less annually under Basel, according to J.P. Morgan. This will increase as further controls defined by the Dodd-Frank Act are implemented.

Overall, the regulation will bring average ROE across the major global banks to 9.7% in 2011, according to J.P. Morgan, compared with an estimated 13.3% under pre-Basel III estimates. Under the harsher regime proposed last February, ROE would have declined to 5.4%.” These rules are making the banking system safer, but not safe,” concludes Peter Boockvar, Equity Strategist at Miller Tabak in New York. There will always be risks inherent in the services that banks provide; better quality capital must combine with better management to control these. David Clark, Chairman of the Wholesale Markets Brokers’ Association, says: “Capital is not the only risk mitigant for banks that do not manage their risks well, and Basel III must also deliver better governance through the wider global use of supervisory powers.”

SIFIs and living wills

Some banks are so important to the global economic system that governments are obliged to intervene to prevent them from failing. This doctrine is known as ‘too big to fail.’ The problem is that these implicit government guarantees encourage excessive risk at such firms. In the words of the former Fed Chairman Alan Greenspan last October: “If they’re too big to fail, they’re too big.”

The Basel Committee is expecting to draw up two lists of systemically important financial institutions (SIFIs), one comprising about 20 global banks whose failure would pose a risk to the global financial system and another of banks systemically important within their own economies. These firms will face additional capital surcharges, as yet unspecified.

In the US, under the new Dodd-Frank Act, financial firms with more than $50bn in assets will automatically qualify as SIFIs. This means 36 banks currently, with six non-banks likely to join this group. In Europe, the Cross-Border Bank Resolution Group of the Basel Committee and the UK’s FSA are spearheading the initiative. At the Seoul G20 conference last November, Mario Draghi, the Bank of Italy Governor who chairs the Financial Stability Board, said this work would take another year. It will be difficult for the G20 to agree over what to do when these firms fail, in part because of differences in creditor rights between the US and Europe.

The Basel Committee will also ask national regulators to require SIFIs to draw up so-called living wills, preparing for market shocks and setting out plans for an orderly wind-down. Living wills will comprise two prongs: a plan to prolong the ability of the firm to continue in business (the ‘recovery plan’) and proposals to ensure an orderly work-out can occur in the event that the firm fails (the ‘resolution plan’).

Among key elements of successful plans, according to consulting firm Deloitte, are defining the level of detail required, preparing steps for liquidity and capital recovery, specifying actions on counterparty failure, scenario planning, defining trigger events and assigning responsibilities.
From 10 January 2011, the CISI Investment Administration Qualification (IAQ) and its international equivalent will be known as the Investment Operations Certificate (IOC)

Find out more at cisi.org/iaqrebrand
Britain may be crawling out of recession, but unemployment is still high – at an annualised 7.7% in the three months to September last year – and it could get worse as Government spending cuts bite. PricewaterhouseCoopers warns that as many as a million jobs could be lost as public services are trimmed back, with a knock-on impact on the private sector. It believes that business services and construction could be particularly hard hit. Yet there were 453,000 job vacancies in October, enough to employ almost a fifth of the 2.45 million people looking for work.

Of course, there will never be a perfect fit between jobseekers and the range of employment on offer. Potential applicants will often lack the right training, experience or skills; others may live in areas where there are few vacancies. For some, the extra income that a job would provide is not sufficient to offset the financial cost of losing unemployment welfare benefits. In the long term, Work and Pensions Secretary Iain Duncan Smith hopes to tackle this problem with the reform package that he announced last November. This does not explain the full picture, however.

How is it that unemployment remains high even when the economy is generating a large number of vacancies?

This is the conundrum that Professor Christopher Pissarides of the London School of Economics and American economists Peter Diamond and Dale Mortensen sought to explore (their theory applied to all markets with search costs but employment was its principal focus). Their innovative labour-market research – for which they were awarded the 2010 Nobel Prize for economics – led them to conclude that the practicalities of searching for jobs often make this market far from efficient. An employment ‘transaction’, as the theory goes, is problematic because, unlike the matching of trade on a large public stock exchange, matching workers with jobs is a drawn-out task. The search process can be costly and lengthy, and subsequent matching may see one party hold out for a better match. These ‘frictions’ - transaction costs, search times and the uncertainty of knowing how a job or a worker will turn out – go some way to explaining why unemployment rates can remain high even when there are jobs available and willing workers. One example provided by Stan Siebert, Professor of Labour Economics at Birmingham University Business School, is the high cost of housing in London and the South East, which dissuades jobless people in other regions from moving to take up jobs in the capital. Friction is also at work when people with highly specialised skills take a long time to find work. Coventry University’s Professor David Bailey studied the time it took for workers made redundant by the closure of the MG Rover plant in the West Midlands in 2005 to find new jobs. Workers with high-level technical skills found work more quickly than those who were generally less skilled or those who were equally skilled but whose skill set was narrowly focused.

City squeeze

The financial sector appears to be exhibiting some of the features identified by this year’s Nobel laureates. Tim Gilbert, Managing Director of UK recruitment firm Ambition UK, reports a shortage of job candidates in London. He notes that, in October 2010, there were 11 vacancies for every ten candidates actively searching for work in the City. This mismatch is projected to rise to an average of 12 vacancies for every ten candidates through the fourth quarter of 2010, a far cry from the three vacancies per ten...
candidates in early 2009. It reflects the growing number of jobs being created in the City: a Q3 survey by employment website E- Financial Careers found that all sectors except private equity have increased headcount by at least 23% compared with this time last year. Ambition’s October 2010 assessment put the number of vacancies available to City workers at its highest since 2007 and 260% above the number on offer in the first quarter of 2009.

Choosy employees
Gilbert identifies another trend that chimes with the theory of Pissarides and his colleagues: as confidence returns, candidates are getting more choosy. “For 2011, we expect significant movement in quarters one and two, as there is a clear appetite among professionals working in the sector to explore new opportunities,” says Matt Crawford, Manager of Senior Finance Recruitment at Robert Walters. “We recently surveyed more than 1,000 professionals working in the financial services sector and this revealed that 41% are looking to move following their bonus payout. A further 31% may do so, depending on its size.” The trend has been driven by an increase in activity, initially in the equities market and subsequently in fixed income and foreign exchange businesses, according to Gilbert. Over the past year, there has been particular activity in the interest rate, structured rates and structured credit markets. Candidates with experience in interest rates, and in complex structured credit products, have been needed for roles in project management, performance analysis, back office, risk and compliance, finance and marketing. “With all the regulatory changes coming in, banks are bolstering their compliance and their risk teams significantly,” says Andrew Evans, Managing Director at Morgan McKinley Financial Services. There is particular demand for skilled back office staff in operations such as product control and accounting, where considerable shortages exist. Firms are also recruiting in areas that can drive business development, such as change management. Many roles even saw supply shortages during the crisis, says Evans: “There are some areas in which we had a bit of a shortage during the worst days of the recession, such as in risk management and compliance. There has usually been consistently strong demand in these sectors.” Those starting out in the industry have fewer opportunities to be choosy. Here, economic conditions more clearly dictate hiring numbers. In 2007, the number of graduates registered for exams at the CISI – a useful proxy for graduate recruitment – was 6,537. In 2009, this dropped to 2,831, but by mid-November 2010, it had already reached 4,762.

Choosy employers
Just like candidates, employers have also become more demanding as firms become increasingly discerning in their recruitment choices. Crawford says: “Employers commonly want exceptional academic transcripts, relevant business experience and skill sets that are not currently plentiful among professionals looking for new jobs.” In cases of senior hires, constraints have been introduced by direct regulatory involvement. In the Nov/Dec S&IR, a profile of FSA Chief Executive Hector Sants detailed greater scrutiny of the hiring process as part of the regulator’s closer supervisory engagement with firms. The FSA announced last October that it would become more involved in the selection of senior officials, noting that it now expects to be shown the briefing documents given to recruiting firms. “The bar is deliberately set high for senior management,” says an FSA spokesman. “We expect firms to have the right people with wide-ranging experience on their board and we expect them to be up to the job.” Some consultants report that suitable candidates accepted by the employer are being vetoed by the FSA. Employers, they say, are asking to see a larger number of candidates in order to adjust to this. Prospective employers are also requiring more, and more thorough, background checks. This involves deep digging from recruiters, who report that the procedure is up to 30% more time-consuming.

City contribution
It’s no surprise that general labour market trends are present in the financial sector, given its importance as an employer. Banks belonging to the British Bankers’ Association employ 419,000 people, 1.4% of the UK labour force. The Nobel Prize-winning theory provides a powerful explanation of how job markets such as financial services are seldom totally efficient. But, as the Financial Times noted following the announcement of the prize, labour economists were still surprised about how the recession affected employment in countries around the world. The complex equations proffered by Pissarides and his colleagues provide a meticulous modelling of the way vacancies and employment rates vary through the economic cycle. They help place in some context the rapid fluctuations in supply and demand for those working in financial services and the wider economy. But they will be of limited use for the Work and Pensions Secretary when deciding how to balance welfare payment with work incentivisation, or for bankers wondering how hard to push their annual bonus negotiations.
Clare Gore Langton, Chartered FCSI(Hon), was the longest-serving Director of the CISI and has spent nearly 30 years in investment management. She tells Hugo Cox how the Institute and the industry have changed in that time.
CLARE GORE LANGTON has the distinction of being the longest serving director of the Chartered Institute for Securities & Investment (CISI). Last September, she stepped down after 18 years as a board member for the organisation. Clare was a founding member of what was then called the Securities Institute (she was its fifth member), and has seen it grow to serve more than 40,000 members worldwide. The huge contribution she has made to the Institute has included developing services for members as Chairman of its Membership Committee for more than ten years and has given her a unique insight into its history.

Clare is an Investment Director and one-time board member of Rathbone Investment Management, the private client investment manager. She is one of only 45 individuals who have been awarded Honorary Fellowship of the CISI by the Institute's board to recognise outstanding contribution to financial services and the organisation. Demonstrating her commitment to the highest standards of professionalism, she has also achieved personally Chartered status of the CISI.

Her involvement with the CISI goes back to before the Institute was formed. After Big Bang in 1986, the Stock Exchange was obliged by the Government to give control to firms instead of individual members, who received non-voting shares that they could sell when they retired.

The benefits of individual membership were much reduced and, in 1989, Clare was co-opted on to the Stock Exchange Membership Committee before being appointed to a sub-committee to consider the future of individual membership.

After much deliberation, the concept of an Institute was eventually agreed upon and the sub-committee was enlarged into a steering group under the chairmanship of Graham Ross Russell FCSI(Hon). Tim Nicholson, who had been in charge of exams for the Stock Exchange and the Securities Association, was appointed Chief Executive and this group became part of the board of the Securities Institute when it was founded in 1992.

The 5,000 Stock Exchange members were given automatic membership and those with other qualifications or long service could apply for admission.

Clare took over from John Woolfenden as Chairman of the Institute's Membership Committee in 1997. The next defining moment for the Institute came in 1999 when the Institute's affiliate membership was created. “The Institute saw that, by focusing on recruiting only fund management and stockbroking staff, we were missing out on a huge middle- and back-office community that was becoming more and more important to the industry,” she explains. There was some resistance at board level to open the membership, with certain members feeling that the move would dilute the Institute’s brand. “But those of us who had worked in stockbroking firms could see the growing importance of operational staff and their qualifications. We had PhDs arriving to run IT departments; we had to reflect this trend in the membership,” she says. A new class of affiliate members, now known as Associate members, was created to accommodate the changing composition of the sector.

Clare’s own career began in 1978 at Lazard Securities in institutional fund management before she moved into private client investment management. “I wanted to move over to private clients, but there were not the opportunities at that time with Lazzards so I decided to join the private client department at Laurence Prust,” she notes.

“Never fall out with anybody in the City. With the merry-go-round of acquisitions and consolidations, you never know when you are going to end up sitting next door to them again.”

Clare’s move to private client fund management was motivated principally by an interest in people, which she feels is a necessary requirement for those entering the sector. “Don’t go into private wealth management unless you’re genuinely interested and care about people,” she says. The most important things to understand about clients, she adds, are their tolerance for risk and the time horizon over which they expect to hold their investments. This is particularly pertinent given the current debate in the industry about the validity of high-risk, high-return investment strategies.

While she acknowledges that the number of high net worth individuals in emerging markets is growing rapidly, she warns of the limitations of pursuing these markets exclusively. “We must also look at how sticky this money is. A lot of the intermediaries who provide access to these clients are pretty fickle; if you’ve had a bad year, the herd moves off.”

“Yesterday was the toughest period of her career, when it became clear that banks were in much worse shape than had previously been thought. “Many of us in the industry were having sleepless nights; by comparison, 1987 seemed like a walk in the park. We really had to think the unthinkable. I think the result is that everyone in the sector is more rigorous in research and recommendations as a result.”

Clare continues to participate actively in the CISI’s development. She is Chairman of the Institute’s Educational Trust, which provides bursaries to promising students who are selected from accredited Centres of Excellence, including Cass Business School, the University of Exeter and Imperial College Business School, via written tests, an essay and interviews. She says: “The programme helps promote the public profile of the Institute, particularly in high-quality academic establishments. We make an effort to follow the careers of winners over time because we believe they will be our ambassadors in the future.”

Beyond the crisis

Clare recalls that 2008 was the toughest period of her career, when it became clear that banks were in much worse shape than had previously been thought. “Many of us in the industry were having sleepless nights; by comparison, 1987 seemed like a walk in the park. We really had to think the unthinkable. I think the result is that everyone in the sector is more rigorous in research and recommendations as a result.”

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To those entering the sector she offers advice that she feels has always been worth heeding. “Never fall out with anybody in the City. With the merry-go-round of acquisitions and consolidations, you never know when you are going to end up sitting next door to them again.”
The search for income is taking investors into riskier corners of the market, but, for discerning long-term players, yield is still available, writes James Gavin.

In investors are tiring of the refrain that they are better off stuffing their money under the mattress, given the paltry rates of return on offer from fixed income investments and savings. For those seeking yield in a climate where low-risk securities offer next to nothing, the market appears to offer few options. Personal savings rates illustrate the dilemma. Last month, the personal finance website Moneyfacts.co.uk identified that just three savings accounts out of a total of 2,203 in the market paid a real rate of return, of which only one was available to higher-rate taxpayers. US Treasury Bill yields, in basis points, are barely in double figures. In the UK, gilts fare little better, with UK ten-year gilts at 3.4%, offering relatively poor value to investors given current inflation levels.

“Ten years ago, you could have bought US Treasuries, held them to redemption and felt confident of a return of 6% to 7%. Nowadays, you’d be lucky with more than 3%, and you would be paying more than par [the bond’s face value] in some cases, so making a loss to redemption,” says Julian Chillingworth, Chief Investment Officer at Rathbone Unit Trust Management.

Settling for less

Both private clients and institutional investors are faced with an unpleasant choice: accept lower returns or head off into riskier areas of the investment universe for greater rewards. With interest rates currently low and unlikely to rise, investors are having their hands forced to take the riskier route.

Those with long-term horizons can consider inflation-linked products. These have the added benefit of protecting against higher inflation that is likely to follow additional quantitative easing, should this take place. Professor Moorad Choudhry FCSI of the Department of Economics, London Metropolitan University, recommends inflation-linked sovereign debt to combat inflation. Index-linked structured products and capital-guaranteed notes provide similar benefits, but carry credit risk from the issuing bank.

Index-linked bonds, meanwhile, are increasingly popular, though some have shown negative real returns and most come at a high price given their popularity. “Everyone is buying them because everyone feels they must have inflation-linked products, but if you end up buying a negative real return, it’s a futile exercise,” says Robert Merrifield FCSI of Savoy Investment Management.

Property exposure via a fund also offers strong yields. Merrifield cites the F&C Commercial Property Trust, a London-listed investment trust with a diversified commercial property portfolio, currently offering 6.1%. Lindsay Tomlinson, Managing Director of BlackRock and Chairman of the National Association of Pension Funds (NAPF), says that he prefers long-term allocations into infrastructure and green sectors.

Move to equity

Wealth managers must look increasingly to equity income for their clients. “We have been looking at equity income holdings to boost yields, but this does involve a higher level of risk. With fixed income investments alone, it’s more difficult to have lower risk and still maintain your income level,” says Victoria Hoskins, Chartered FCSI, Director at Barclays Wealth Management.

Hoskins reports growing tolerance on the part of investors for the risks associated with equities as they accept the scarcity of alternatives. “When we have discussions with clients, they respect that conditions have changed and that, to obtain higher yields at this time, they may need to take a greater level of risk. It is very difficult to get yields in that 5% range in a low-risk manner,” says Hoskins. So long as the risk that the client is prepared to take is clearly discussed, there remain a range of choices for yield, but it does mean taking a long-term perspective.

Combining downside protection with equity exposure in structured products is an increasingly popular route for these managers. Barclays Wealth is offering fixed-term income notes that provide downside

Wealth managers must look increasingly to equity income to generate yields for their clients.
Reaching further

Reaching further

Tim Cockerill, Head of Research at Ashcourt Rowan Asset Management, identifies the Schroder’s Income Maximiser fund as a strong performer in this category. “We have added this, which is going to be targeting 7% income by writing covered call options, to our best advice list,” he says. “It could be a useful tool for asset managers who want to generate income, but it does cap the upside from a capital growth perspective. It means bigger income, but there is some risk.”

**Government debt**
Riskier EU sovereign debt is another route that investors must now consider. Barclays recently issued a recommendation for very short-dated Greek debt. But it comes with risk and is mainly for those who will hold bonds to maturity. “Sovereign risk is now a risk asset,” counters Chillingworth. “To find any measurable yield away from index-linked products, you have to pay more than par, which erodes capital. Secondly, sovereign debt markets are very volatile.”

Allocations to Asia-Pacific government debt help to diversify sovereign risk, with countries such as Australia ahead of the US and Europe in the interest rate setting cycle. Commodities are proving increasingly appealing, meanwhile, for investors seeking exposure to developing markets’ growth, with exchange-traded funds (ETFs) a useful route. “Commodities will certainly be on a rising trajectory in the long term, as demand from Asia-Pacific economies increases exponentially. Investors don’t need to pick a mining company or a commodities company; they can use ETFs to get access to a sector they like. These are liquid and give access to a sector as a whole for one price,” says Choudhry.

A final note of caution is worth sounding against the clamour for improved yields. In a climate where yield is encountered in the riskier corners of the market, fixed-interest bearing instruments look like a hedge against inflation rather than a source of substantial yield. But, if the much-feared double-dip recession occurs, investors in fixed income will be grateful for the present caution. Besides, concludes Tomlinson, a fixation on yield helped bring about the financial crisis: “Part of the reason we’re in the current mess is that investors started chasing yield from 2003, following the burst of the technology bubbles when interest rates were held very low and investors piled into credit. Yield-chasing is inherently dangerous.”
Historically, the UK’s response to bank or investment firm scandals and collapses has been to amend the regulatory system in a knee-jerk reaction to prevent similar situations from arising. However, as each new event differed from the last, regulatory changes have provided inadequate protection from coming crises. The big question is whether things may be about to change.

Overend, Gurney & Co
For 40 years during the mid-19th century, Overend Gurney & Co (OG) was the world’s greatest discounting house, having secured many clients of the Bank of England (BoE) during a financial crisis in 1825. Following substantial investment in railway stock and other long-term investments, it ran short of liquidity and had to relaunch as a private company.

After further stock and bond price falls, monetary difficulties increased and OG called for the BoE’s assistance, which was refused. Panic ensued and OG went into liquidation in June 1866. The bank rate soared for a time and 200 other companies, including banks, failed in what was the first significant UK regulatory failure and a precursor of the perils of insufficient liquidity.

Baring Brothers
November 1890 saw Barings, at the time one of the City’s largest and most prestigious merchant banks, over-committed in Argentina. The Governor of the BoE pushed through a rescue fund, to which other City firms had to contribute.

Secondary banking crisis
Following the development of new money markets in London in the 1960s, fringe financial institutions began to expand their balance sheets on the back of mounting volumes of short-term wholesale deposits. This increased the mismatch between assets and liabilities, and consequently the risk of catastrophic failure.

In November 1973, London and County Securities fell into liquidity difficulties and was unable to renew deposits through the money markets. A number of fringe banks soon found themselves with similar problems, and to avoid a domino effect, the BoE launched its lifeboat.

Johnson Matthey Bankers
In 1984, Johnson Matthey Bankers (JMB), which was authorised as a recognised bank, collapsed after suffering two large bad debts, a situation that the regulator failed to identify.

Regulatory actions
In 1890, the authorities determined that the banking system itself might be in jeopardy, based largely on the events of 24 years earlier and bailing out Barings without full consideration of whether it should have been saved. This is a conundrum that regulatory authorities are still grappling with today, as they try to decide whether a bank is ‘too big to fail’.

Barings failed to learn its lesson, crashing a century later through the actions of Nick Leeson, the inaction of management and another failure of bank supervision.

Lessons learnt from the secondary crisis included the need for greater supervision, tighter definition of banks and increased deposit protection. During 1974, the BoE identified most of the UK registered companies holding large public deposits, inviting them to submit to voluntary supervision. By 1975, all significant banks and deposit-taking institutions had agreed to prudential supervision.

Ten years later, there were delays in identifying the scale of the problems facing JMB, highlighting the need to distinguish between recognised banks and licensed deposit-takers. The then-BoE Governor, Robin Leigh-Pemberton, was tasked with reconsidering the system for supervising banks. His committee recommended that a single authorisation should take deposits and that all the Bank’s supervisory powers should be applied to every authorised institution.

The 1985 banking white paper proposed a new Board of Banking Supervision to assist the Governor. This replaced the two-tier system of regulation, which had clearly failed, and increased co-operation with auditors, culminating in the 1987 Banking Act. Such actions were satisfactory as far as they went, but the Wilson Committee had observed in 1981 that there was no single authority with clearly defined responsibility for overall regulation of the financial system.

After recommendations from Sir Martin Jacomb’s advisory group and another considering the life assurance/unit trust industry under Marshall Field, a Government white paper was published in January 1985, followed by the Financial Services Bill at the end of the year. The Financial Services Act took effect in 1986. For the first time, it provided a comprehensive regulatory framework for UK investment business through a series of self-regulatory organisations (SROs), with oversight via the Securities and Investments Board (SIB) – a statutory body and forerunner to today’s FSA. This created another...
continuing professional development

In 1991, the Bank of Credit and Commerce International (BCCI) hit the headlines for all the wrong reasons, having had its operations forcibly shut down in five countries on 5 July by the co-ordinated actions of regulators. The BoE was heavily involved, having previously commissioned Price Waterhouse in March to conduct an external inquiry into the bank’s activities. In June, parts of the report were leaked to *The Sunday Times*, detailing how the Abu Nidal terrorist group used fake identification to open bank accounts to purchase arms illegally. The Sandstorm report confirmed the suspicion of many in the City that BCCI was rotten, leading regulators to conclude that closure was the only sensible option. Despite the co-ordinated actions of regulators, BCCI had circumvented effective supervision by deliberately obscuring its organisational structure and locating its actual seat of operation and control in countries where regulators had only limited resources available, something Allen Stanford is alleged to have done a decade or so later.

In May 1993, Sir Andrew Large, then Chairman of the SIB, published *Making the Two-Tier System Work*, concluding that both the SIB and the SROs needed to improve effectiveness and public perception of – and confidence in – the system of financial regulation. He was not confident that the recommended changes in attitudes and approach would happen and thought that they might need replacing by a fully statutory unitary system, once again recognising deficiencies in the existing regulatory process. The Government implemented radical changes by moving bank supervision from the BoE to a new and strengthened SIB, with responsibility for the regulation and supervision of insurance companies transferring from the Department of Trade & Industry to the Treasury. Yet more changes were proposed in late 1999, effective from June 2000, when the FSA was created from the merger of the SIB and the SROs.

Roll forward another decade and the global financial crisis arrived following excessive government-inspired mortgage lending, resulting in massive liquidity problems for financial institutions worldwide as supposedly unconnected markets dried up. Despite being primarily a failure of management, prudential supervision undoubtedly also failed as a result of confusing liquidity with capital, along with ineffective supervision, such as in the case of Northern Rock.

**Summary**

Over the space of 100 years or so, we have probably seen the full range of regulatory structures, all of which have at times failed to spot ‘the bleeding obvious’. As Mark Hoban, Financial Secretary to the Treasury, recently put it: “Britain’s system of financial regulation failed to identify the risks posed by a rapid and unsustainable rise in debt, and when the crunch came, no one knew who was in charge.” This point was also recognised by Ralph Norris, Chairman of the Australian Bankers’ Association, who recently observed that “US, UK and EU regulators had been poor referees in their supervision of the business playing field” and that “supervisors were asleep at the wheel.” The UK is once again embarking on a fundamental revamp of its regulatory structure, led by politicians who have a short-term view of the world. There has been insufficient input from practitioners, the vast majority of whom are nothing like their current public persona. Will this prevent the next financial crisis? Despite the best efforts of compliance officers, I very much doubt it. ■

**Andy Sheppard** led the UK Compliance team at the Commonwealth Bank of Australia for more than a decade before taking early retirement at the end of 2010, acting as CF10 and CF11 for most of this time. He previously held similar roles at a number of Middle Eastern and US banks.

“Over the space of 100 years, we have probably seen the full range of regulatory structures”
How would you react if you found information that could boost your company at the expense of a rival?

RACHEL IS AN investment adviser and manager for Outrageous Wealth Managers, a company she joined last year. Previously, she had worked for the wealth management subsidiary of Azure, a major UK bank.

One day, as she returns from visiting clients at their home in the country, she boards the train and spots a passenger she knows – Bruce, a former colleague who still works for Azure. Bruce is engaged in reading what look like business-related papers, but Rachel says hello and sits down opposite him. Rachel asks Bruce how he is getting on at Azure, which she hears is undergoing a periodic reorganisation, and he responds gloomily that life is not getting any easier. He is only on this train because he has been to see his doctor, who says that he is suffering from stress. Rachel sympathises with him, adding that she will not disturb him from his work, and she begins to read a magazine. Meanwhile, Bruce continues reading his papers, sometimes apparently signing what Rachel takes to be letters to clients. After a while, the train slows and Bruce begins to gather his papers, which he places in two piles. One he gathers up and puts in his briefcase. The other, which seems to have handwriting on, he tears in half and puts under his empty coffee cup.

The train pulls into the station, Bruce says goodbye to Rachel and hurries off, putting his cup in the bin as he does so. As Rachel gets up and puts on her coat she notices the Azure Bank logo on the papers that Bruce pushed into the bin. She wonders whether she should retrieve them.

*A mine of information*
Rachel tries to rationalise this thought by telling herself that she will ensure the papers are more securely disposed of, since they may be confidential. And, although she no longer works for Azure, she would not like Bruce to get into trouble. Rachel takes the papers out of the bin and, although they have been torn in half and one edge is damp, she can see quite clearly that they are draft letters to Azure customers and contain their contact and detailed financial and investment information. At this point, Rachel finds her mind racing. These papers could be extremely valuable to her in providing an entrée into valuable new clients without any great effort on her part. Bruce must really be under stress if he can be so careless, she thinks. But she wonders whether it would be fair to Bruce if he were suddenly to lose all his best clients. Rachel and he were never more than fellow advisers at Azure but, even so, she would not like it if the boot were on the other foot.

Nevertheless, Rachel dries off the papers, puts them in her briefcase and returns to the office, where she types out a report on her customer visit. But, even as she does so, the question of the Azure papers plays on her mind, and she decides

**FINDERS KEEPERS?**

- Return the papers to Azure’s Compliance department
- Return the papers to Bruce at Azure
- Shred the papers and any copies that have been made
- Keep the papers and make use of them

WHAT WOUL
They are draft letters to Azure customers containing detailed investment information
to discuss the matter with Simon, a fellow manager, with whom she gets on well.
She tells Simon what happened on her train journey, concluding that there are four options for dealing with the letters she has retrieved. Rachel’s initial thought is simply to shred the papers, since that way she will not be tempted to do anything with them and no one will be any the wiser, although clearly Bruce is entirely unaware of what he has done. Secondly, she could send the papers to Bruce saying that she had perhaps saved him from some embarrassment if someone else had found them, which might cause him to think a bit harder about what he does. Alternatively, she could send the letters to Azure’s Compliance department but it would no doubt conduct an investigation and Bruce might get into trouble, possibly even losing his job, which she certainly does not want. Finally, why should she not use the information that she has found?

Making a decision
Simon says that he understands Rachel’s dilemma, which has the added personal dimension that, because she worked with Bruce, she does not want any action that she might take to rebound on him. He then asks Rachel if she would worry less if the person who had abandoned the papers had been a stranger. She replies that it would make life a bit simpler but does not resolve her fundamental dilemma, which is whether she should actually make use of the information. Simon and Rachel debate this issue for some time, saying that a useful yardstick would be to consider how they would feel if the boot were on the other foot. If they had ‘lost’ some client information that was found by a competitor, would they expect it to be returned, or would they assume that the finder would try to use it, and what would be their reaction if they did?

Rachel continues to feel that shredding the papers is the right course of action. She is dismayed that Simon argues that since the papers had been abandoned and Rachel had done nothing dishonest in obtaining them, there was absolutely no reason why she should not make use of them. He even suggests that if Rachel does not intend to use them, she should give them to him. At the team meeting next Monday, Rachel recounts what had occurred on the train and her struggle to decide what to do with the papers that she had retrieved from the bin. She adds that she had discussed the matter with Simon but that they had been unable to come to a conclusion. Matthew, the partner, says that this represents an interesting dilemma and that he would be interested to hear the views of the other six team members. He recommends that they take some time to discuss it between them. After he gives them a few minutes to consider the matter, Matthew gives his team four possible courses of action for the Azure documents, shown to the left. Which one would you choose?

D YOU DO?

Visit cisi.org and vote for the course of action you feel most appropriate in this situation.
The results, together with the CISI’s own opinion, will be published in the March edition of the S&IR and will also be posted on the CISI website.
New Workbook Edition

Risk in Financial Services

The objective of Risk in Financial Services is to ensure that candidates have a broad understanding of the general principles of risk in business, the key risks that arise within the financial services industry, the influence of corporate governance, regulation and codes of conduct, and the approaches that are typically used to identify, reduce and manage specific aspects of risk.

A new edition of the Risk in Financial Services workbook (valid for exams from 22 March 2011) is due out, covering:

- principles of risk management
- international risk regulation
- operational risk
- credit risk
- market risk

Price: £75

Three New Workbooks

International Introduction to Securities & Investment

The International Introduction to Securities & Investment workbook provides an introduction to the world of finance and the global financial services industry for candidates working outside the UK. A new edition of the International Introduction to Securities & Investment workbook (valid for exams from 21 April 2011) is due out and will cover:

- the financial services industry
- the economic environment
- financial assets and markets
- equities
- bonds
- derivatives
- investment funds
- financial services regulation
- other financial products
- taxation and trusts.

Price: £75

Principles of Financial Regulation

The Principles of Financial Regulation unit is part of both the Investment Operations Certificate (IOC), also known as the Investment Administration Qualification (IAQ), and the Certificate programmes. It aims to give candidates an understanding of the regulations and legislation that underpin financial markets and the investment business conduct that is more appropriate to the wholesale sector. A new edition of the Principles of Financial Regulation workbook (covering exams from 12 March 2011) is due out now and will cover:

- the regulatory environment
- the Financial Services and Markets Act 2000
- associated legislation, regulation and European Union directives
- FSA Conduct of Business Sourcebook/Client Assets Sourcebook.

Price: £75

Wealth Management

The CISI’s Wealth Management qualification is the first career pathway to be launched as part of the CISI’s new Masters Programme (CISIM).

The CISIM (Wealth Management) represents the natural evolution of the existing IOC Diploma for wealth managers, private client managers and IFAs, and has allowed the CISI to blend together aspects from existing Diploma modules into a package that offers wealth management firms and practitioners a dedicated professional qualification. The programme comprises three units:

- Financial Markets
- Portfolio Construction Theory in Wealth Management
- Applied Wealth Management.

There are new workbooks for each of these units, with corresponding exam dates in June.

Price: £150 each

Investment Management

The Certificate in Investment Management is the appropriate competence-based qualification targeted at investment professionals who are engaged in managing investments, dealing in or advising on securities or derivatives, and undertaking activities as a broker fund-adviser.

A new edition of the Investment Management workbook is due out (valid for exams from 22 March 2011), covering:

- economics
- financial mathematics and statistics
- industry regulation
- asset classes and investment strategies
- financial markets
- accounting
- investment analysis
- taxation
- portfolio management
- performance measurement.

Price: £75

External specialists

The CISI relies on industry practitioners to provide knowledge and expertise for its exams and workbooks, as workbook authors and reviewers, item (question) writers, item editors and exam panel members. All of them receive several benefits for their involvement.

About 300 external specialists have volunteered their time, knowledge and experience to assist the Institute – but more are needed.

The CISI is currently looking for specialists in derivatives to write questions for its level 4 Derivatives exam. While technical expertise in the subject matter is required, training will be provided in question writing for multiple-choice exams. A modest fee will be paid for each question that is supplied.

To register your interest, please contact Iain Worman on 020 7645 0609 or download the application form available via:

Conferences
The ideal way to gain practical insight into the latest issues from key regulators and practitioners and to network with industry peers.

17 MARCH Private Wealth Management
Haberdashers’ Hall, London
Sponsored by Raymond James Investment Services

14 JUNE CISI Annual Conference
Glaziers Hall, London

London Events

20 JANUARY FCSI Masterclass: John Moulton, Chairman, Better Capital
Ironmongers’ Hall, Shaffesbury Place, Barbican, EC2

24 JANUARY The HR Professional’s Guide to the RDR
America Square Conference Centre, 1 America Square, E14

2 FEBRUARY Fundamentals of Asset Servicing
SWIFT, The Corn Exchange, 55 Mark Lane, EC3

7 FEBRUARY Long Commerce: Transactions Across Time
Museum of London, 150 London Wall, EC2

8 FEBRUARY Founders’ Series: Anthony Thomson, Co-founder and Chairman, Metro Bank
Willis Ltd, 61 Lime Street, E1

10 FEBRUARY Next Generation Energy – Investment Opportunities in the Renewables Sector
20 Canada Square, Canary Wharf, E14

16 FEBRUARY An Inspector Calls – A Run Through of the Powers of the FSA, HMRC, SFO and BIS
Reynolds Porter Chamberlain, Tower Bridge House, St Katherine’s Way, EIW

21 FEBRUARY Risk Governance – Designing the Board’s Role
America Square Conference Centre, 1 America Square, E14

24 FEBRUARY The ABC of the Bribery Act
America Square Conference Centre, 1 America Square, E14

1 MARCH UCITS and its Implications for Europe
Standard & Poor’s, 20 Canada Square, Canary Wharf, E14

3 MARCH Depositary Receipts Demystified
TBC

7 MARCH Technology: Making Sense of the Systems Available Today in the Financial Sector
CISI, 8 Eastcheap, EC3

8 MARCH Austerity and Growth – Can They Co-exist?
America Square Conference Centre, 1 America Square, E14

31 MARCH The Role of Financial Planning in Wealth Advice
America Square Conference Centre, 1 America Square, E14

Professional Courses
Venue: London unless otherwise stated

19/20 JANUARY Understanding Regulation and Compliance £895.00

1 FEBRUARY Mastering Communication Skills in Financial Services £495.00

7 FEBRUARY Investment Principles and Risk (PCIAM)* (half day) £295.00

7 FEBRUARY Investment Principles and Risk (IAC)* £495.00

7/8 FEBRUARY Investment Principles and Risk (LSE)* £995.00

9 FEBRUARY Pensions and Retirement Planning* £495.00

16 FEBRUARY Securities* £495.00

2 MARCH Training Competence and Managing Expertise in a Regulated Environment £495.00

15 MARCH Introduction to Financial Markets £495.00

23 MARCH Operational Risk: Taking it to the Next Level £495.00

24 MARCH Pensions and Retirement Planning* (Venue: Leeds) £495.00

*This event fulfils the requirements for qualifications top-up to fill gaps between existing CISI exams and the new Retail Distribution Review exam standards

Attendance at CPD events is free to all Institute members as part of your membership benefits. Bookings for all events, except dinners and FCSI masterclasses, can be made online at cisi.org

For further information about London CPD seminars, or to obtain your login information in order to book online, please contact Ged O’Mara on +44 (0)20 7645 0648 or email cpdevents@cisi.org

For further information about regional CPD events, please call Hannah Steele on +44 (0)20 7645 0648 or email region@cisi.org

Attendance at CPD events, conferences and training courses earns you active learning hours in the CISI CPD scheme. Hours are added automatically to your log after attendance at CISI events.

For details about regional social events, including annual dinners and luncheons, call Alexandra Blunden on +44 (0)20 7645 0717 or email regionalsocial@cisi.org

Member and Fellow discounts

Conferences/training courses discount: Fellows 35%; Members 30%; Associates 20%.

Extra training courses discount: make two bookings together and get a 10% discount; three bookings together, a 15% discount; four or more bookings together, a 20% discount.

Visit cisi.org, call +44 (0)20 7645 0680 or email clientservices@cisi.org for more information.

CISI members can now attend any CISI conference for just £199 (non-members £399). For further details, visit cisi.org, call +44 (0)20 7645 0680 or email clientservices@cisi.org

CONFERENCE SPONSORSHIP
If you would like to raise your profile among CISI members and be associated with the excellence and integrity promoted by the Institute, you might like to consider taking up one of the sponsorship or exhibition opportunities at a conference. For more information, please contact Fran Murrells, Head of Professional Development Events, at +44 (0)20 7645 0725 or email fran.murrells@cisi.org

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Visit cisi.org, call +44 (0)20 7645 0680 or email clientservices@cisi.org for more information.
EVENTS

CISI annual dinner

The unmistakeable voice of actor and adventurer Brian Blessed boomed out at the CISI annual dinner. The guest speaker regaled about 280 guests with tales from his television career and expeditions, including three ascents of Mount Everest.

The welcome speech at the Institute's premier social event of the year, held at Plaisterers' Hall in the City of London, was given by CISI Chairman Alan Yarrow, Chartered FCSI(Hon).

• A lifetime achievement award was presented to Tom Tutton, Chartered FCSI, at the annual dinner of the CISI’s Manchester & District branch. Tom, a partner at S&T Asset Management in Stockport, was recognised for his 50 years’ service to the financial services industry.

The dinner at the Lowry Hotel in Manchester was attended by 110 guests and the speaker was entertainer Roy Walker. More than £750 was raised for Forever Manchester, a charity that supports local community projects.

SELECT BENEFITS

Work out for less

If your New Year’s resolution is to get in shape, help is at hand through the CISI Select Benefits programme. As part of a package of exclusive offers for Institute members, Select Benefits enables you to save pounds while you lose them at the gym.

Scheme partner Incorpore provides access to a network of more than 2,000 health clubs, gyms and leisure centres, all of which offer the lowest available corporate rate for the type of membership you require.

You are guaranteed to save at least £50 and as much as £250* against the normal rate, assuming you don't already qualify for lowest corporate rates through your work. Participating health clubs include Fitness First, Nuffield Health, LA Fitness and Esporta.

Other benefits available include:

Energy savings
Member Energy’s free energy price comparison service will help you find the cheapest gas and electricity suppliers in your area. Average member savings are £172*.

Discounted holidays
Frequent Holidays work with some of Europe’s largest leisure companies and can offer you unbelievable deals on holiday properties worldwide. Enjoy a week’s break in a choice of 1,500 resorts worldwide for only £250.*

For more information about how to obtain these deals and other savings, visit cisi.org/memberlogin

* Terms and conditions apply. See website for further details. All details above are correct at time of print. Figures above have been gathered from actual member savings where possible.
**Professional interest forums: 2011 dates**

The CISI's professional interest forums (PIFs) are a key membership benefit. These are discussion groups that meet regularly to debate current issues and hear presentations from industry speakers.

There are seven forums, each covering a different topic. This year, the forums will be on compliance, corporate finance, IT, operations, risk, wealth management and, new for 2011, Islamic finance. The sessions are free and open to all CISI members.

When you attend a forum, the CISI will automatically log the hours for you as ‘Active Learning’ hours on the Institute’s CPD scheme. The forums are held at various locations in the City and usually take place from 12.30pm to 2pm, with a light lunch served. Provisional dates for the 2011 programme, which will feature a record 36 events, are as follows.

**Compliance Forum**
- 19 January
- 16 March
- 18 May
- 5 July
- 21 September
- 16 November

**Corporate Finance Forum**
- 19 January
- 16 March
- 18 May
- 5 July
- 21 September
- 16 November

**Islamic Finance Forum (New)**
- 18 January
- 21 June
- 18 October

**IT Forum**
- 3 February
- 28 April
- 30 June
- 27 October

**Operations Forum**
- 11 January
- 9 March
- 10 May
- 29 June
- 5 October
- 1 December

**Risk Forum**
- 13 January
- 17 March
- 12 May
- 23 June (evening event)
- 15 September
- 17 November

**Wealth Management Forum**
- 25 January
- 29 March
- 24 May
- 12 July
- 27 September
- 29 November

**Corporation Finance forum annual dinner**

Ethics in the City was the theme of guest speaker Anthony Hilton, Financial Editor of the London Evening Standard, at the second annual dinner of the corporate finance forum.

The black tie event, held at London’s Naval & Military Club, was attended by 21 members of the forum and guests.

An update on activities of the forum was given by its Chairman, Frank Moxon, Chartered FCSI. The CISI would like to thank Hoyt Moxon for sponsoring the dinner.

**More information about forthcoming events can be found at cisi.org/pifs and will be sent by email to members of each forum in due course. To join the mailing list for any of the PIFs, please email pifs@cisi.org**

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**Membership admissions and upgrades**

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**IMEF**
- Iad Boustany
- Bilal Sheity

**Inenco**
- Katrina Oldham
- Jonathan Fry plc

**J.P. Morgan**
- James Scott
- Chandrika Sheshadri Iyer

**Kleinwort Benson**
- Mark Childs

**Mazars**
- Louise Wise

**Montpelier**
- Paul Dickinson

**Octopus**
- Heinrich Schutze

**Pamment**
- Claire Robbins

**PricewaterhouseCoopers**
- Stuart Callion

**Psigma**
- David Kness

**Quilter**
- Katie Davey
- Edward Lummis

**Rathbones**
- Jonathan O’Hara
- Redmayne Bentley
- Louise Brearley
- Neill Talbot

**Royal Bank of Canada**
- Adam Dorey
- Christopher Girdler
- Michael Greenwood
- Edouard Le Miere
- Jamie Winton

**Royal Bank of Scotland**
- Denis Clark
- SG Hambros Bank
- Daniel Cooper
- Charles Moss

**Smith & Williamson**
- Nicola Landes
- Graeme Risby
- James Smyth
- Speechly Bircham
- Sharon Fernando
- Tata
- Ravi Veeraraghavan

**Yorkshire Bank**
- Steve Drury

**Others**
- Julian Cafla
- Martina Faherty
- Aizhan Kalkayeva
- Thomas Malone
- Jitendra Mehta

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This list includes membership admissions from August 2010

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**Answers to the quiz from page 10. Question: 1:D, 2:B, 3:A, 4:B**
Janine Catterson, Chartered MCsI, believes that everybody should have the opportunity to experience life at sea. Lora Benson reports

**All aboard!**

Janine Catterson, Chartered MCsI, believes that everybody should have the opportunity to experience life at sea. **Lora Benson** reports

All aboard!

Janine Catterson, Chartered MCsI, believes that everybody should have the opportunity to experience life at sea. Lora Benson reports

Janine Catterson, Chartered MCsI, believes that everybody should have the opportunity to experience life...
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Course participants are also prepared for the Derivatives Examination of the CISI Chartered Institute for Securities & Investment. Since the Certified Eurex Trader Exam is accepted as a credit against the UK regulatory paper, participants can gain the full “International Certificate in Derivatives” after passing both examinations.

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