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FSFocus

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COMPETITIVE EDGE
THE FUTURE OF UK COMPETITION LAW AFTER BREXIT

TROUBLED WATERS

Could the next crisis be an unpredictable 'black swan' event?

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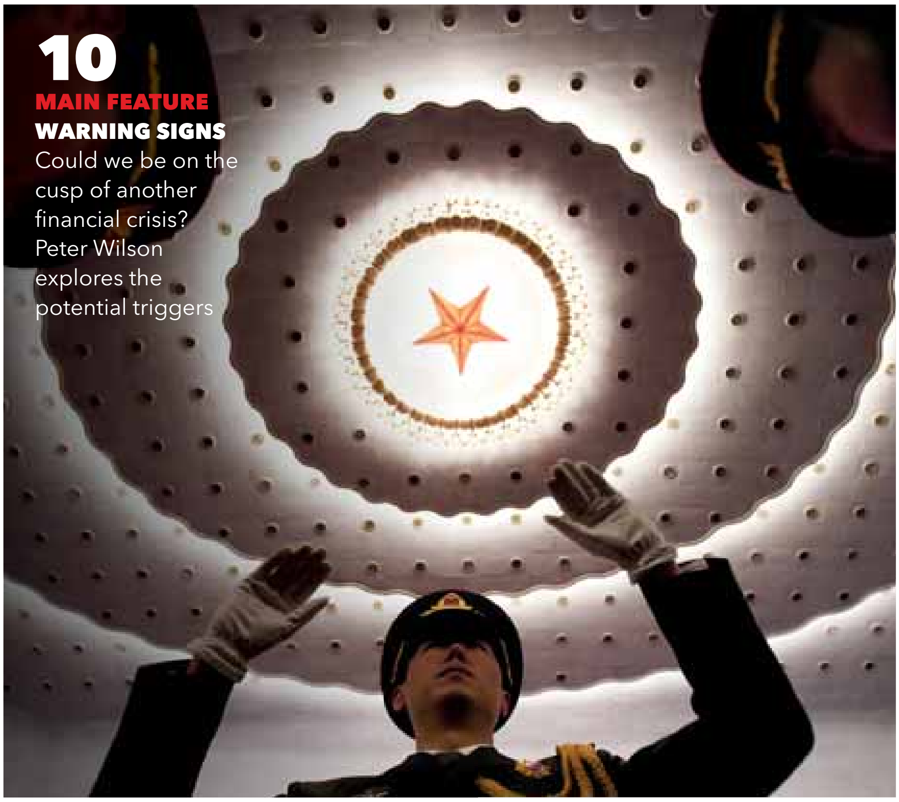

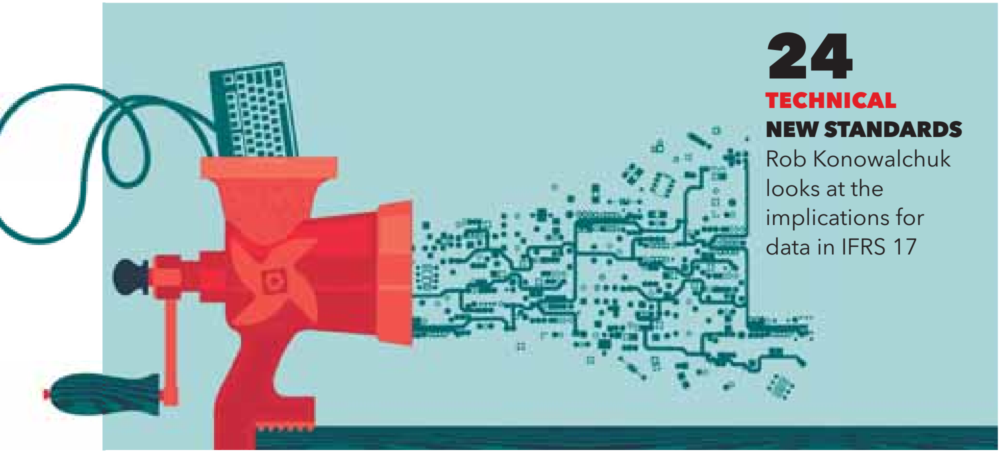

Do the right thing

Whether it's the gender pay gap, claims to have reduced plastic consumption or supplier payment terms, companies' practices and behaviours are rightly coming under increasing scrutiny. People are ready to vote with their money, their feet and their social media when the places they buy from don't align to their values. This is reflected in the increasing interest in environmental, social and governance reporting by business.

While expectations of companies are increasing, so are expectations of stewardship. In her speech on the future of audit made at Chartered Accountants' Hall on 2 April, Rachel Reeves, chair of the Business, Energy and Industrial Strategy Committee, said that investors do not ask enough questions. Statistics on shareholder voting and the dominance of proxy advisers would say she's right.

It is an interesting time for stewardship, as more and more of us – whether we label ourselves as such or not – are investors, be it through auto-enrolment, ISAs or other products. However, an increasing amount of our investment is passive, through trackers, index funds and other products such as exchange-traded funds. These types of investments are concentrated in three large institutional investors, who use two main proxy advisers for shareholder voting.

The nature of passive investment means there is inherent conflict in putting effort into stewardship, due to its cost, the fact that any benefits gained would benefit other trackers and indexes equally, and given the large number of companies forming the index, any incremental gain is not likely to meaningfully benefit the fund overall.

So when everyone's an investor, who is responsible for making sure companies do the right thing? The Financial Conduct Authority said in its 2019/2020 business plan that it is prioritising further focus on stewardship. This is well timed as there are some increasingly difficult questions to answer, particularly around the increase of passive investment (Moody's predict passive investing will overtake active in the US by 2021) and its effect on stewardship.

Climate change protests taking over London, Waterstones staff petitioning the company to pay the living wage, potential audit reforms to make reporting more accessible and meaningful to other stakeholders...These things may not seem to have anything in common, but they all point to the fact that everyone has a role in making sure the right thing happens.

As more of our futures are inevitably tied to company performance, better engagement is needed.

Philippa Kelly

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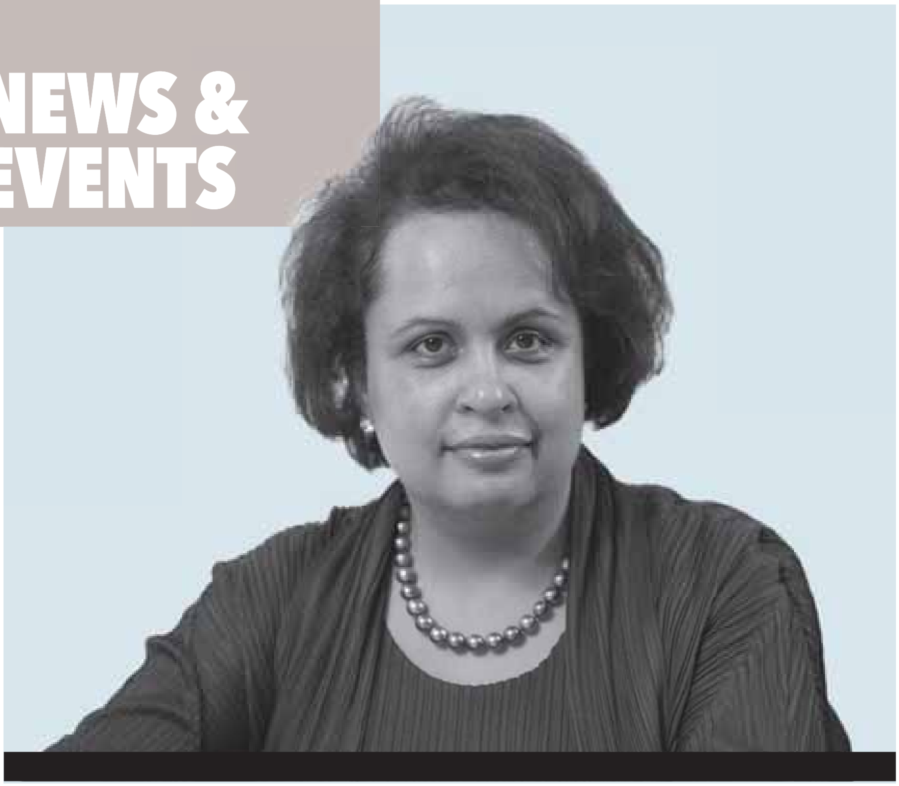


CHAIRWOMAN'S REPORT: FACULTY CHAIR

Pam Kaur talks about the big picture challenges currently facing the financial services sector

The faculty has engaged on a broad range of issues with a variety of stakeholders over the last 12 months. We continue to think about how to best serve our members, helping them to stay up-to-date with topical issues like Libor transition and Senior Managers & Certification Regime readiness for all solo-regulated firms, and you will see some changes to the faculty from next year.

We have been progressing our thought leadership in tackling the big picture challenges. Last month the faculty published principles on the ethical use of big data in financial services, and will be hosting roundtable discussions to test and challenge these with a variety of people and organisations.

Society has started to wake up to the power and influence of big tech, which is underpinned by data. Financial services may face similar ethical considerations as use of big data and artificial intelligence becomes more prevalent. We need to make sure the sector is true to its social purpose and gets it right first time, whether it be in relation to banking, insurance or investment management.

Society is also more and more engaged with the impact that the choices made by financial services firms, and the choices they help others make, affect the world we live in. And this impact is increasingly measurable.

We are acutely aware of the increasing momentum behind environmental, social and governance criteria – and in particular the Taskforce on Climate-related Financial Disclosures. We are working on a guide to implementing the recommendations, which will be a practical resource for members undertaking this new challenge as part of the Better Information strand of our thought leadership programme.

Society is also more and more engaged with the impact that the choices made by financial services firms, and the choices they help others make, affect the world we live in

There has been excellent engagement with our recent report *Information overload: effective boards and committees in financial services* demonstrating the faculty's role as a critical friend and the continued commitment of our members to strive for best practice.

While banks and others are gaining confidence in their IFRS 9 reporting, insurers are still waiting for the IFRS for insurance contracts to be finalised. The past months have also seen detailed engagement with the International Accounting Standards Board on technical issues related to IFRS 17, including accounting for equity release mortgages and deferred annuities to help reach a pragmatic and practical approach to these complex issues. There is continuing support for Client Asset sourcebook (CASS) auditors and CASS firms in working toward best practice on applying the rules and the assurance standard, through events, webinars and helpsheets.

We hope you have enjoyed *FS Focus* magazine so far this year. ●

Pam Kaur, chairwoman, Financial Services Faculty

BREAKING THE BANK

As fake heiress Anna Sorokin hits the headlines for duping a bank, *FS Focus* takes a look at the other creative ways criminals have conned banks

Anna Sorokin lived a lavish lifestyle, staying in a five-star hotel in New York and spending thousands on cryotherapy, makeup and shopping expeditions. She hung out with celebrities, such as Macaulay Culkin, was a familiar fixture of the European fashion set and planned to set up a Los Angeles art club.

To fund all this, Sorokin pretended to be a German heiress called Anna Delvey due to inherit a $60m fortune. In reality she was the Russian-born daughter of a lorry driver from a town near Cologne. She stole from friends, hotels and, perhaps most surprising, a bank. Her act was so convincing that the City National Bank lent her $100,000.

"We always believed that she had the money," Ryan Salem, a banker at the City National Bank, told a Manhattan court. "She seemed to speak the language. She understood the financial jargon that you need to know to interact and transact in this environment."

But she's not the first person to cleverly exploit a bank and she won't be the last. Fraudsters can be very convincing, and it has never been easier to bypass banking systems and protections and evade prosecution, especially online. Here are just some new methods that have been used...

STUDENT MULES

This unbelievably simple method involves students selling their bank accounts – giving another person their account details such as log-ins – for as little as £50, often as they are finishing university and heading abroad. To evade strict checking procedures, these 'mule' accounts are then used by fraudsters to transfer and launder money through the banking system.

Sometimes fraudsters even involve the students in their actions – for example, telling students that £20,000 will be going into their account and that they should send £19,500 of it to a different account, and keep £500 for themselves.

THE DARK WEB

At Monzo, the fraud team has had to deal with a person they refer to as Fraudster No. 1 (as he was the first account holder that the bank identified as a con man).

This person used the dark web to buy a few hundred debit and credit cards, then loaded cash stolen from these cards on to his Monzo pre-paid card and bought a load of goods. Fraudster No. 1 even posted the high-value electricals he bought on Instagram. But the amount he stole (£40,000) was deemed not large enough for the National Crime Agency to apprehend the suspect.

£100K
AMOUNT ANNA SOROKIN WAS LOANED BY CITY NATIONAL BANK

£50
STUDENT MULES SELL THEIR BANK ACCOUNT DETAILS FOR AS LITTLE AS £50

£40K
AMOUNT FRAUDSTER NO. 1 STOLE AND LOADED ONTO HIS PRE-PAID MONZO CARD

CRIMINAL FOR HIRE

Cybercrime is now even being offered as a service online. This means you don't have to be a hacker yourself, you can just hire one per hour. This is known as 'pay-as-you-flow', and it's proving surprisingly and worryingly popular behind the scenes.

To try and combat these growing challenges, banks have been redoubling their efforts, throwing vast amounts of money at defensive measures, but these are not proving good enough.

Instead, financial crime experts insist it is about the institutions using technology more wisely. At present, the majority of crime alerts are of no use to law enforcement. Better machine-learning technologies will allow financial service firms to evaluate vast quantities of data more quickly and fine tune surveillance tools, freeing up experts to investigate truly suspicious patterns of behaviour and transactions as a result.

There also needs to be greater collaboration between specialists in cyber and financial crime. The crossover is now becoming so common, it makes perfect sense for them to map a combative route together and share knowledge and resources. Mapping virtual currency use to spot bad actors attempting to breach system defences and profiling the digital fingerprints left behind by criminals is key.

"This year could be a pivotal one in the fight against financial crime," wrote Bill Winters, chief executive of Standard Chartered, in the *FT*. "The bad guys are not standing still. Neither should we." ●

GETTY

FUTURE PROOF

Laura Barber talks about the importance of empowering your business with the ACA qualification

As technology continues to change the face of the profession, your organisation needs people who are financially literate to survive. To thrive, it needs people who can see the bigger picture. The ACA can help you with both.

The ACA equips students to work in an age of rapid technological change. Its integrated components provide them with an in-depth understanding across accountancy, finance and business. We constantly evolve the ACA to ensure it meets market needs, providing peace of mind that what your employees learn is relevant and you're future-proofing your organisation. The introduction of a banking and an insurance variant to the Business Planning paper provides students with the opportunity to gain sector-specific knowledge while studying.

We recognise that professional qualifications are a significant investment for any organisation. However, we have made sure that ours deliver greater returns, faster. Thanks to the high level of support we provide, first-time pass rates for the ACA are typically 79%. Higher pass rates mean fewer resits and less time out of the office.

Our tuition providers offer a range of flexible evening, weekend and online studies, meaning employees can fit it around busy times and the business's operational needs. The ACA exams are computer-based assessments, reflecting developments in technology and workplace skills; and our certificate level is on-demand meaning they can be sat at a time most convenient for all. As an employer we give you the tools to monitor your employees' progress, and the support provided to you is unrivalled.

We are committed to widening access to the profession and have five main routes to becoming an ICAEW Chartered Accountant, so you can choose the option that works best. Apprenticeships are available at level 4 (CFAB) and level 7 (ACA), as well as fast-track and joint-qualification options with both Association of Accounting Technicians and Chartered Institute of Taxation. If you'd like to explore ACA training options further we'd love to hear from you, but don't just take my word on how well it can be integrated within financial services…

"The ACA has provided an integral base of the knowledge expected in my role within Morgan Stanley. The ability to choose modules, such as Business Planning: Banking, gave a tailored experience more applicable for us and touched on many business areas we work on in our day-to-day roles. The qualification and training has given us credibility in our jobs and helped the progression of our careers as junior analysts, allowing us to add value in areas where previously we may not have."
Jack Wallwork ACA, Morgan Stanley

"The ACA and the variation in the different modules have provided a platform of knowledge I will be able to build on throughout my career. Business Planning: Banking was particularly relevant at the time of sitting the exam, and the piece on Basel III has really helped with my progression throughout the graduate programme."
Megan Prescott ACA finalist, RBS

"We ask our graduates to complete the ACA as part of their programme as it's important for us to have qualified accountants. It also opens up bank-wide opportunities for them in the future. The qualification gives them wider knowledge, skills and capabilities for them to add value and insight across various pieces of work within internal audit."
Lynn Wight, people support manager, internal audit, RBS

Laura Barber, client relationship manager, ICAEW

E-BULLETIN

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

BLOG AND PODCAST

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

DAVID SMITH

GROWTH FORECASTS

Looking for an economic early warning system

With every passing year, the number of people who claim to have seen the global financial crisis coming grows. Soon it will be hard to find any expert who did not predict it. In reality, the run-up to that dreadful autumn of 2008 was highly confusing. Everybody knew something bad was happening in credit markets but assessing how that would impact on the economy was much harder. What happens in markets does not always make the transition to the real economy.

That task was made more difficult by the economic data. Forecasters are at their weakest at big turning points, not least because of the tendency to assume that what is happening now is likely to continue to happen.

Looking at the data in the run-up to the crisis, assuming things would continue much as they were would have sent anybody badly astray. Employment in the UK rose by a strong 344,000 in the year to the summer of 2008, while in the figures published at the time, GDP continued to rise.

The best canary in the coalmine, in fact, was house prices. They began to weaken significantly in autumn 2007, after the run on Northern Rock, and by the summer of 2008 the Nationwide house price index was showing a fall of 10.5% on a year earlier. Of all the data, house prices provided the clearest warning.

Now fast forward to 2019. What do the conventional statistics tell us? They show that GDP has continued to rise, albeit slowly – by 0.2% or 0.3% a quarter – with most growth forecasts for this year clustered at just above 1%. Brexit uncertainty has clearly been playing a part.

House prices have weakened, though nothing like as much as they did in 2008. House price inflation has dropped to just above zero, according to Nationwide, while the official house-price measure has prices rising at their slowest pace for six years.

Both GDP and house prices tell us that the economy is fragile. They also tell us that it would not require much of a nudge to push the UK into recession. They may, however, merely be pointing to a period of stagnation rather than anything worse.

The purchasing managers' surveys, covering manufacturing, construction and services, are seen by many as good indicators of future changes in GDP. These business-to-business surveys are more timely than the official figures. Their message so far, though, is similar to that of the GDP figures. If anything, they are weaker in some of the big eurozone economies, notably France and Italy, than Britain. They are also capable of giving misleading signals; immediately after the referendum the purchasing managers index readings plunged into recession territory but there was no recession.

There is, then, a gap here. At one time the Office for National Statistics (ONS) used to produce leading indicators for the economy, including a range of financial market indicators, but they were scrapped to save money.

The ONS has, however, been working on some new datasets, what it calls "faster economic indicators". According to the ONS: "The new indicators include producing a diffusion index using early VAT returns that will show whether, on average, UK businesses are seeing turnover grow or not. There will also be a new index that uses ship tracking data to monitor the level of traffic coming in and out of each UK port and an index using road traffic camera data to track the number of lorries on England's roads."

The ONS stresses that it is not trying to second-guess or predict what the GDP figure will be, but the new indicators are said to have performed well in signalling that earlier downturns were on the way. The test will come with the next one. And that may not be too far away. ●

David Smith, economics editor, *The Sunday Times*

LESSONS LEARNED

Alison Miles explores the darker side of financial innovation

Financial innovation often promises to reduce costs and improve products and services, giving access to new customers and markets. But it also has a darker side.

For example, subprime mortgages - the demon of the financial crisis - emerged in the 1990s as an innovation that allowed those who were previously excluded from being able to take out a mortgage to join the ranks of homeowners. The development of credit default swaps, collateralised debt obligations and other derivatives gave rise to new and innovative financial products that were hailed at the time as beneficial, allowing improvement to efficiency by the sharing of risk.

In 2007, Ben Bernanke, then-chairman of the Federal Reserve Board of Governors, called for a light regulatory touch to innovation. “Regulators should resist the temptation to devise ad hoc rules for each new type of financial instrument or institution,” said Bernanke.

Within the banking sector at the time, there was a genuine belief that risk, previously the curse of the sector, could be reduced or even eliminated by financial innovation. History, as is so often the case, took a different view, with the onset of the financial crisis.

But should we be worried by the rise of financial innovation?

A NEW ERA

Fintech 3.0 is a term used to cover cryptocurrencies such as bitcoin, blockchain, as well as peer-to-peer (P2P) lending, crowdfunding and mobile payment systems. Together they have led to a change in how banks and borrowing operates.

The growth in Fintech 3.0 began with the unintended consequences of the Basel III regulations. This led to a squeeze on the availability of capital for small- and medium-sized companies that turned to new P2P lending platforms for credit. The growth of P2P lending came from society’s change in attitude towards more of a sharing economy. These same attitudes led to the growth of market disruptors such as Airbnb.

At the same time, the market for residential mortgages moved from traditional banks to non-depository institutions. These lenders, such as Quicken Loans, process online mortgage applications using big data to screen borrowers, rather than traditional loan officers, which makes them faster and cheaper. They work almost entirely through securitised loans rather than holding the loans on their balance sheets. In a notable recasting of roles, Fannie Mae and Freddie Mac in the US now play a dominant role in guaranteeing the shadow banking sector loans.

The rise of this innovation is not lost on the traditional banks, with research from IBM predicting that 66% of banks will have commercial blockchain by 2020.

Bank of America, Citigroup, Morgan Stanley, Deutsche Bank and Barclays have already started down this path and Goldman Sachs has more programmers and tech engineers than Facebook, according to *Business Insider*.

Fintech 3.0 gives life to the shadow banking sector, which the Financial Stability Board estimated was around $45trn in 2016. The sector is self-governing and outside current regulations. This is worrying to regulators and policymakers alike as they move to get tough on some products. The Basel Committee’s March 2019 statement on crypto-assets saw it being as clear as can be that it is nervous and concerned.

BOARD IDENTITY

The question is: how can we avoid failures in financial institutions embracing financial innovation? After all, the FICC Markets Standards Board analysis of 225 years of misconduct in financial markets showed the same poor behaviours repeated and simply adapted to new products, geographies or with new technologies.

One answer is to consider the leadership styles and characteristics of the boards. In the July/August 2018 issue of *FS Focus*, we explored this very topic. It found that those who show a vision, are good at public speaking and show absolute confidence in their position - coupled with more ‘transactional’ characteristics of a concern for the numbers and processes - were good at treading the line between managing the risks and embracing the opportunities of financial innovation to be successful.

As long as there are regulations, there will be new financial innovations. It’s a case of making sure firms are in the right hands to weather the next financial storm. ●

Alison Miles, module leader, corporate governance and international business, Plymouth University

THE NEXT FINANCIAL CRISIS

The clock is ticking on a shift in the global economic cycle and there are fears it could turn into a genuine financial crisis. Peter Wilson looks at the potential triggers for a downturn becoming a calamity

This month, the US is due to achieve the longest period of economic growth the country has seen since the Second World War – an achievement that will thrill president Donald Trump but set many nerves on edge.

"Everybody knows that the growth cycle cannot last forever," says Antonio Fatas, an economics professor at INSEAD business school in Singapore.

"And before too long things will turn down," he adds. "In fact, there are enough imbalances and economic indicators blinking right now that if a recession happened tomorrow nobody could say it is a surprise."

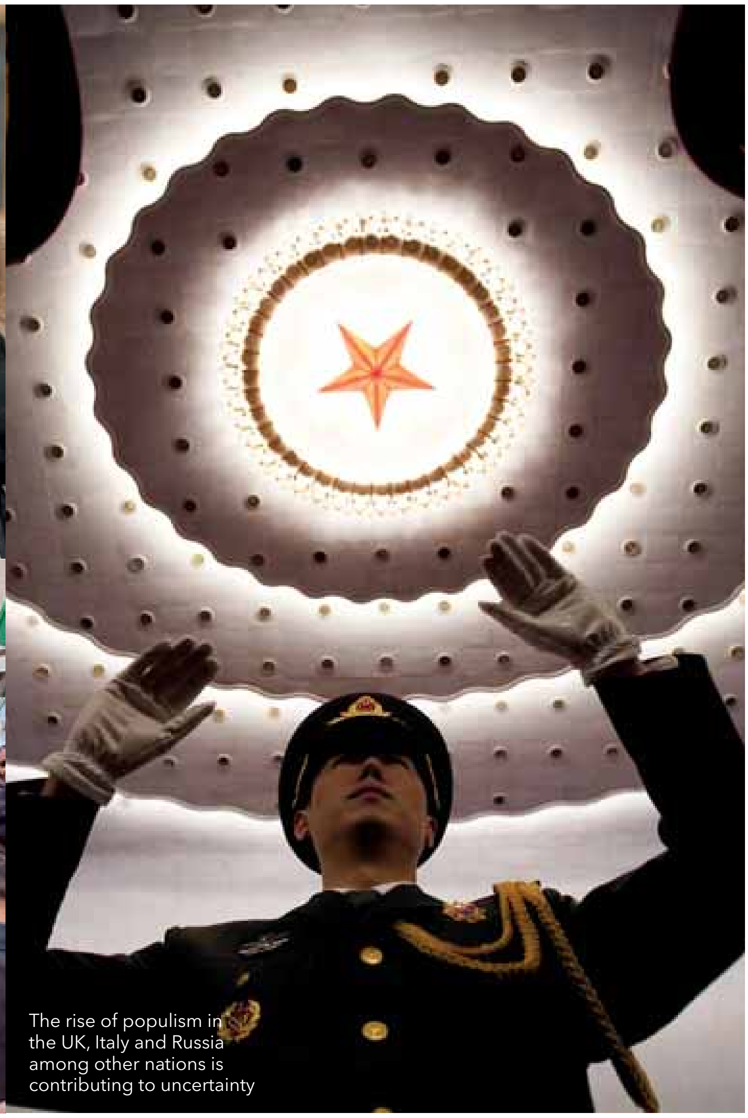
The current expansion cycle nears the 118-month boom of the 1990s. Stretching the good times beyond this record will inevitably bring the US and global economies closer to a recession. But the real question is whether there will eventually be not just a cyclical slowdown but a genuine financial crisis akin to the carnage of 2007/08.

"All we really know is that the next crisis will not be like the last one because it will come from some other channel or trigger," says Matthew Oxenford, a researcher on financial regulation at the Chatham House thinktank in London.

A scan of the economic horizon shows plenty of potential triggers and quite a bit of concern about whether governments and central banks will be able to cope with any shocks.

Amid a surge of populist politics on several continents there is a growing danger that policy missteps may spark a meltdown and there are genuine fears about the capacity of the current generation of leaders to deal with any such crisis.

Ken Rogoff, the former International Monetary Fund (IMF) chief economist, notes that the British government's



The rise of populism in the UK, Italy and Russia among other nations is contributing to uncertainty

handling of Brexit has left little confidence in its ability to provide the agile leadership displayed by Gordon Brown during the 2008 financial crisis.

Rogoff poses a pessimistic question: "Can anyone honestly say that Donald Trump's administration has the skill and experience to deal with a major collapse?"

None of the threats stand alone. An unexpected surge in interest rates, for example, could spark corporate collapses and exacerbate populism in Europe, where there are already record debt levels, anxiety over Brexit and tensions over financial burden-sharing.

So, what are the most dangerous triggers of the next financial crisis?

TRUMP'S CREDIT CARD

Under Donald Trump, growth in the US has relied heavily on a sugar-hit of unfunded tax cuts and Washington's soaring fiscal deficit.

Dr Elliott Morss, a US economic consultant and former IMF economist, believes the single greatest danger to the world economy is the US president's willingness to keep borrowing ahead of his 2020 re-election campaign.

"He will do anything to keep the economy growing until the election and that includes running up more and more debt and badgering the Federal Reserve (Fed) to keep interest rates down," says Dr Morss.

"The markets will wake up to the fact that the US is now the most fiscally reckless country in the world and its trade deficit makes the fiscal deficit even less sustainable. It's just a matter of time before a global rush to liquidate US dollar assets generates a severe financial crisis."

Oxenford agrees that a breach of Congress's debt ceiling could spark panic, noting that during Trump's 2016 election campaign he openly mused about defaulting on US debt. "I don't think he would do that but the fact we are even discussing the possibility is a sign we should be worried," he says.

COMPLACENT REGULATION

Congress and the White House moved quickly after Trump's election to roll back the tighter rules that were introduced after the last crisis, exempting smaller and mid-size banks from the more stringent oversight and stress tests and clearing the way for a new burst of high-risk corporate lending.

Banks in most countries generally remain better capitalised than a decade ago, but those in the 'too big to fail' category are now even bigger and a lot of risk has migrated to the shadow banking sector, where lending is carried out by less regulated non-banks.

The Bank of America estimates that assets in the global shadow banking

The single greatest danger to the world economy is the US president's willingness to keep borrowing ahead of his 2020 re-election campaign

systems are equal to 76% of world gross domestic product (GDP), dwarfing conventional bank assets of 40%.

China's shadow banking system is widely seen as precarious and the connections between national financial systems mean a crash in one country is even more likely to spark contagion.

In April, former Fed chair Janet Yellen warned that Trump's rush to loosen the lending rules so that more money could be pumped into the economy meant the next downturn "could be more serious and longer-lasting and more difficult to deal with than it would have been if we had constrained these practices".

RISE OF THE ZOMBIES

Record low interest rates and high global debt have seen a growth in the number of 'zombie' companies – firms that are fatally indebted but can stagger on because of their cheap financing.

The Bank of America defines zombies as companies with interest bills that are larger than their profits (earnings before interest and taxes). A frightening 536 major firms in Organisation for Economic Co-operation and Development countries are now in that category. A credit crisis, interest rate surge or collapse in corporate bonds would cause a liquidity crunch that could rapidly bring down the corporate 'living dead' in the US and, elsewhere, European banks and Chinese lenders.

Over-easy lending has seen a tidal wave of US corporate borrowing to fund share buybacks, which has lifted share prices, earnings per share and executive bonuses without producing any real investment in productive assets. US firms have issued $14trn of debt and spent a massive $5trn on stock buybacks since the last crisis.

Many analysts are concerend about the threat posed by a cyber attack big enough to disrupt the financial system or the infrastructure of a major nation

BLACK SWAN

An unpredictable event – or 'black swan' – poses a growing risk in an increasingly interconnected world.

It is hard to envisage a natural calamity on such a scale that would disrupt the world economy, according to senior Turkish economist Sabri Öncü, a former head of a Reserve Bank of India research centre.

It will hopefully be many years before climate change threatens the viability of the insurance industry or impairs the real economy, for example.

A major war would obviously rattle markets. The usual suspect as a tinderbox is the Middle East, but the rise of renewables and US domestic energy production means that a disruption of oil and gas exports is becoming a less significant threat. A military misadventure in the South China Sea could also have a global impact, but the threat that many analysts find most worrying is the possibility of a cyberattack big enough to disrupt the financial system or the infrastructure of a major nation.

Russia, China, North Korea and various others have the cyber-clout required to cause enormous problems, but state players know it would be the modern nuclear option, capable of prompting not just an economic war but perhaps the real thing.

THE OLD ENEMY: INFLATION

Easy money, tech innovation and the integration of China into the world economy have all helped to keep prices under control. However, it is risky to assume that we have ended the normal pattern of recessions resulting from inflation and rising interest rates.

In recent months, central banks have backed off their efforts to tighten monetary policy for fear of the knock-on effects to heavily indebted companies and governments, especially in the eurozone where countries such as Italy have borrowed heavily in a currency over which they lack sole control.

The worry is that fighting a serious outbreak of inflation would be harder now than a decade ago. The inexorable growth of both public and private debt, historically low interest rates and the stretched balance sheets of central banks have weakened the policy arsenal used in the last crisis. This has prompted Deutsche Bank analyst Jim Reid to worry that "we could be out of bullets when the next recession arrives".

"Could the next recession be the one where policymakers are the most impotent they've been for 45 years or will they simply go for even more extreme tactics and resort to full on monetisation to pay for a fiscal splurge?" he asks.

"It does feel that we're at a crossroads and the next downturn could be marked by extreme events given the policy cul-de-sac we seem to be nearing the end of."

Trump, meanwhile, has undermined confidence in US monetary policy by criticising Fed chairman Jerome Powell and appointing two fiercely partisan Republican critics of Powell's to the Fed's board of governors in an attempt to rein in the era of easy money.

TRUMP'S TRADE WARS

The president's tariffs and quotas have helped to give China its slowest growth rates in three decades and there are serious concerns that he could lash out against Mexico or other traditional allies in search of a vote-winning victory or simply as a distraction as the 2020 election approaches.

Retaliation could see things spiral out of control. Trump has already undermined confidence in rules-based global trade and Professor Fatas says other countries are anxiously watching the US-China friction over both trade and technology.

The recent efforts by Italy's populist government to endorse China's strategic rise point to the trouble that Trump may have in rallying support in a confrontation with Beijing.

Any suggestion that China might start to dump some of its $1.12trn of US Treasuries could trigger much wider issues for US government debt, shaking the strength of the dollar and making it harder for the US to finance its massive $20trn debt pile.

$20trn
The US's current debt

$14trn
The amount of debt issued by US firms since the last crisis

$5trn
The amount spent on stock buybacks since the last crisis

CHINA'S SLOWDOWN

The world economy's biggest growth engine in recent years, China is now so deeply integrated in global trade and investment markets that policymakers on every continent are worried about whether Beijing can control the pace of its slowdown.

Chinese officials made it clear at the National People's Congress in March that they are reluctant to launch a major stimulus campaign after earlier efforts in 2007 and 2015 left large debt loads, opting instead for limited tax cuts and targeted measures to keep domestic demand above 6%.

Dr Zhe Wen, a strategic risk analyst at RBS, says Beijing faces a delicate balancing act in trying to lower its leverage levels without stopping economic growth.

"Its private non-financial sector debt has shot up to 213% of GDP and history shows us that a credit boom like that is often followed by a crisis," he warns.

In March, China's slowdown was named for the first time in the Bank of America-Merrill Lynch monthly survey of global fund managers as the biggest "tail risk" for world markets.

FALL OF AN EMERGING MARKET

The perilous financial wobbles of Turkey and Argentina during 2018 were a reminder that emerging markets have in the past been regular breeding grounds for economic crises.

Öncü says developing economies should still be seen as a risk centre, although they do not pose as much threat as US stock markets, eurozone banks or China's credit system.

Most emerging markets have done a good job over the past two decades of reducing their debt levels, especially reliance on US dollar debt, while diversifying economies and building better-regulated and more sophisticated financial sectors.

Energy and resource stocks made up 36% of the EM equity index in 2008 but that is now down to 15.6%, compared to 24.3% for the financial sector and 14.6% for tech industries.

Venezuela is officially the world's worst economy, with credit default swap spreads ranking it as the country trusted least by the markets. But, like most emerging markets, it is too small to pose a global threat.

Brazil is large enough to get the attention of global fund managers, who are watching closely to see if its new government can rein in a fiscal deficit fuelled by unsustainable spending on pensions and other public services.

BREXIT AND EURO-POPULISM

Brexit is certain to cause economic damage in the UK and, to a lesser extent, the EU. But the resulting fall in growth and higher trade barriers have already been factored into the plans of most market players.

The firm hands of EU regulators have avoided the danger of regulatory arbitrage as many financial activities migrate from the City of London to new bases in Europe, with the new hosts unwilling to condone high-risk financial products. The Bank of England is also unlikely to allow the UK finance industry, the largest in Europe, to lower its regulatory standards after Brexit and become a riskier and more aggressive offshore centre.

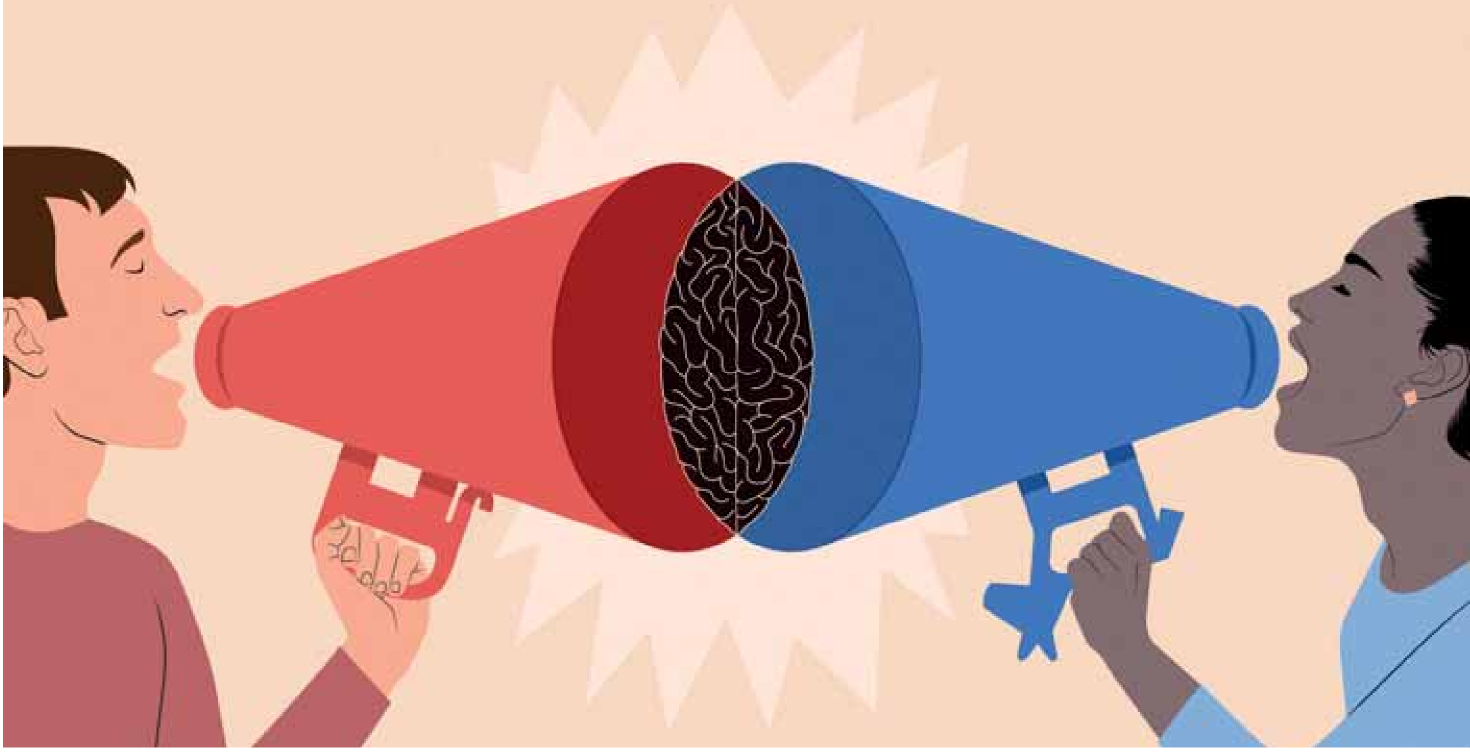
The consensus among analysts is that the greatest danger in Europe actually comes from Italy, which makes Greece look like a sideshow in terms of its economic size, debt levels and importance to the euro. The populist government in Rome is challenging EU limits on its deficit spending with other nationalist-leaning politicians across the continent closely watching the results.

Italy's poorly managed and under-funded finance sector makes up 32.3% of its national share market, compared to 10.9% in France and 17.5% across the eurozone, leaving Italy's growth-starved economy precariously vulnerable to a banking crisis. ●

GETTY

SPEAKING TRUTH TO POWER

With financial and sexual misconduct still hitting the headlines, Professor **Megan Reitz** takes a look at what firms should be doing to protect staff and encourage them to speak up



MITCH BLUNT/IKON

You only have to look at the growing list of corporate scandals to see just how important - and urgent - it is for organisations to tackle the reluctance people have to speak up at work.

In the past few years, we have seen revelations of financial misconduct at Wells Fargo, the emissions scandal at VW and the whistleblowing fiasco at Barclays. These are just a few highly damaging incidents that have ruined hard-won reputations, blighted brand credibility and negatively affected share prices.

The continuous stream of allegations of sexual harassment, which have affected industries from fashion to finance and sent shockwaves through the corridors of government and the charity sector, are yet another symptom of our inability to speak truth to power.

Of course the imperative to get people to speak up isn't just about the calling out of unethical or inappropriate behaviour. If organisations want to keep ahead of the game in a highly competitive world, they need to tap into the collective intelligence and wisdom of their people. Employees on the front line in organisations have their finger on the pulse of what the customer needs and how the business can meet those needs faster or better than their rivals.

Encouraging people to get involved and share their ideas is vital but, as countless surveys have shown, employee engagement levels have hit an all-time low with staff leaving their energy and enthusiasm at the door.

Put all these factors together and it becomes clear that organisations - and the people who work within them - seriously need help navigating the power and politics of conversations at work.

GOOD INTENTIONS

Organisations are beginning to realise this is a problem that can no longer be ignored. The typical response is high-profile, preventative measures, such as whistleblowing hotlines or more stringent disciplinary and grievance procedures. Leaders are also trying to make themselves more approachable, touting phrases like 'my door is always open' and inviting their people to 'leadership lunches'.

The problem with these well-intentioned interventions, however, is that they are little more than a sticking plaster approach that doesn't really get to the heart of the issue.

No matter how approachable management aims to be, employees will always be careful about what they say, only ever disclosing what they think is 'safe' or politically acceptable.

Phrases like 'my door is always open' are never going to work when it comes to encouraging people to speak up. It's a complex balancing act that calls for a deep understanding of the impact power differences have on what can be spoken, and what is heard.

So what can we do to give people a voice and encourage the more open, honest dialogue that really needs to happen at work?

RELATIONAL AND SOCIAL

Ashridge Executive Education has conducted a four-year study titled *Being silenced and silencing others: developing the capacity to speak truth to power*. The study is based on interviews, surveys, action inquiry and ethnographic study, and is a project that has involved more than 4,000 people from around the world and at all hierarchical levels.

The research set out to find exactly what was getting in the way of people speaking up and what leaders can do to encourage better quality conversations with their people.

One of the key findings was that the ability to speak up was not an individual act of courage as it is often assumed to be. There is an element of that but, in fact, speaking up is relational and social.

What we say and who we listen to are conversational habits that need to change. To change them, we have to raise our in-the-moment awareness of ourselves and how power plays out in our environment. We need to choose to say different things, to different people and to hear different voices.

SIMPLE TRUTH

On the back of the research, Ashridge has developed the TRUTH framework (see box). This tool can be used for a variety of different things, including assisting with speaking up effectively when necessary and encouraging others to do the same. It can also help with overcoming blind spots.

The best way to get familiar with the framework is to think about an issue you would personally like to address, whether it's giving someone feedback, sharing an idea or raising an issue you are concerned about. Working through the questions will help you think through how to speak up, how you would invite others to speak up and how you would listen to them.

Silence is a dangerous thing for any leader and any organisation. What gets said, what doesn't get said, and how we interact with each other on a daily basis is fundamental to organisational success. If we want to change the culture, we first have to change the way we interact with people – one conversation at a time. ●

Megan Reitz, professor of leadership and dialogue, Ashridge Executive Education

THE TRUTH FRAMEWORK

Trust
How much do you really trust the value of your opinion? What are the voices inside you that make you doubt your contribution? How many of them are relevant to who you are now (often voices of doubt come from way back)?

Risk
What are the risks of speaking up about this specific matter? What is the worst you could imagine happening? What is the worst that could actually happen? What are the upsides? What steps can you take to manage both the risks and rewards?

Understand
Do you understand the politics of who says what to whom and why? Who are your allies? How does your agenda fit with those of powerful others? What are the sources of your power in this context and how can you make good use of them?

Titles
How are the titles you are putting on people, and those being put on you, helping or hindering you in saying what you want to say? How can you work with, rather than wish away, the conscious and unconscious biases of how people will treat you?

How
How do you need to phrase what you say? What are the words that will land well with people? How do you speak so you will be heard? How much certainty or doubt in your tone will work best? Is this something best spoken up about formally or informally, on the record or off the record?

NOT LISTENING

A survey of more than 72,000 employees across 26 banks in the UK, published by the Banking Standard Board in April, found the following:

- Only 63% of staff with concerns about bad practices such as sexual harassment chose to report them and, of those that did, only 41% said they were listened to and taken seriously.
- Around three-quarters of respondents said they came forward with concerns about actions that were "not in the best interests of customers, clients or members", compared with 53% of people who were worried about sexual harassment and 36% who saw discrimination.
- One positive is that 66% of staff agreed that bosses took responsibility when things went wrong, up from 58% in 2016.

Only 63% chose to report concerns in the workplace

Just 36% came forward when they witnessed discrimination

66% agreed that bosses took responsibility for failings

BREACH OF THE PEACE

Stuart King looks at the growing threat of cybercrime and how firms can better manage operational disruptions

Before you begin to read this article, just let the following statistic sink in for a minute: the number of data breaches reported by UK financial service firms to the Financial Conduct Authority (FCA) increased 480% in 2018.

Yes, that's not a typo. Reported breaches rose from just 25 in 2017 to 145 in 2018, according to research from law firm RPC. This is no longer a side issue to be handled by IT. And if firms don't know that yet, then they're in serious trouble.

IN BREACH

There have been so many examples of serious attacks. But one that grabbed most of the headlines last year was on Tesco Bank, which was fined £16.4m by the FCA as a result of a cyber attack that led to £2.26m being taken from personal current accounts.

Perhaps unsurprisingly, retail banks saw the sharpest rise in breach reports in percentage terms, from one to 25. But it's not just the banks that are being affected. The insurance sector saw the number of breach reports rise from seven to 33. Part of this can be explained with the introduction of the General Data Protection Regulation (GDPR), which requires businesses to identify and report cyber attacks within 72 hours or face penalties. But CEOs at leading banks and payment companies have conceded that they are now under constant fire from attackers.

These companies are often targeted due to the sensitivity of the data being held, but criminals will also exploit them for tasks such as generating cryptocurrency or diverting traffic. Perpetrators are rarely caught because they work remotely, and few are prosecuted under the Computer Misuse Act. According to a report from Accenture and the Ponemon Institute, cybercrime costs the financial services sector more than any other industry, with breach rates tripling over the past five years. Yet, just over a quarter (26%) of banks are using artificial intelligence (AI), and less than a third (31%) are using advanced analytics to combat cybercrime.

However, firms are starting to take some protective measures, with things like intensive training and response plans being key. RPC says that insurance against data breaches is also now one of the fastest growing areas of the insurance industry.

REGULATOR RESPONSE

Parliamentarians, such as the Treasury Select Committee, which is currently carrying out an investigation into IT failures in financial services, and a range of regulatory bodies are also starting to clamp down on breaches.

Following last year's problems at TSB where 1,300 accounts were hit by fraud amid an IT meltdown, the Committee concluded that it had "lost confidence" in then-TSB CEO Paul Pester, who subsequently left the bank. Other measures introduced by policymakers and regulators include:

- The G7 issuing guidance on aspects of good practice in respect of cybersecurity in finance.
- The Financial Stability Board and the Basel Committee carrying out surveys of cyber-related regulatory activities in their areas of focus.
- The Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions publishing guidance on cyber resilience for financial market infrastructures.
- The International Association of Insurance Supervisors publishing a draft *Application Paper on Supervision of Insurer Cybersecurity*.
- The European Central Bank carrying out work on 39 payment systems across the EU and released its Threat Intelligence-based Ethical Red Teaming.
- The Network and Information System directive, implemented in 2016, placing new obligations on firms to manage cyber risks actively and to report significant events to the authorities.
- GDPR creating significant new obligations on firms to handle personal data carefully including its security. GDPR allows regulators to impose fines of up to 4% of turnover where justified.

Despite all this activity, significant differences in approach continue to exist across different jurisdictions, posing a challenge to firms with cross-border activities.

Meanwhile, the Bank of England's Financial Policy Committee (FPC) is carrying out work on the operational resilience of the UK financial services sector. Later this year, the FPC intends to establish its tolerance for the length of any period of disruption to the delivery of vital services the financial system provides to the economy. Working with the National Cyber Security Centre, the Bank will test whether firms are able to meet the FPC's standards.

The Bank has established the CBEST framework for intelligence-led penetration testing of systemically critical organisations. Within the Senior Managers and Certification Regime, the regulators require firms to allocate clear responsibility to specific individuals.

SERGIO INGRAVALLE/IKON

Responsibility for internal operations, including cyber security, are normally allocated to the COO.

The Bank, Prudential Regulation Authority (PRA) and FCA have suggested that boards should set their own tolerances for operational disruption on the assumption that some or all supporting systems and processes will fail. An effective resilience according to the Bank's *Building the UK financial sector's operational resilience* report requires firms to do things such as prevent material incidents from occuring and return to normal operations once an event is over.

Financial services firms now face obligations to report certain issues both to the FCA/PRA and to the Information Commissioner's Office (ICO). Further cases will make more explicit how the ICO will work alongside the PRA/FCA in light of their respective regulatory responsibilities and enforcement powers.

BOARD CHALLENGES

Operational resilience, especially surrounding cybercrime, is key for boards and senior management. One of the first things management should consider is setting a clear strategy for the organisation in managing risk. As with other technically complex risks the organisation needs to be able to access the required specialist skills and consider whether the board itself needs additional expertise and guidance in an area.

Whatever the threat of AI-improved polymorphic malware, building access and responses to plausible looking spear phishing attacks may be a more pressing problem for many businesses. As well as focusing on prevention, it is important to define the acceptable impact on customer services assuming a failure of systems or process does occur. Not only is this an emerging regulatory requirement, it is key to managing reputational and commercial risk.

Well developed contingency arrangements are vital. The rapid evolution of cyber risk underlines the need for an intelligence-led capability that can track and respond to emerging threats. Developing and maintaining such a capability is a relatively new discipline and will require development and investment. Differences in approach by regulators are likely to continue. Where firms have multiple regulators, effective management of these relationships will be key. If different functions within the firm manage the relationship with the ICO as opposed to the PRA or FCA, for example, close internal co-ordination will be required.

A failure to effectively control outsourced relationships has been a feature of a number of regulatory fines. Cyber risk complicates that situation significantly as outsourcing needs to address issues such as the increasing reliance on Cloud approaches by the firm itself and by its outsourced partners. Additionally, attention needs to be given to suppliers who are not traditionally regarded as outsourced relationships. As firms restructure operations to meet rising customer expectations and new competition, the growing threat of cyber attack and the focus of regulators and others on maintaining operational resilience, they will require additional and ongoing engagement from boards and senior management teams. ●

Stuart King, NED and business adviser

145

Number of breaches reported in 2018

480%

How much the number of breaches reported to the FCA increased by in 2018

£16.4m

Amount Tesco Bank was fined after a cyber attack last year

BUILDING BLOCKS

Blockchain expert **Igor Pejic** talks to Chris Evans about how the back-office technology could transform financial services

"Blockchain has the potential to force the finance industry through a change unseen for centuries" – these are the impassioned words of author Igor Pejic. And he should know. His book, *Blockchain Babel: The crypto craze and the challenge to business,* is receiving rave reviews and he's dedicated countless hours of personal research to understanding its potential.

While topics like bitcoin, artificial intelligence (AI) and machine learning dominate the headlines, blockchain has mostly remained background chat. It's something most people have heard of but are not necessarily clued up on in terms of how it works or what direct effect it has.

In the words of Pejic: "Blockchain is a computer protocol that enables distributed ledgers and promises almost instantaneous and near free-value transactions. Money and assets can be moved without a central authority; validation is performed via a peer-to-peer network without the need for intermediaries to authenticate or settle transactions.

"When I first started looking into blockckain a few years ago, it was a talking point at conferences, but mostly in relation to cryptocurrencies. There wasn't any direct correlation between blockchain and how it affects the wider industry. There was just technical literature superficially proclaiming that it will disrupt everything."

But that's now changing. It's getting into the public consciousness and financial services firms are busy testing – and, in some cases, going live with – a variety of blockchain designs. One area where firms have been particularly busy is remittance payments and cross-border money transfers.

A good example of this is Santander's One Pay FX app model, launched last year. This blockchain-based technology allows customers to complete international transfers at no charge and potentially on the same day. The service also shows them the exact amount that will be received in the destination currency before they make the transfer.

"Some have argued that it's not the real blockchain technology yet," says Pejic. "It's still different ledgers, rather than one big ledger, as blockchain was intended to be. But it's blockchain-inspired and we now have a live production example. There are plenty more pilots in development but it's not easy to scale the solution. Banks are currently trying to work this out."

The other area where blockchain could prove hugely beneficial is trade finance. Currently, this is still largely a paper-based process with physical letters of credit mailed or even faxed. This exposes institutions to operational risk and high costs, and potentially prevents them from accessing the credit they need.

IBM has already entered this field with its own blockchain platform, which matches engines of bank-verified participants to automatic, event-based payments. Its distribution ledger technology, smart contracts and built-in control capabilities give institutions real-time access to trade finance data and information.

"They are using blockchain technology to bring the trade finance process down from 10 days to about four hours and saving a lot of costs for organisations," says Pejic. "In the next few years, we'll see more of these platforms arising."

The potential stumbling block is regulation, he says: "When you're talking about cross-border trades, such as asset management, you need to get different legislators in unison with overseeing the transactions. They need to be able to see and say if something recorded on blockchain is a legally approved concept. We don't have that certainty in most legislation yet. The judicial process for this takes a couple of years."

CRYPTOCURRENCIES

Pejic believes that blockchain will rise in importance. But he doesn't think its connection to bitcoin will be a game changer. Instead, he is more convinced by stablecoin; a cryptocurrency that is pegged to another stable asset, like gold or the US dollar. It is global, but not tied to a central bank, and has low volatility.

"This could be the application of the future, especially if they're backed by big institutions or even governments," Pejic believes. "We've seen JP Morgan come out with its own stablecoin, which enables the bank's customers to transact with the coin in the background, but they still see the dollars."

This move sparked executives at competitors to ask their innovation managers how they should be responding. Do they jump in and be the first in the fast-follower line or wait to see how it performs?

Interestingly, the CEO of JP Morgan openly expressed scepticism towards cryptocurrencies. So the move was considered a big one, though some commentators saw it more as a feat of marketing than one of technical innovation.

"Blockchain is so important because it is the vital backbone for any digital activity. The banks are starting to realise this"

That said, blockchain does offer the opportunity to reduce the time and costs of settlements – the process of paying crediting and debiting bank accounts between financial institutions in exchange for the transferring of a security, such as a stock, bond or derivative. It enables institutions to settle instantaneously by settling in digital cash rather than crediting and debiting each other's accounts at the end of the day.

One such initiative is the Utility Settlement Coin, a UBS-backed innovation that projects annual industry savings of between $65m and $80m.

DIGITAL SHIFT

Broadening it out, Pejic believes this is all part of the banking sector's shift of its operations into the digital paradigm post-crisis. "Blockchain is so important because it is the vital backbone for any digital activity," Pejic insists. "Things like AI and machine learning enhance the back-office processes, but blockchain is transforming them.

"I think the banks are starting to realise this and are investing to improve their digital technology. Before it was just to put their fancy customer-facing app on an old legacy system. But now they are exploring the new technology from an efficiency and cost benefit side as well." He talks about the fact that most core banking systems have been reliant on common business-orientated language, a programming language from the 1950s.

"Banks are realising that they can't find any staff to update those systems because no one codes in that language any more," Pejic explains. "Changing and adapting to new systems is now no longer the remit of just chief technology officers, but the entire board. This should be a big strategic priority. Bank boards are now having to look at their margins more closely and figure out what has been going wrong."

SILICON CHALLENGE

Aside from streamlining their own back-office functions, banks also need to be wary of the Silicon Valley giants entering the payments (and blockchain) arena. Along with the likes of Google Pay and Apple Pay, Facebook is developing its own cryptocurrency for payments.

"These are potential threats to the incumbent banks," says Pejic. "Some are taking the 'if you can't beat them, join them' philosophy. For example, lots of banks are rushing to be included in Apple Pay and paying a lot of money for the privilege."

Looking ahead, Pejic believes that banks and other financial institutions could fulfil other trusted services using blockchain technology.

"As a customer, why not have my medical records stored there, or have my university degrees verified by the banks?" he asks. "They could act as a broker of digital trust. Like with everything, it's 80% good business and 20% the technology. It's time for them to think about and address other areas rather than just the traditional, core financial services." ●

Igor Pejic, head of marketing, BNP Paribas. He has also advised Fortune 500 companies and taught at the University of Vienna

CRYPTO. IS IT A BIRD? IS IT A PLANE?

Although the holdings of crypto-assets are small, the PRA's **Ian Michael** says regulators are getting to grips with them

We hear a lot about crypto-assets, as well as about blockchain technologies. Two recent publications from the IFRS Interpretations Committee (IFRIC) and Basel Committee on Banking Supervision (the Basel Committee) have added to the conversation.

The IFRIC announcement will bring much greater clarity to the accounting treatment of direct holdings of crypto-assets. In March, the IFRIC discussed how existing International Financial Reporting Standards (IFRS) applied to such holdings. It concluded, in a draft agenda decision that is available for comment until 15 May, that:

- crypto-assets are not cash or financial instruments. Rather, they are intangible assets: an identifiable non-monetary asset without physical substance;
- most holdings of crypto-assets will need to be accounted for in accordance with IAS 38 *Intangible Assets* – in general measured at cost, subject to periodic impairment tests;
- if crypto-assets are held for sale in the ordinary course of business, the holding will be required to be accounted for in accordance with IAS 2 *Inventories*. This will usually mean measuring the assets at the lower of cost and market value. However, should the holder be a 'broker-trader' buying or selling the crypto-assets for others or on their own account, the assets will be measured at fair value less costs to sell.

This interpretation of IFRS is unlikely to prove controversial, but is nevertheless valuable because it helps to clarify the treatment of direct holdings of crypto-assets for regulatory capital purposes. Under Basel's capital rules, intangible assets are disallowed for the purposes of determining a bank's capital resources. Indirect holdings of crypto assets, for example as collateral or through derivatives, will be treated according to the applicable Basel rules – not usually complete disallowance.

Knowing how crypto-assets should be treated for accounting and prudential purposes is important, but the need for firms to approach such assets with the right mindset is even more so. The Prudential Regulation Authority addressed this in an open letter to CEOs in June 2018 and a recent paper from the Basel Committee, *Statement on crypto-assets*, has done the same on a global basis. The paper makes clear that the growth of crypto-assets and related products has the potential to create risks for financial stability and to increase the risks faced by banks. The paper says:

- it is unsafe to rely on crypto-assets as a medium of exchange or store of value;
- crypto-assets are an immature asset class given the lack of standardisation and constant evolution;
- crypto-assets have exhibited a high degree of volatility; and accordingly
- crypto-assets present a number of risks for banks, including liquidity risk, credit risk, market risk, fraud and cyber risk, money laundering and terrorist financing.

The paper goes on to explain that Basel expects that a bank should at a minimum:

- conduct comprehensive analyses of the risks arising from any direct or indirect crypto-asset holdings it is minded to take on;
- have a clear and robust risk management framework for its crypto-asset exposures and related services, and integrate that framework into its overall risk management processes;
- publicly disclose any material crypto-asset exposures or related services as part of its regular financial disclosures; and
- keep its supervisor informed of actual and planned crypto-asset exposures or activity in a timely manner.

Although directed at banks, many of Basel's messages are also relevant to other firms that may be considering acquiring exposures to crypto-assets.

The Basel Committee's paper adds to the messages that have been delivered by regulators – such as the Financial Stability Board in a report issued in October 2018 and the Bank of England's Financial Policy Committee, following its meeting in March 2018 – on the implications of crypto-assets for financial stability as a whole. ●

VALERO DOVAL/IKON

Ian Michael, senior technical specialist, Bank of England

SHIFTING JURISDICTION

Alan Davis on the future direction of UK competition law post-Brexit

In the event that the UK leaves the EU without a transitional arrangement for withdrawal, the Competition and Markets Authority (CMA) will take up an enhanced role to enforce competition law, merger control and state aid rules in the UK.

However, if a transitional deal is agreed, the current arrangements will remain in place until the end of the transitional period in December 2020. As things stand at time of going to press, a decision is still up in the air.

For now, the European Commission has exclusive jurisdiction to enforce these rules for the whole of the EU where a transaction or anti-competitive practice has an effect on EU cross-border trade.

After a no-deal Brexit, the Commission's jurisdiction over the UK will cease and the CMA will have to undertake parallel investigations of mergers and anti-competitive practices that have effects on the UK market. The CMA will remain responsible for enforcing UK domestic competition law in the usual way.

The Commission has typically undertaken the larger cross-border EU antitrust and merger control investigations. Post-Brexit, the CMA will have an expanded remit and significantly increased caseload, especially in relation to mergers. This is expected to result in a doubling of the CMA's workload and has led to a need for the CMA to recruit up to 240 additional staff. The CMA has also been allocated additional budget but it still remains to be seen how it will prioritise its workload.

MERGER CONTROL

Currently, merger cases that meet EU turnover thresholds are reviewed exclusively by the European Commission, even if competition in the UK market would be substantially affected by the transaction. Remaining cases that fall below the EU thresholds are handled by the CMA or other national competition authorities.

Following a no-deal Brexit, the UK would cease to be a part of the EU one-stop shop regime. A post-Brexit merger may therefore trigger parallel filings in both jurisdictions. Apart from the risk of divergent approaches or outcomes, one of the key implications of parallel filings is that the CMA and EU merger control regime review periods differ significantly. There has been no indication from the CMA that the UK government will harmonise the UK merger timetable with the EU process. Accordingly, the different timescales will need to be considered carefully in post-Brexit transactions.

The UK government is not currently proposing to make any immediate changes to UK merger control procedures or how UK mergers will be assessed, even in the event of a no-deal outcome, so the current regime will continue to operate largely as it does now.

The biggest impact of a no-deal Brexit will be felt by EU mergers that are still under review at the date of withdrawal. For those cases, the CMA could decide to immediately commence a parallel investigation and intervene by using interim orders to prevent or unwind any integration steps.

COMPETITION ENFORCEMENT

As with merger control, the UK government is not planning to make any major changes to the UK antitrust regime in either a deal or no-deal scenario. However, the CMA and UK courts will no longer be bound to follow future decisions of the Commission or European Courts from the date of withdrawal.

UK competition law is based on EU competition principles and will continue to be interpreted in accordance with pre-Brexit EU decisions and case law. However, the CMA, sector regulators and the UK courts will have the freedom to depart from these pre-Brexit principles where they consider it “appropriate” to do so and where at least one of a number of stipulated factors applies. This will potentially allow for divergent outcomes between the UK and EU in relation to all aspects of competition enforcement.

Current EU block exemption regulations will however be implemented into UK law as exemptions to the UK competition prohibitions. The block exemption regulations exempt certain types of agreements from the Chapter I prohibition where certain conditions are satisfied and there are benefits for consumers (such as vertical agreements).

Because the Commission will no longer have jurisdiction to undertake new investigations in relation to UK conduct, it is likely that in many circumstances (such as a pan-European wide cartel) both the Commission and the CMA (or the relevant UK sectoral regulator) will undertake parallel investigations into the same conduct. In such cases, leniency applications and settlement considerations would need to be assessed in relation to both jurisdictions at the same time.

STATE AID

The UK is currently subject to the EU state aid rules, which apply with direct effect in the UK, and which are enforced strongly by the Commission. The CMA has repeatedly made clear that it will continue to support a rigorous state aid system. Therefore, in either a deal or no-deal Brexit scenario, the UK has confirmed that a new domestic UK state aid regime will be introduced that mirrors the EU regime. The CMA will be responsible for the supervision and enforcement of the UK state aid regime with effect from the date of withdrawal in the event of a no-deal scenario.

In addition to its competition and merger powers, the CMA has already increased the use of its other powers

If a transition deal is passed, the Commission will remain competent to initiate (and later determine) new proceedings in respect of aid granted before the end of the transition period and for a period of four years after the end of the transition period.

CHANGE IN FOCUS

Wider proposals for the reform of the UK competition law regime have also been proposed by the CMA’s new chairman, Lord Tyrie. The proposals create new duties and responsibilities on the CMA to enable it to better respond to the twin challenges posed by the growth of the digital economy and declining public confidence in market competition. This includes an overriding statutory duty to treat the interests of consumers as paramount. The new duties would be backed by strengthened tools and powers to facilitate earlier and more robust intervention to address consumer detriment, and to deter wrongdoing.

In addition to its competition and merger control powers, the CMA has already increased the use of its other powers, including consumer law enforcement and market studies and market investigations. Recently, it has investigated companies, particularly in the online sector, for suspected breaches of the consumer protection rules with the aim of securing binding undertakings from these companies. The CMA has announced an investigation of antivirus software for breaches of consumer protection rules following the loyalty penalty super complaint by Citizens Advice. The increased activity of the CMA in using its consumer protection powers reflects an overriding concern to protect vulnerable consumers.

The CMA also continues to stress the importance of its markets work, where it looks at how a whole market is working rather than just focusing on specific businesses. The CMA has recently been investigating investment consultants, funerals and the audit market.

In relation to the audit market, the CMA has announced a range of bold and novel potential remedies to address perceived concerns about competition in the sector. These include requiring a split between audit and advisory businesses, scrutiny of audit appointments and increasing choice by requiring the audits of the UK’s biggest companies (FTSE 350) be carried out by at least two firms, one of which must not be one of the Big Four.

It remains to be seen whether the CMA will continue to have the resources to carry out as many wide-ranging market studies or consumer protection investigations due to the increase in its workload post-Brexit. However, the CMA has already warned that a no-deal Brexit will heavily constrain its ability to launch investigations into price-fixing and markets that are not working well for consumers over the next financial year. ●

Alan Davis,
partner and head of competition, EU & trade, Pinsent Masons LLP

HARRY HAYSOM/IKON

STANDARD BEARERS

Rob Konowalchuk explores the data implications of IFRS 17

Insurers are rapidly undergoing a digital revolution to meet customer demands and make business decisions. And the onset of IFRS 17 will prove to be a further digital challenge.

There will be new data requirements, new calculations, more granular data and more detailed disclosures, which present a data management problem across the entire data lifecycle – from source to target. The standard has been pushed back to 2022, which should allow for fuller examination and implementation of data governance to allow insurers to seize the opportunity that IFRS 17 presents.

DATA SHIFT

Most insurers' IFRS 17 implementation is already fully in flight and the accounting and reporting concepts are already well understood. However, there is more to do on how this data will be controlled and governed.

To design a strategy for data governance for IFRS 17, the impact on data acquisition, storage, analysis, analytics and reporting must be understood. Walking through a simplified end-to-end reporting cycle, some examples of these impacts are described below.

A DATA GOVERNANCE WORK PROGRAMME FOR IFRS 17

Many insurers already have an enterprise-wide approach to data governance. However, a large number of those are in the process of rebooting and modernising this approach, employing new techniques and technologies. This is usually characterised by a bottom-up, more distributed (less centralised) approach and greater business engagement. In this case, IFRS 17 provides a good basis for deploying or expanding such an approach.

However, in some firms, formal data governance may be weak or virtually non-existent. In which case, IFRS 17 is exactly the catalyst needed to get board and executive level buy-in for securing budget and resource for an investment in data governance.

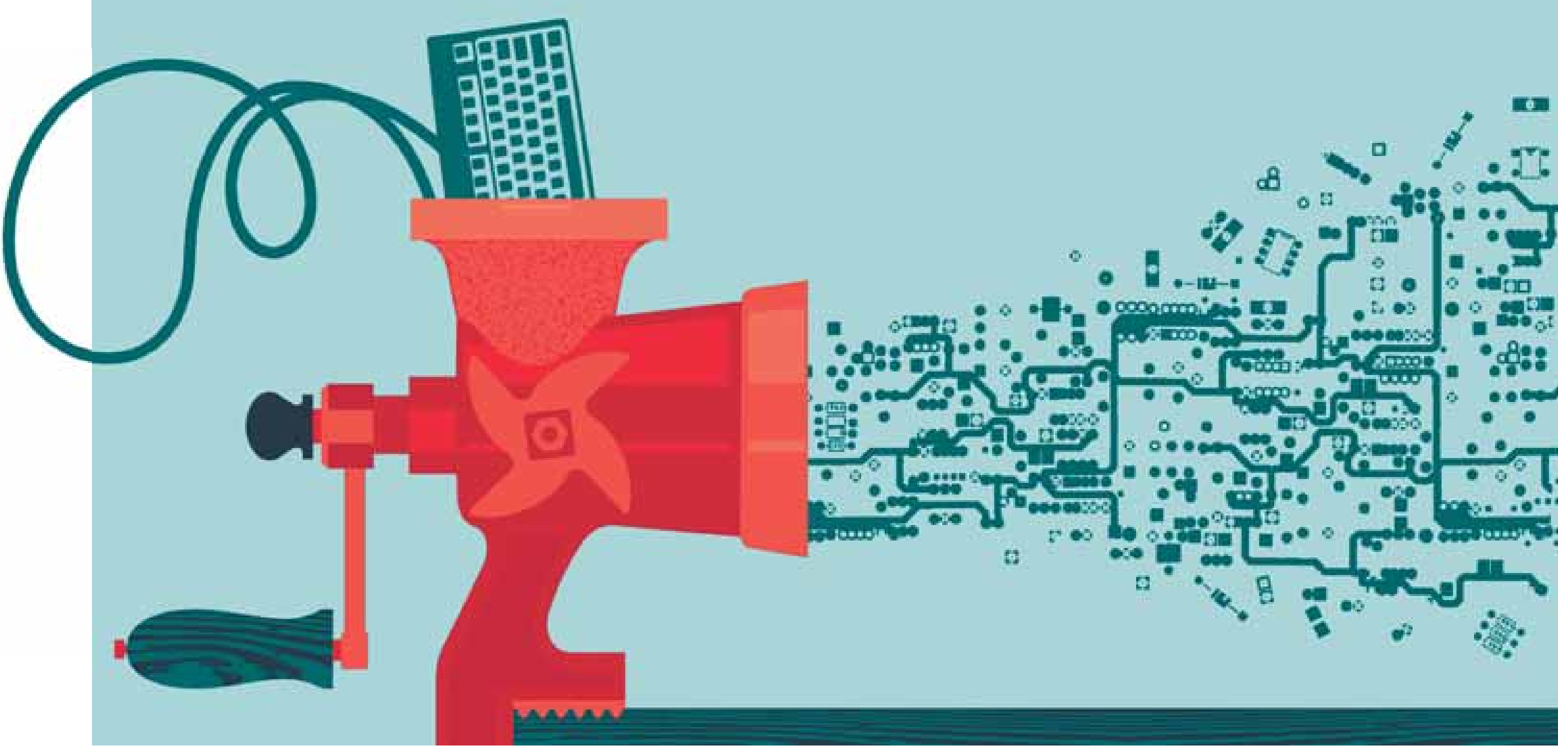
Whatever the situation, if IFRS 17 is a driver for enhanced data governance, then a clear, structured and disciplined work programme is needed to ensure success.

A ROADMAP TO GET FROM COMPLIANCE TO STRATEGIC VALUE

With technical implementation for IFRS 17 already underway, it's the perfect time to get the data governance stream up and running.

Once the programme is defined, a roadmap is key to ensuring that it moves beyond the attainment of compliance towards more strategic initiatives such as enhanced risk management, better informed underwriting and pricing, improved customer experience, stronger data security and innovative new product design.

There are many ways to measure the success of a data governance programme, but all must link to the goals set in the formative stages. Quantitative measures (eg, data quality scores) and qualitative measures (business engagement and process improvement) should be considered.



TECHNOLOGICAL INNOVATION TO ENABLE DATA GOVERNANCE

A technology platform to enable data governance for IFRS 17 must be scalable and adaptable, business-centric and efficient.

Insurers of course already have data management tools and systems such as database platforms, extract, transform and load tools, data profiling and quality tools, and data governance artefacts such as business glossaries and data dictionaries. So, any new data governance platform must be interoperable with this existing estate and the insurer's technology stack, including transactional and reference data systems.

Modern data governance approaches are all about collaboration between business users, the business and IT, consumers and owners of data. Technological tools can facilitate this, but only with the right level of business adoption. This requires tooling with an engaging user interface including visualisation of concepts such as data lineage and the linkage between facets of data and metadata.

Cataloguing and describing business and technical metadata about the vast amount of data used to produce IFRS 17 reporting can be cumbersome and difficult to maintain. This therefore requires data cataloguing tools that can automatically (and intelligently) scan systems and databases to curate metadata and lineage for onward translation into business usage and analysis.

CONCLUSION

There is no one-size-fits-all approach to data governance for IFRS 17. Whether it is a catalyst for a new approach to data governance for the insurer, or fits into an existing enterprise-wide approach, a disciplined and tailored approach will ensure that data used for and produced by IFRS 17 is secure, relevant and of value to the business. ●

Rob Konowalchuk, partner, Avantage Reply

TABLE 1: PROCESS-WIDE IMPACTS ON DATA GOVERNANCE

Process stage	Components	Example data governance impacts
Inputs	Policy administration, assumptions and methodology, and associated data sources	**Data attributes**: Incremental requirements are imposed for policy data, premium information, reference data or investment data. **Process:** Scope and aggregation may necessitate additional information capture at policy origination. **Data quality:** Suitable business rules need to be defined. In cases of data input gaps, proxy data must be used in a controlled manner.
Calculations	Actuarial and financial models, manual inputs, data warehouse, rules engines, analytical tools	**Data attributes:** The higher volume of data attributes, including internally generated transactional data, static data and external market data, necessitates a sensible data stewardship model. **Process:** The changes to the measurement methodology affect the design of business processes. This will require business process modelling and the curation of data lineage documentation and visualisation. **Systems:** Data warehouses need to be created or enhanced to enable timely and reliable access to high quality enterprise data. **Data quality:** The data journey data from source to target is complex, involving multiple extractions, transformations, aggregation and calculations. Lineage can help identify the points at which data quality must be measured, scored and reported.
Reporting and disclosure	Consolidation, financial statement production, including note disclosures	**Data attributes:** Disclosure requirements define a new set of data attributes for public reporting. **Processes:** Reporting and disclosures are more voluminous (metrics like CSM, cash flows and risk adjustment). **Systems:** Insurers' accounting consolidation systems will adopt an updated chart of accounts. **Data quality:** Data quality at this stage is dependent on upstream processing and quality checks. An evidence system is needed to provide comfort from data owners to data users.

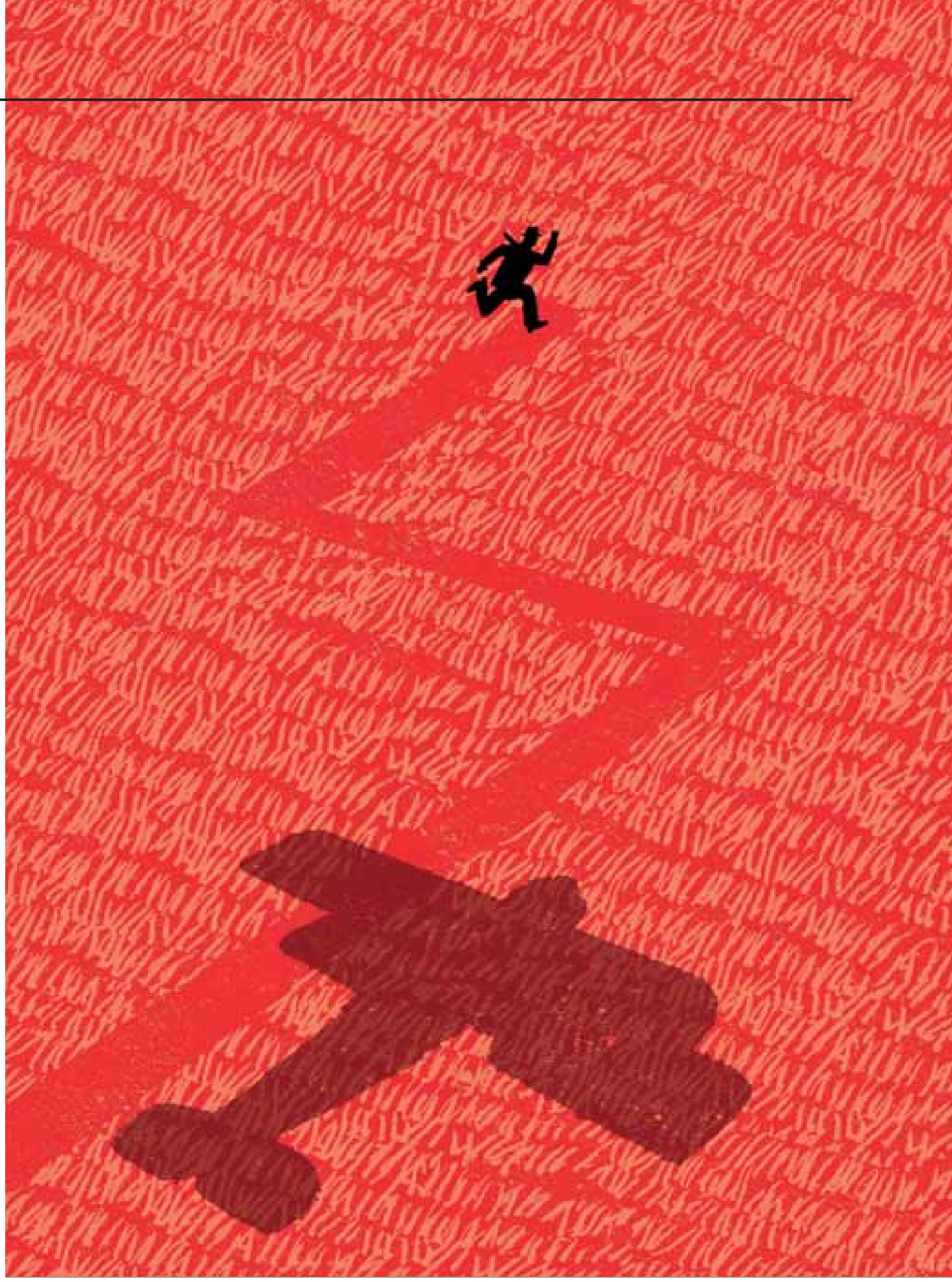
TABLE 2: FOUNDATIONAL QUESTIONS WHEN DESIGNING A DATA GOVERNANCE PROGRAMME

Programme stage and key questions	IFRS 17 implications
Who is the executive sponsor and are they the right person for the job?	The CFO may be the overall sponsor for the IFRS 17 programme, being the senior executive accountable for external reporting. They will also have an interest in process efficiency and data-driven insights into financial performance. However, other stakeholders will have priorities that focus more on business value. For this reason, the sponsorship of the data governance programme may need to look somewhat different from the accounting and reporting focus of the main implementation. At a minimum, the chief financial officer, chief data officer (or equivalent) and at least one business representative should co-sponsor the initiative.
What are the objectives of the data governance programme?	As with many new regulations, there are two broad sets of objectives: 1. achieve compliance; and 2. get some business value from your investment (advanced analytics and decision-making ability).
Who are the relevant stakeholders?	Application of IFRS 17 clearly extends beyond the accounting function, affecting most of the business processes involved in generating, managing and reporting on insurance activities (risk, actuarial, IT, operations, marketing, etc).
What are the business processes and what people or systems are relied upon to execute them?	Business process mapping is an important tool. It provides a foundation for understanding data lineage, assigning data ownership and applying business rules for measuring data quality.
How confident are business users in the data?	Key questions to explore are: ● Controls over capture of data, especially newly acquired data; ● System stability, reliability and security; and ● Testing of new calculations and manipulations.

GILLIAN BLEASE/IKON

NO ESCAPE

Ali Kazimi assesses how firms should be tackling the growing concern of tax evasion



Financial institutions have been seen as posing a high-risk of tax evasion facilitation by HMRC and have historically taken a somewhat lax approach. However, this is changing and firms need to wise up.

The Financial Conduct Authority (FCA) and HMRC's powers have been extended under the Criminal Finances Act 2017 (CFA 2017), which now imposes an unprecedented level of tax obligations on financial firms. This includes the regulators needing to foresee and prevent tax evasion facilitation risks on a global scale. To emphasise their importance, the sanctions for failure are now criminal and regulatory.

CHANGING LANDSCAPE

HM Treasury recently boasted that more than 100 measures have been introduced to counter tax avoidance, evasion and other forms of non-compliance since 2010. Since the banking crises, successive governments have been under pressure to act against the tax abuse perpetrated by the financial services sector. The code of practice on taxation for banks was introduced in 2009 to enable institutions to voluntarily adopt a principled approach to taxation and desist from repeating the excesses of the past.

The critical turning point was the publication of the Panama Papers by the International Consortium of Investigative Journalists in 2016. More than 11.5 million documents were leaked, revealing the personal financial information of wealthy individuals and public officials. The leak also revealed that companies had created 214,000 shell companies to hide offshore assets, launder money and avoid taxes.

Shifting public opinion resulted in co-ordinated government action. Taking the global lead, the Organisation for Economic Co-operation and Development introduced the Automatic Exchange of Information (AEoI) regime to effectively combat tax evasion. Under the AEoI, financial institutions are required to report customer financial account details to their local government, including the jurisdiction of tax residence of the account beneficial owners and their tax identification numbers. The information gathered is automatically shared with participating jurisdictions.

The EU has seen a concerted drive towards tax transparency, improving information exchange to tackle cross-border evasion and mounting pressure on non-co-operative jurisdictions. The first filings under the invasive DAC6 regime requiring the mandatory disclosure of reportable cross-border tax planning schemes will be seen in 2020. The EU has also published a list of tax havens or high-risk countries. The recent blacklist of tax havens, issued in March 2019, has tripled to 15 countries and now includes the United Arab Emirates.

REPERCUSSIONS

In 2013, HMRC issued its blueprint, *No Safe Havens*, setting out the approach to offshore evasion. Successive measures have included the worldwide disclosure facility, requirement to correct, 'naming and shaming', and more.

For financial institutions, the key legislative measures include:

- civil sanctions for enablers of offshore evasion (Schedule 20, Finance Act 2016); and
- the corporate criminal offence for failure to prevent the facilitation of evasion (sections 45 and 46 of CFA 2017).

From 1 January 2017, heavy civil penalties can be imposed on enablers of offshore tax evasion or tax non-compliance. The enabler regime applies in respect of UK taxes where there is an offshore connection. 'Enabling' offshore tax evasion or non-compliance is broadly defined and includes encouraging, assisting or otherwise facilitating conduct by the taxpayer that constitutes offshore tax evasion or non-compliance.

Any individual or corporate body that provides tax planning, advice or other professional services including moving funds offshore could be charged up to 100% of the evaded tax and may also be publicly named. It is not necessary for the perpetrator to have played an active part: merely encouraging or facilitating the evasion is enough.

CFA 2017 introduced the strict liability criminal offences for any entity that fails to prevent the criminal facilitation of tax evasion by its associated persons. The legislation introduces two offences: one related to the evasion of UK taxes and the other related to foreign tax evasion.

'Strict Liability' means that no proof is necessary of a criminal intent, knowledge or condonation by senior management. Firms that have been found guilty will face an unlimited fine and disclosure may also be required to professional regulators. There is a statutory defence where the firm has in place such prevention procedures as are reasonable in all circumstances.

Since the introduction of CFA 2017 offences, the response of the financial services industry has been uneven. For financial institutions with an awareness of the legislation and resulting exposure, there was a notable panic to implement the required 'reasonable prevention procedures' as protection.

This concern has not been uniformly felt across the financial services sector. In our experience, banks appear to have undertaken some form of risk assessment – with varying degrees of rigour. The UK branches of foreign banks find themselves in the difficult position of having to convince their head office banks of the risks where there is a failure to introduce reasonable prevention procedures across the whole corporate. Larger international banks have realised the full extent of the risk of inaction and implemented programmes.

Within insurance and the riskier wealth management sectors, the results have been mixed due to a genuine lack of appreciation of the potential risks.

The concern is that under the various taxation governance developments in the UK, such as the requirement to publish a tax strategy (Finance Act 2016) and the senior accounting officer (Finance Act 2009) regimes, the significant taxation risks need to be escalated to the board of directors for consideration and

OIVIND HOVLAND/IKON

Financial institutions must be able to engage with the tax evasion challenge in a coherent and consistent manner

implementation. Boards mostly remain uninformed, leaving under-resourced middle management tax professionals to make tax policy judgements that should have been made at the board level, per HMRC expectations.

REASONABLE PROCEDURES

Reasonable prevention procedures, the sole defence to the CFA 2017 offences, refers to both formal policies and the practical steps taken to enforce compliance. It is possible to build on existing anti-money-laundering (AML) and Bribery Act risk assessments and procedures, but it is imperative to consider the specific risk of tax evasion facilitation independently.

The HMRC guidance is that effective preventative procedures must be carefully considered in conjunction with a comprehensive risk assessment. A risk-based approach is permissible, but the risk in focus must be the risk of an associated person facilitating tax evasion.

There are numerous challenges to the implementation of these procedures, including adherence to guidance issued by a host of authorities and associations (eg, EU, Financial Action Task Force, FCA, and more). This is in addition to a variety of legislation, such as CFA 2017 and Proceeds of Crime Act 2002 (POCA 2002), and an equally expansive list of operational regimes, such as Foreign Account Tax Compliance Act and DAC6.

But financial institutions must be able to engage with the tax evasion challenge in a coherent and consistent manner. Where tax evasion facilitation risk assessments may have been carried out, there is often no consideration given to the evaders regime or wider tax evasion risks under POCA 2002.

REGULATORY CROSS-OVER

For those subject to supervision by regulators, the new CFA 2017 offences create several regulatory challenges. Firms have to ensure that their existing financial crime, whistleblowing and Senior Managers and Certification Regime polices are updated and complete. Additionally, systems and controls need to be reviewed to ensure that systemic risk resulting from the introduction of these offences is properly assessed and managed.

While policies approved by the board and senior management denote good intentions, their implementation does not translate to the de facto day-to-day procedures carried out at middle and lower levels of the institution. It is often the frontline staff of an institution that form the first line of defence in spotting a potential tax evasion offence, and the inadequate communication of in-house policies and procedures to these staff has resulted in the numerous high-profile, reputation-damaging, and extremely costly, tax evasion prosecution cases.

Where incidents occur, consideration needs to be given to the escalation and regulatory self-reporting mechanisms.

TOP-DOWN APPROACH

The first step an institution should take is a top-down, strategic approach consistent with its overall tax strategy, a clearly articulated risk appetite and governance processes with clear accountability.

A common key deficiency is the lack of tax evasion-specific documentation. While risk appetite policies make brief mention of the bank's attitude towards tax evasion risk, the development of formal tax evasion prevention frameworks is necessary.

Compliance officers and financial crime teams need to understand how to efficiently detect and resolve tax evasion, and this knowledge should be shared with frontline staff to ensure they can adequately spot tax evasion risks. Updating in-house policies and procedures, and updating IT systems with the latest technologies is vital in preventing tax evasion at a customer, jurisdictional and transactional level. ●

Ali Kazimi, managing director, Hansuke Consulting

TECHNICAL DIRECTORY

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

INVESTMENT MANAGEMENT

CP19/12: CONSULTATION ON INVESTMENT PLATFORMS MARKET STUDY REMEDIES

14 March 2019

This Financial Conduct Authority (FCA) consultation sets out proposed changes to improve competition for customers when using investment management platforms.

This follows the Investment Platforms Market Study and final report, which highlighted the FCA's concerns that consumers often find it difficult to move from one platform to another.

The FCA is seeking further views on three areas relating to exit fees: How an exit fee should be defined; the scope of the intervention; and whether the intervention should be a ban or a cap on such fees.

Feedback to the consultation is expected by 14 June 2019.

CP19/14: MORTGAGE CUSTOMERS: PROPOSED CHANGES TO RESPONSIBLE LENDING RULES AND GUIDANCE

26 March 2019

The FCA is proposing amendments to its rules to reduce regulatory barriers to consumers who are struggling to switch to a more affordable mortgage.

Changes to the responsible lending rules and guidance for mortgage lenders will allow them to undertake a modified affordability assessment of consumers who have a current mortgage; are up-to-date with payments; and do not want to borrow more or are looking to switch to a new mortgage deal.

Under the modified assessment, mortgage lenders must not enter into a new regulated mortgage contract with an eligible consumer unless they can demonstrate that the new mortgage is more affordable than their present one.

The FCA is also proposing that inactive lenders and administrators acting for unregulated entities will be required to identify existing eligible consumers and write to them highlighting this rule change.

Mortgage lenders will be required to flag which mortgages have been sold using the modified affordability assessment when submitting product sales data reports to the FCA.

BANKING AND INSURANCE

INSURANCE FIRMS FAILING TO CONSIDER VALUE OF THE PRODUCTS AND SERVICES PROVIDED TO CONSUMERS

10 April 2019

The FCA has issued this report warning general insurance (GI) firms about manufacturing, sales and distribution approaches that can lead to customers purchasing inappropriate products, paying excessive prices or receiving poor service.

The *Insurance Distribution Directive* requires that all firms in the GI distribution chain act in accordance with the best interests of the customer. The Senior Manager and Certification Regime is designed to make senior managers accountable for the actions of their firms. The FCA warns that it will not hesitate to intervene where it sees a failure to have appropriate regard to the value their customers receive.

The report highlights how in some distribution chains there can be a high risk of unsuitable sales, for example, where the distributor is selling insurance alongside a non-financial product like a car, white goods or a holiday.

PS11/19: ENHANCING BANKS' AND INSURERS' APPROACHES TO MANAGING THE FINANCIAL RISKS FROM CLIMATE CHANGE

15 April 2019

The Prudential Regulation Authority (PRA) has issued a policy statement in response to its consultation paper 23/18 on financial risks from climate change. This highlights that respondents to the consultation broadly welcomed the PRA's proposals, with some urging the PRA to move more quickly on climate change issues. The PRA expects firms to have an initial plan in place to address the expectations and submit an updated Senior Management Function form by 15 October 2019.

PRA BUSINESS PLAN 2019/20

15 April 2019

The PRA has released its long-awaited Business Plan, which sets out some of its key strategic goals.

These include having robust prudential standards in place comprising the post crisis regulatory regime; continuing to adapt to market changes and pre-empting and mitigating risks to its objectives; and ensuring that firms are adequately capitalised for expected risks.

Other goals include ensuring banks and insurers have credible plans and capabilities to recover from financial stress events, and to deliver a smooth transition to a sustainable and resilient UK financial regulatory framework following the UK's expected exit from the EU. ●

Policy updates, with information on recently published and upcoming documents, are posted regularly by the FCA. The site is updated the week following the FCA's board meeting (tinyurl.com/FCA-DevUp).

PEOPLE IN FOCUS



ARRIVALS AND DEPARTURES AT BMO

BMO Global Asset Management has appointed Nina Roth, Alan Fitzpatrick and Derek Ip to its responsible investment team.

Roth joins as a director, providing expertise on key European markets, managing client relationships in Germany and undertaking environmental, social and governance (ESG) analysis and engagement. She previously worked for Germany's development agency GIZ and started out at Deutsche Bank's ESG department.

Fitzpatrick joins as a production specialist from Hermes and will oversee delivery of the firm's global reo business.

Ip is an ESG analyst, specialising in working with banks and asset managers on bespoke environmental risk assessments. Past employers include the Climate Bonds Initiative and RESET Carbon Limited.

The firm has also made changes to its Responsible Investment Advisory Council. Martin Smith, the Council's internal representative, will be replaced by Phil Doel, director in the fundamental investment and EMEA investment team.

Marga Hoek is stepping down and will be replaced by Elizabeth McGeveran, director of Investments at the McKnight Foundation.

In Germany, BMO also has a new MD and head of sales for institutional clients. Jürgen Florack takes over from Claus Heidrich, who is retiring after 18 years as head of sales.

NEW ESG HEAD AT AVIVA INVESTORS

Aviva Investors has appointed Paul LaCoursiere as global head of ESG research in the global responsible investment team.

In the newly created role, LaCoursiere will be responsible for the corporate ESG research process within the global asset management unit of Aviva Plc.

LaCoursiere reports to Steve Waygood, chief responsible investment officer, and will jointly lead the research team with Mirza Baig, global head of governance.

London-based LaCoursiere has 17 years' experience in the asset management industry. He was previously Aviva Investors' global head of corporate research.

Oliver Judd and Kevin Gaydos have also been named co-heads of credit research, reporting to Colin Purdie, chief investment officer for credit.

5 MINUTES WITH...

RICHARD NORRINGTON, CEO, IPSWICH BUILDING SOCIETY

What are your thoughts on the current banking landscape?

These are interesting times. Clearly the regulation has had an impact post-crisis, and rightly so. There is now a different level of scrutiny from the regulators, and firms are also expected to be able to self-regulate better.

What do you make of the battle between incumbent banks and fintechs/challengers?

It is a very different world to the year I started out, in 1989, when there were just four main bank players and the building societies. The internet has completely changed the landscape. As a customer myself, I welcome the competition. As a player

WHO'S WHO?

Since the last round of elections to the European Parliament in 2014, the bloc has witnessed unprecedented woes. This year's election is shaping up to be the most contentious yet, but who are the leaders vying for control?

MANFRED WEBER

Weber has chaired the centre-right European People's Party (EPP) Group since 2014, which describes itself as "the largest and most influential political family" in the EU. Comprised of some of the continent's biggest political hitters, including the Christian Democratic Union of Germany and France's Les Républicains, the grouping advocates fiscal conservatism alongside an enthusiastic embrace of the European project.

FRANS TIMMERMANS

Timmermans (pictured) was the Netherlands' foreign minister until 2014, when he became vice president of the EU Commission. At the end of 2018 he was nominated to lead the centre-left Progressive Alliance of Socialists and Democrats into the 2019 elections. Like his EPP rivals, opinion polls suggest more eurosceptic upstarts could threaten Timmermans' brand of moderate pro-Europeanism.

RYSZARD LEGUTKO

Polish political philosopher Legutko leads the European Conservatives and Reformists (ECR) group. The group is economically similar to the EPP, but more sceptical about immigration and EU expansion. This year could be a difficult one for you need to be clear about what you stand for and how your customer is benefiting. That's why our focus is on the communities we operate in.

Is it about maintaining a balance between face-to-face interaction and embracing digital?
Absolutely. We've maintained our branch presence, while some of the larger players have obviously decided to close branches. For us it's more than just offering products, it's about our role in the community, including events for charity, workshops, staff providing financial education, and so on. But we are also improving our digital presence, making sure we're open banking-ready.

Do members still value the mutual model?
Our customer satisfaction in 2018 was 98%. That comes from the quality of our staff and how they interact with the customers. Hundreds of members turn up to our AGM to vote. They are keen for us to be stable, but also agile.

What is the state of the savings market?
Margins and offerings have been fairly slim with the current base rate. There is also increased competition from digital players. But for savers, there are plenty of options.

It's possible that competition in the market could heat up, especially after the closure of the Term Funding Scheme. Financial institutions will need to change their lending plans, especially those reliant on central bank funding to drive growth. Securitisation markets are likely to revive and deposit rates should increase in the near term, especially around peaks in the scheme's maturity profile. The notional value of UK covered bond schemes is also likely to rise for smaller issuers seeking attractive spreads.

These are interesting times. Clearly regulation has had an impact post-crisis, and rightly so

What are your thoughts on the expansion of later life lending and mortgage products?
Financial institutions are listening to their customers' changing lifestyle habits and offering something that works for them. We are moving away from an individual having a fixed retirement plan in terms of final salary scheme and retiring earlier. Instead, people are living and working longer with a variety of employments that will increasingly not be final salary. People might be looking to downsize, renovate or release funds for children or grandchildren. That's more common. Financial service firms understand that. That's why we don't have a maximum age we'll lend to.

But while there are plenty of major high street banks offering mortgages that are relatively straightforward, and in huge volume, we can offer products with individual underwriting capability. We still do residential mortgages, but our real stock and trade is niche lending like later life, self-build, shared ownership, buy-to-let for expats, and so on.

Are credit scores still the best way to determine affordability for mortgages?
We take a different approach. We still have information flowing in from credit agencies and look at affordability data for households at different phases of their lives, but the application of it is when the skilled underwriter comes in. Our customers don't fit into neat categories conducive to a tick-box approach.

This also allows us to look at complex cases like self-build, where you're lending before someone's actually got a building to show for it. It's a phased release of funds as the build goes up. We also provide for larger renovations and modern methods of construction, such as off-site pre-fabricated units (hub houses). We can be a fleeter-foot provider.

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the ECR, with more radical eurosceptics threatening to haemorrhage support, and the British Conservative Party, currently a major force in the group, set to pull out of the EU altogether.

GUY VERHOFSTADT
The Alliance of Liberals and Democrats for Europe has the longest history of any EU party, and chair Verhofstadt is one of parliament's most recognisable faces. The former prime minister of Belgium and current Brexit negotiator is an avowed federalist. His group could pick up votes in an election likely to be polarised between nationalists and Europeanists.

VIOLETA TOMIĆ
Ex-Slovenian Assembly member and former actor Tomić (pictured) chairs the European United Left/Nordic Green Left. The group's moderately eurosceptic, economically left-wing parties have enjoyed some unexpected advances since the last European election – notably Syriza in Greece and Jean-Luc Melenchon in France – and hope to build on the 52 seats secured in 2014.

MARCEL DE GRAAFF AND NICOLAS BAY
De Graaff and Bay are co-chairs of the Europe of Nations and Freedom Group. The former spent time as an IT consultant and teacher before entering the Netherlands senate for the Party for Freedom, while the latter is a long-time National Rally (formerly National Front) member and current general secretary. A hazy coalition of populists, its main selling point is outspoken support for reversing EU integration to reclaim national sovereignty. In the year of Brexit, they may capture the mood of the moment.

THE BIG IDEA

UP FOR THE CHALLENGE

Tom Lansdowne looks at why challengers break the rules in their desire to innovate

Achieving genuine innovation is hard and outdated rules don't make it any easier.

As customers we applaud the challengers and innovators who consistently find fresh solutions to problems we weren't aware of. Whether it's helping us get from point A to point B that little bit faster, performing financial transactions quicker and easier, or perhaps letting us travel anywhere in the world and somehow manage to feel like home.

Challengers not only hit and hope, but test and learn. They build businesses that are purposefully lean because overinvestment inhibits them from changing tack. And they create teams of renegades because they need to act and think differently in order to achieve something new.

But regulators often force those challengers to innovate within constraints. They write the rules and expect challengers to abide by them. They're there when they step out of line with their carrots and sticks, and they do it to keep customers safe. And they do a very good job at it too. But at what cost to progress?

BENDING THE RULES

Rules aren't made to be broken, but they can really get in the way if they fail to keep up with the changing pace of business. Innovation comes from trying things no one else has, pushing boundaries and seeing where it takes us. And, when it works, it enables businesses to grow and reach more and more people with less and less money.

So it shouldn't come as a surprise that the challengers look to bend and break the rules when they inhibit progress – after all, there's no prize for second place.

It can start small as a by-product of a rule of law that wasn't built for test and learn entrepreneurship. There will be countless thousands of ventures taking off today without even the consideration of registering with Companies House, already serving their most loyal customers of the future, because that's the last thing on an entrepreneur's to do list.

Why register a business without testing the waters first? When life gives you lemons buy a lemonade stand. Don't apply for a license to sell lemonade.

This mentality only gets stronger as businesses mature. A few years ago, I spent some time working in the customer acquisition team of a high-growth meal kit start-up. We had the idea to give away branded umbrellas outside Wimbledon on quarter-finals day, so we pitched up on a local resident's front drive paying cash in hand for their prime real estate, with our free strawberries and cream for passers by in return for taking one of our free umbrellas. We were the only ones hoping for rain, wanting to light up Henman Hill in the brand's colours with millions watching on TV. Rules were the last of our concern and we ended up with a slap on the wrist, a fun story and a handful of new customers.

As these challengers get even bigger and more established, the stakes get higher. New General Data Protection Regulation legislation threatened to cripple many ecommerce businesses who had over several years accumulated an impressive mailing list of customers with which to share anything from luxury travel at discounted prices to a mattress in a box. If new rules threatened to derail what you'd spent the last five years building, would you accept it and invite competition or search for a lawyer that speaks your language?

STRIKING THE RIGHT BALANCE

When laws don't evolve fast enough, the aim of the challengers becomes building a culture that encourages and enables the right amount of rule-breaking. We're not short of instances where innovators have taken it too far, from Deliveroo's zero-hours PR disaster to Revolut failing to block thousands of suspicious transactions by allegedly switching off its transaction monitoring system.

To achieve the right balance, businesses need to provide their

employees with two things. The first is clarity. Businesses need to know with absolute conviction the types of behaviours that are fine and encouraged, and those that aren't. The start-ups that do this well have clear guiding principles or values, often with the customer at the heart. Sharing anecdotes and telling stories that get repeated helps to strengthen them too. The second is accountability. Those in positions of authority making the decision to bend the rules should expect to be held accountable when it goes wrong, by peers, senior leaders, investors and by customers.

Sometimes, however, company culture can get overlooked. Where focusing on the customer and doing right by them gets buried behind a desire to win at all costs. The absence of guiding principles in this case can get toxic. Fast.

Building a successful, sustainable business within the law is hard. Nobody disputes that. Perhaps none more so than in insurance or banking where competition is rife and regulation stringent. Add the pressure of declining growth, overly-ambitious investor targets and employees taking a risk simply by working there, and it's no surprise that sometimes decisions are made that go beyond the realms of what's legal and, at times, ethical too.

When life gives you lemons, buy a lemonade stand. Don't apply for a licence to sell lemonade

One wrong decision at the top can set a dangerous precedent and mould company culture into something few founders ever envisage when setting out on their entrepreneurial journey. Revolut has felt the heavy hand of the law in recent months for its financial misdemeanours, but it's the company's toxic culture that's getting even greater coverage with instances of whistleblowing and brutal Slack messages from the CEO. This mentality and these behaviours then trickle down to what customers see and hear as well, not just via media coverage but in Revolut's own 'single shaming' ad campaign that received a lot of hate from viewers, for example.

This behaviour certainly isn't unique to Revolut, of course, and is only being made easier through the rise of digital. Other challenger banks have been calling out their competitors for war-like tactics of driving huge amounts of traffic into newly-built web apps with the sole aim of taking them down. Fake Trustpilot reviews written by competitors aren't uncommon either. These behaviours are never okay.

THE RIGHT INTENTIONS

While breaking outdated and maladapted rules that inhibit growth and innovation might not be right, there are some instances where it's understandable. So long as effort is being put into building a responsible company culture where employees know right from wrong. Of course, when rule-breaking negatively affects the customer, action needs to be taken. But by being genuinely customer-led, businesses should be able to credibly seek to collaborate with regulators and policymakers with the mutual intent of doing right by the customer, in a way that doesn't hinder progress.

Regulators and policymakers have an equally important role to play here. While keeping up with the pace of innovation will always be a challenge, there's ground to be gained from working with those businesses that see the commercial value in putting customers first and want to stay on the right side of the law, but come up against outdated regulatory barriers that inhibit success for business and customer. This applies to all sizes of operations, from the might of Facebook to our friend with her lemonade stand. ●

Tom Lansdowne,
consultant,
The Foundation,
an independent management consultancy

UNFOCUSED

REUTERS

THEY SAID IT...

Last month, big bank CEOs faced tough grilling from the House Financial Services committee on Capitol Hill. The line of questioning varied from salaries to fossil fuels, but one consistent was the squirming from the all male executive bench. Here *FS Focus* presents some of the most amusing and awkward exchanges….

Q **"If you were an employee, and you saw your boss making £486 for every dollar you make, how would you feel about that situation"**

Democrat Nydia Velazquez of New York asked

"If you believe that your likely successor will be a woman or a person of colour, would you kindly extend a hand in the air?

Democratic representative Al Green

"I would be hopeful there's opportunity to continue to advance within the firm"

Citigroup CEO Michael Corbat responded rather pathetically

"…"

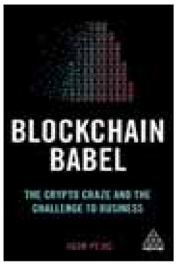
Not a single CEO raised their hand in response

"Unbelievable"

Velazquez's unimpressed response

"Boy, I really miss my old job"

Former Goldman Sachs CEO, Lloyd Blankfein, chipping in on Twitter with a sarcastic remark in reference to avoiding the grilling



BOOK REVIEW

Blockchain Babel: The crypto craze and the challenge to business

Igor Pejic
Kogan Page Limited
£14.99

FS Focus rating: ★★★★★

Blockchain is much talked about and even being experimented with, especially in financial services, but few know how transformative it could actually be. Pejic clearly does though. This book is packed with insights on how and why blockchain should be used.

What is very clear is that blockchain will change the financial service system from the ground up, and could even save banks $15-20bn a year from 2022 onwards, according to Santander.

Pejic refers to it as a "radical innovation", potentially on a par with the arrival of the internet, in that it has fuelled the emergence of a host of adjacent, interrelated industries and holds the potential to influence many industries beyond payment and transactions.

Centralised systems make transactions quicker, are more energy efficient and secure, make it easier to meet regulatory requirements, and reduce the likelihood of a hostile takeover attack, because banks have control of their decision-making 'nodes', Pejic reckons. Apparently, "financial institutions are already embracing the silver bullet solution of combining centralised blockchain technology with state-issued, 'real' currencies".

He talks about how incumbent banks should embrace the technology, including through partnerships with challengers and start-ups, insisting that it could revolutionise the movement of money.

Admittedly, he concedes there are still concerns with blockchain, including that it lacks transactional capacity (meaning that bugs and system failure would be likely if it were suddenly deployed on a large-scale basis). Plus, interfaces are not very consumer friendly and better wallets need to be developed. But the upsides far outweigh the downsides.

It is all genuinely interesting stuff. When reading through the book, I found myself underlining copy on every page. That's not happened for a while. If you're keen to learn and understand why blockchain is so important and how to use it properly this is definitely the book for you. ●