The London Institute
of Banking & Finance

# Financial World

DECEMBER 2019 / JANUARY 2020

## THE MILLENNIAL CONSUMER

When they're 84
*Richard Tomlinson*

Missing out on being social
*Gren Manuel*

Cognitive pain killers
*Tim Green*

## ANALYSIS AND FEATURES

Trials and tribulations
*Diane Coyle*

Banking with bottle
*Ouida Taaffe*

Money, but not as we know it
*David Birch*

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## In this edition

This edition of *Financial World* comes at the end of a year in which open banking finally went fully live and Google finally announced what many have long expected: that it intends to offer a "smart" retail current account, at least in the US.

The year ahead is likely to be eventful, which is why we have asked a number of experts to give us their opinion on some of the important questions around banking and the economy.

**Paul Dales** – *chief UK economist at Capital Economics* – might surprise some with an upbeat view of the outlook for the UK economy.

**Stuart P.M. Mackintosh** – *executive director of the Group of Thirty* – is less sanguine about what awaits the US.

**Otmar Issing** – *former member of the ECB executive board and one of the fathers of the euro* – is forthright about his concern that further easing by the ECB will increase the 'zombification' of the economy.

**Imran Gulamhuseinwala** – *implementation trustee for open banking* – looks forward to a transformation of how we interact with data across all sectors.

**George Graham** – *a long-time financial journalist and a trustee of one of the UK's largest DB pension funds* – takes a hard look at what really needs to be done to fund UK pensions.

**Martin Stewart** – *visiting professor at The London Institute of Banking & Finance and director of supervision, UK banks, building societies and credit unions, Bank of England 2013–18* – explains why the regulator is becoming 'tech-activist' and what this will mean for banks.

**Jenny Tooth** – *chief executive of UKBAA* – looks at the promise that investment in women founders and in the regions holds.

**John Somerville** – *relationships director, corporate & professional learning, The London Institute of Banking & Finance* – examines what 2020 might bring for financial advice.

Part of the final answer to at least some of the questions our experts examined will come down to the way in which young people react to the financial services provided by big tech.

As this issue's set of cover stories shows, many young people are under financial pressure in an economy that is awash with money but low on growth and productivity. Perhaps, as some have argued, ten years of ultra-low interest rates and quantitative easing have distorted the normal investment channels, keeping alive zombie companies and preventing asset managers who are desperate for yield from making careful decisions about the assets that really offer innovation and longer-term growth. Technology, others argue, will help sort that out. However, even if "normal" financial conditions are restored, it seems unlikely that young people will have, and use, mortgages, pensions and credit in the way that their parents did. If nothing else, many cannot afford a mortgage, nor the sort of pension payments that would be necessary to fund twenty or thirty years of retirement in a low yield world. (See Richard Tomlinson, p17 and Richard Northedge p18.) Further, many may value the sort of tailored and flexible financial products that machine analysis of personal data promises to bring – and be quite happy to give a provider access to all of that data if the same provider can offer, say, responsive credit products that are geared to fluctuating incomes. They are also likely to value a good user experience. As Tim Green points out, p29, millennials prioritise interfaces with speed, clarity and "a sense of self-direction, however illusory". Big tech is set up to provide that, which could mean big changes for retail financial services.

There are also changes coming to the magazine next year, as we too seek to evolve. We will, however, aim to keep some things the same: a forward-looking and well-reported look at financial services.

# Letters

## Politics and the punchbowl

The two articles on monetary policy (*FW* October/November 2019) from Jamie Dannhauser and Warwick Lightfoot really stretched the mind and imagination. In the best traditions of stimulating journalism, they use a shared intellectual framework of analysis to reach subtly opposed conclusions.

Lightfoot's thesis – that fiscal policy will, and should, come to dominate macro-economic management as monetary policy loses its traction in an era of ultra-low interest rates – appears at first glance to be spot on in today's markets. In contrast, Dannhauser's cautionary warning against the risks of politically induced inflation from the application of modern monetary theory (MMT) may seem outdated in a world of near endless flows of global productive capacity (hence near nil inflation in goods, if not asset, prices) and global cash (hence negative long-term sovereign bond rates).

As I understood it, Dannhauser worries that the popularity of MMT – lending creates deposits, governments can fund their own debts, or Magic Money Tree – will return the punch bowl to the drunken entertainer (politicians running fiscal policy) and sideline the sober sommelier (central bankers issuing bonds and fixing rates). Lightfoot refills the entertainer's glass with his prediction of "a return to a more coordinated monetary policy in which fiscal decisions dominate".

Both articles use scholarly analysis of sovereign financial flows to support their contrasting conclusions. Lightfoot argues that increased coordination of fiscal and monetary policy is the last and essential resort to prevent a global economic slowdown. Dannhauser believes this could blow apart this century's benign climate of low inflation.

I am daring here to tread the clumsy hoof of an amateur in the hard-wired complexities of monetary theory mastered by these two experts, but does not the following trivial soundbite sum up both theses: Keynes reigns (still)? Lightfoot's "more co-ordinated" fiscal and monetary policy is surely FDR's New Deal in twenty-first century clothing. And his reference to "all the monetary taps having been turned on full but not much has happened" is a similarly updated version of Keynes's attack on the 1920s classical theory that the supply and demand for money will clear in a free market at an equilibrium interest rate.

Dannhauser is closer to Milton Friedman's Chicago School than to Keynes in his warning against allowing the fiscal spenders to outclub their monetary minders. But he is basically the obverse of the Keynesian coin. Chicago looks a little out of fashion now but, like the proverbial prophet in the wilderness, Dannhauser is reminding us that the eternal sins of the flesh – in this case, over-spending, over-borrowing and over-issuing of money – are not eliminated through a couple of digitally driven low-inflation decades and will return to punish us unless we keep them under control.

My own unreconstructed Keynesian riposte to this riveting Dannhauser piece is that the sober sommelier still carries the strongest anti-inflationary club. It might hurt, which is why the decision resides with the independent central bank, but increased issuance of government bonds at higher rates is the most effective way to reduce money supply and curb inflation. There are lags, of course, as well as populist pressures, but it is the most powerful contractionary weapon. And, mixing the metaphors, the sober sommelier is the only person in the room wielding it. Unless, like the Fed earlier in 2019, he blinks as the drunken entertainer threatens to trash the house.

***Jamie Stevenson****, visiting fellow, University of Exeter*

## Do the right thing

Following reports that Apple Card has been discriminating against women users (a problem that only came to light because those most obviously affected are married to very wealthy tech titans), I was interested to read Gren Manuel's article 'The only way is ethics' (*FW* October/November 2019).

He is surely correct to point out we should not have a naive faith in the objectivity of machines. They are, after all, built and programmed by people who bring their own assumptions about the outcomes that are "right" and "fair". He is also clearly correct that dealing with bias will be one of the biggest challenges fintech faces.

***James Brown****, London*

*We would encourage readers to respond to the articles in the magazine with any thoughts and also with any suggestions for issues that* Financial World *should tackle. Please write to: The editor, Financial World, 73 Leadenhall Market, London, EC3V 1LT, or email: editor@financialworld.co.uk*

# No waiting for Godot

*Martin Bresson and Jacques Lafitte show how Brexit has had little influence on the EU agenda as the bloc continues work on policy initiatives affecting financial services*

For the past four years, the assumption has been that almost any EU agenda is overshadowed by Brexit. Brexit has been a massive source of political distraction for heads of state as well as a burden on some policy desks – especially those in charge of defining or redefining regulatory equivalence. Yet the London-centric view that the creaking EU machinery has had no time for anything else, and will not find any time until Brexit is completely settled, is wrong.

EU institutions have not just been waiting for Godot/Brexit. That should not be a surprise. What is surprising, given how massive the impact of Brexit is bound to be, is how little influence it has had on the EU agenda. One would be hard pressed to name even one policy initiative that Brexit has derailed or slowed down. Both Donald Trump and China's Belt and Road initiative have probably had more influence.

There is one sector where this lack of upset is particularly surprising. Given the importance of the financial services sector for the UK, and continued continental dependence on the City, banking and finance might have been expected to face some disarray. But a look at the mission letters sent by Ursula von der Leyen, the new European Commission president, to her commissioners-designate, and discussions with Commission officials on their preparatory work, suggest that it is "business as usual" – and that this will continue. The drumbeat for change could speed up a little, especially now that Germany seems to understand that finishing Banking Union before the next crisis is highly desirable, but that change in tempo will not hinder EU affairs.

Von der Leyen wants the EU to become more sustainable, climate-friendly, safe and self-reliant, and to be at the forefront of technological development. Leaving aside the unfinished part of Banking and Capital Markets Unions, the future agenda for financial services can be divided down very much the same lines. Some initiatives are already in the pipeline with regard to "safeguarding the financial stability" of the EU. Schemes such as reviewing the rules on bank resolution and recovery will definitely reopen the fault lines that developed in the post-financial-crisis negotiations on those issues. Those fault lines criss-cross between home and host countries and between universal versus investment banks. Although London, Europe's largest financial centre and home to some of the biggest operators subject to these rules, may shortly be placed outside the EU, the review will not stop. Having the City outside the single market just makes discussions on compliance and equivalence an overarching issue.

In parallel, the transposition of the newest batch of recommendations from the Basel Committee on Banking Supervision into the EU's capital requirements directive and regulation will stoke disagreement between member states. This is likely to happen within the time frame of the current Commission's mandate. At the same time, with protectionism on the rise around the world, the UK's global approach to banking regulation faces serious headwinds – particularly compared with the continental desire to allow for European/eurozone specificities. How long the UK's current "as closely aligned as possible" approach will resist these tensions is anyone's guess.

> *The EU's crown jewel initiative of capital markets union is still high on the implementation agenda*

In insurance, the review of the Solvency II regime may offer the opportunity to correct some of the imbalances in the rules that were rolled out mid-crisis and in a different interest rate environment. The review is set for 2020 and will be one of the major "financial stability" initiatives.

The deadlock on a fully operational and truly pan-European deposit insurance scheme, the key to delivering a "complete" EU Banking Union, might be resolved. Recent plans by Olaf Scholz, Germany's finance minister, on how to move ahead with the project did not please Italy but they signal a new, and welcome, openness to dialogue.

The EU's crown jewel initiative of Capital Markets Union (CMU) is still high on the agenda, with interesting semantic nuances in the political phrasing between "building", "completing" or "a new CMU strategy". CMU has been on the EU drawing board for years – some readers may remember the courageous but fruitless Giovannini report on cross-border clearing and settlement arrangements in 2001. It might stay there for years to come, but we think that Brexit creates a new, more favourable, context.

The new name of the game is to build an investment "ecosystem". The concept looks brilliant, but only time will

tell whether the EU is really ready to move beyond uniform reporting and disclosure rules. SME funding, a sore point for the EU, is now on the agenda, which is good, but other important topics, such as retail investor participation, are still missing. Whatever route is taken in the near term, there will be many CMU-relevant legislative reviews. MiFID-MiFIR (Markets in Financial Instruments Directive; Markets in Financial Instruments Regulation), AIFMD (the Alternative Investment Fund Managers Directive), UCITS (Undertakings for the Collective Investment in Transferable Securities) and CSD (Central Securities Depositories) are at the top of a long list.

So much for the old stuff. Now to the new. Let us start with money laundering. There is no financial services policy field where the EU has been found more wanting, with some massive scandals affecting the core of the banking establishment in Northern Europe. But a quiet revolution has begun. Responsibility for combating money laundering has already moved from the justice department of the European Commission to the one in charge of financial services. A consensus also seems to be emerging on the creation of a dedicated European agency. It is a bit early to say whether this agency will become an authority but the EU looks determined to solve its most shameful supervisory problem.

The EU also seems equally resolute about fixing its most dangerous supervisory problem. Serious work has started recently on non-performing loans, with a view to bringing an end to the toxic mismatch between European resolution rules and national insolvency regimes. As with money-laundering, the cultural challenge with non-performing loans is to shift the issue out of the slow-moving, inherently national-conservative civil law agenda into a twenty-first century EU-wide financial services framework. It is no small task but the ambition seems to be there.

One area where the EU has been ahead of the curve is in sustainable finance. A road map had already been set out by Jean-Claude Juncker's Commission, but it will be for the new Commission to give life to its 10 initiatives. The key taxonomy work is underway at the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG-FISMA) and stakeholders should engage if they have not already.

As for a more innovative and technology-driven EU, cybersecurity and resilience requirements feature high on the agenda, in line with the aims of the G7 and the Financial Stability Board. Threat response aside, the focus will be on open banking, cryptocurrencies and artificial intelligence. Legislators have not yet fully grasped what needs to be regulated so the timing is uncertain, but it is a virtual certainty that the new Commission will propose something in these fields, either on a standalone basis or as a consequence of a wider move, maybe from the G20.

Finally, taxation. When one thinks about the words "taxation", "European Union" and "financial services", just one topic springs to mind, the financial transaction tax (FTT). We believe the tax is a zombie that may never be buried. It is a project that it is quasi impossible to implement for economic and practical reasons – and quasi impossible to drop for political reasons. Expect many more inconclusive meetings between member states.

Even if we consider FTT part of the walking policy dead, the EU is not short on ideas that may have a live impact on finance. These include the digital tax; energy tax(es); the revised emissions trading system (ETS) (economically an intra-EU carbon tax) and the border adjustment tax (the opposite number to the ETS for non-EU imports); the plastics tax; and then maybe one day a sugar tax or some sort of timber-felling tax. Our crystal ball is too small to show which of these taxes will be imposed, let alone when. Yet it is a safe bet that some will. And the revival of ideas for EU taxes that directly affect financial services is far from unthinkable.

The recent EU name and shame action against tax havens will continue and might become more high profile. A relatively short Ecofin list of non-cooperative tax jurisdictions has been running in parallel to the OECD and IMF ones since 2017. There is also a would-be, and much messier, anti-money laundering and terrorist financing blacklist resulting from the Anti-Money Laundering Directive. This led to the biggest slap ever given by member states to the Commission, with a unanimous rejection of the first draft list in early 2019 because the proposal was not established in a transparent and resilient process. Expect the Commission to try harder.

Whether there is Brexit with a deal or without, or no Brexit at all, the EU will not say "I can't go on" – and certainly not where financial services are concerned. There will be no waiting for Godot. They will go on. ■

***Martin Bresson****, partner and group chair of financial services and corporate issues at Rud Pedersen, and former Danish PermRep official at the EU*

***Jacques Lafitte****, founder of Avisa Partners, and a former official at the French Treasury and the office of the European Commissioner for Economic and Monetary Affairs*

# Trials and tribulations

*__Diane Coyle__ discusses the controversy over the award of the Nobel Prize in economics to the three pioneers of using randomised controlled trials as a way to fight global poverty*

The award of the Nobel Prize in economics always triggers an outbreak of controversy, and this year's award to Abhijit Banerjee, Esther Duflo and Michael Kremer is no exception. The three are highly respected and many people welcomed the decision to honour Duflo in particular, as only the second woman ever to win the prize.

The controversy concerns instead the recognition the Nobel committee gave to the method the three scholars have brought to economics: randomised controlled trials (RCTs). As the citation put it: "This year's Laureates have introduced a new approach to obtaining reliable answers about the best ways to fight global poverty… They have shown that these smaller, more precise, questions are often best answered via carefully designed experiments among the people who are most affected." In their new book, *Good Economics for Hard Times*, Banerjee and Duflo emphasise that good economics is based on evidence, writing of "the urgent need to set ideology aside and advocate for things most economists agree on, based on the recent research".

Interest in the use of RCTs in economics has exploded since the mid-1990s, when the trio began to publish their work exploring questions such as whether free meals or free textbooks are more effective in improving educational outcomes for Kenyan children, or whether adding a free bag of lentils as an incentive will persuade more parents in Indian villages to get their children vaccinated. The method has often been described as the gold standard for economics evidence. Banerjee and Duflo established at MIT a Poverty Action Lab deploying RCTs around the world. The American Economic Association maintains a register of new RCTs and the many enthusiasts for this method of reducing poverty even have a name: the randomistas.

How can the use of an empirical approach imported from medicine and some of the "hard" sciences be controversial? There are two powerful critiques. One often voiced by economists working in the pre-RCT and somewhat heterodox tradition of development economics is that the micro-intervention focus of the randomistas entirely overlooks the macroeconomic and political context. While not disputing the impact of some RCTs on the effectiveness of policies, critics point out that this ignores structural economic disadvantage.

As Ingrid Kvangraven, lecturer in international development at the University of York, expressed it: "While such small interventions might generate positive results at the micro-level, they do little to challenge the systems that produce the problems." From this perspective, to set the ideology aside is to do bad economics.

The second critique concerns the uncritical celebration of RCTs as a method of empirical investigation. Its most forceful voice is Angus Deaton, a previous Nobel winner and another highly respected development economist. In a new paper, he writes: "RCTs have no special status… There is no gold standard." He is concerned about the ethics of running RCTs in poor countries, exactly where they have been most widely used. Often commissioned by western aid agencies or research funders, RCTs frequently involve an externally determined view about what is best for the experimental subjects. To put it bluntly – as Deaton does – rich people are experimenting on poor people.

He sees the fashion for RCTs as similar to the Silicon Valley view that problems have technical fixes: "There is no great difference between designing a gadget and designing social policy. Both are exercises for engineers." Duflo herself has described the economist as a "plumber", naturally seeing this as a positive where Deaton considers it as either irrelevant or dangerous.

Banerjee, Duflo and Kremer deserve the Nobel Prize. The three are brilliant economists and have had a significant impact on their discipline. But the critiques of their flagship method are powerful. The rather heated debate about the award is a healthy reaction to the uncritical over-use of RCTs, both by aid donors keen to see "impact" from their funding of projects, and by young researchers leaping on the methodological bandwagon. "Evidence" is never neutral, political problems do not have technical solutions, and untangling causality in the complex world we live in needs every possible method we can bring to bear on it. ■

*__Diane Coyle__ is Bennett Professor of Public Policy at the University of Cambridge*

# All change for climate change

***Alex Fraser** highlights how the financial sector is responding to the challenges of climate change, and stresses the role education can play in building knowledge and expertise*

Our rapidly changing climate threatens to cause irreversible damage to habitats and economies around the world. That threat is, beyond doubt, the defining issue of today and will be for the foreseeable future. How we address the issue will shape the world for all of us.

Financial institutions globally are rushing to take advantage of what has been described as the biggest investment opportunity in history. They have taken up the cause of responsible economic growth and have ambitions to be leading players in the complex transition to a low-carbon world. Banks are committed to reducing their own exposure to new fossil fuel extraction and are becoming wary about lending to customers whose businesses rely on such activity. There is a big push to become clean lenders and, at the same time, there is a strong and welcome commitment to increased transparency in the area of sustainability.

Demand on the investment side, particularly from the younger generations, for sustainability-related products is soaring, leading to a rise in the number of green and sustainability bonds. There is also a significant increase in the number of funds that focus on specific sustainability themes such as water, health and waste. Although there is opportunity for financial services firms in sustainable investing, there are also major challenges. Data is still very patchy and definitions and disclosure still inconsistent. How do we dig beneath the hype and find out what is really going on?

There are many think-tanks and well-informed pressure groups that are ready to call out inconsistent behaviour within the financial services industry. That helps, but firms have a central role to play in ensuring transparent disclosure. If nothing else, institutions that emerged seriously damaged from the financial crisis have a clear need to beware of the reputational risks posed by sustainability.

It is not enough to talk the talk; financial institutions have to walk the walk, too. If they say that they are demanding better disclosure from investee companies, then they should be able to demonstrate this. If they claim to be expanding the range of sustainable investment products they offer to clients, then those claims need to be backed up by readily accessible data. If they are still investing in new fossil fuel extraction, then it is reasonable to expect an explanation for this.

The transition to a low-carbon economy has very many moving parts and the industry is at the start of a corrective turn, not yet fully set on a new course. I believe that organisations can mitigate the risk of reputational damage by improving the quality of the conversation with their stakeholders during this transition.

Education will play a very important part. As the City Minister, John Glen, said at the World Conference of Banking Institutes in London last September: "If we are to meet the challenge of climate change, then we need to embed sustainable thinking at every stage of professional development – from the newest recruit to senior board members."

The London Institute of Banking & Finance is supporting the agenda both through our educational programmes and through our thought leadership. With strong backing from our partner in the UAE, Abu Dhabi Global Market, we have recently launched our Certificate in Sustainable Finance that will allow those working in financial services to build knowledge and expertise in this important and rapidly evolving area. This certificate features topics such as risk, investment strategy and policy and will be a blend of academic theory and real-life case studies, delivered by academics and practitioners. Our Centre for Sustainable Finance is a hub for discussion and debate.

> *"Banks are committed to reducing their own exposure to new fossil fuel extraction and want to be clean lenders*

We will take every opportunity to engage with other academic institutions, public bodies and financial institutions around the world. This is a global challenge and our work as educators needs to reflect this. ■

***Alex Fraser** is the chief executive of The London Institute of Banking & Finance. His previous positions include chief operating officer at Cass Business School and logistics director at HM Customs and Excise, after a decade fulfilling a variety of operational roles in a number of investment banks*

# Will it be the roaring 20s?

*As we prepare to enter a new decade, **Financial World** asked various financial experts to give their predictions for what we might expect in the coming year*

## New year, new hope

UK ECONOMY

Although the UK economy is unlikely to shoot out of the blocks in the first year of the 2020s, there are reasons to believe that it will perform better in the first half of the new decade than most people expect.

Years of austerity and the uncertainty caused by Brexit meant that the 2010s was not a golden decade for the economy. Market expectations that interest rates will be no higher in five years' time than the current Bank Rate of 0.75 per cent suggest that investors see the 2020s as being similar. But I think they may end up being pleasantly surprised.

Admittedly, unless the Labour party or the Liberal Democrats pull off a victory at the general election on 12 December, there is little chance that Brexit will go away. And even if the Conservatives secure a majority that allows Boris Johnson to pass his Brexit deal by 31 January, uncertainty may linger and hamper economic growth. After all, unless the UK and the EU quickly strike a new trading arrangement or soon extend the status quo transition period beyond the end of December 2020, the fear of something similar to a no deal on 31 December may prompt businesses and households to keep their spending plans on ice throughout the coming year.

But a Brexit deal accompanied by some assurance that the UK will not be trading with the EU on World Trade Organisation

rules after December 2020 would release the handbrake of uncertainty that has been holding back the economy in recent years. In the near term at least, that would lead to stronger business investment and higher growth in household spending.

Even if Brexit uncertainty continues, the headwind from fiscal policy over the past decade is about to become a strong tailwind. That could make a big difference. Indeed, the Conservatives have rewritten the fiscal rules so that they can increase investment by up to £22bn per year. And Labour has pledged to boost investment spending, possibly by £55bn a year. In theory, such spending could increase GDP growth by 1 per cent and 2.5 per cent respectively spread over a number of years.

While the UK economy may only grow by somewhere between 1 per cent and 1.5 per cent in 2020, a marked loosening in fiscal policy will set the foundations for growth averaging closer to 2 per cent in the first half of the 2020s. Any reduction in the uncertainty caused by Brexit would be an added bonus. ■

***Paul Dales** – chief UK economist at Capital Economics*

## Turbulence seen ahead

US ECONOMY

The US economy appears to be headed into a turbulent period, but just how bad those storms might be and when and where they will hit hardest remains to be seen. Currently, the economic outlook is mixed at best.

But there is much to be positive about. US consumer spending was up by 4.6 per cent in the second quarter, spurred by rising median wages, even as an increasing number of voters say they see a recession as a possibility.

Importantly, the housing market remains tight, with no signs of the excesses that resulted in the global financial crisis of 2007-08. US unemployment is at a 50-year low and median wages are rising at well above the rate of inflation.

But there are some worrying economic

signals. New car sales are way down as Americans slam on the brakes – for now – on their car love affair. The manufacturing sector limps along, hindered by trade uncertainty, tariff increases and worries about what comes next, with the Purchasing Managers' Index at 51.5 in October.

The service sector is also on the cusp of contraction. Business investment is lackluster, declining at 1 per cent – the steepest decline since the fourth quarter of 2015. Foreign direct investment is also down in the US and elsewhere. This all suggests, and US economists expect, that the economy will limp along, growing at between 1 per cent and 2 per cent in 2020.

Unfortunately, there is no clarity on that. Other factors complicate the economic outlook. The trade war with China will not end. Even if a temporary truce is called, it will continue to hit key sectors hard, from agriculture to aerospace. Geopolitical risks and policy and business decisions are affecting forward looking investment, in the US and globally. Debt levels, both government and corporate, stand at record highs.

Recently, the yield curve inverted, which historically occurs a few quarters in advance of the onset of a downturn in the business cycle, alarming investors. In recent months, the economic outlook in Europe, China and Japan has also weakened.

Two possible scenarios present themselves. First, a period of uninspired growth, low inflation and business uncertainty about the road ahead. Second, a risk that recessionary dynamics driven by that uncertainty, trade woes, tweetstorms and the eventual end of US consumers' spending binge may cause the business cycle finally to turn, at a time when central banks and governments are ill-prepared or unable to rescue the economy.

I know which scenario I would prefer. ■

***Stuart P.M. Mackintosh** – executive director of the Group of Thirty*

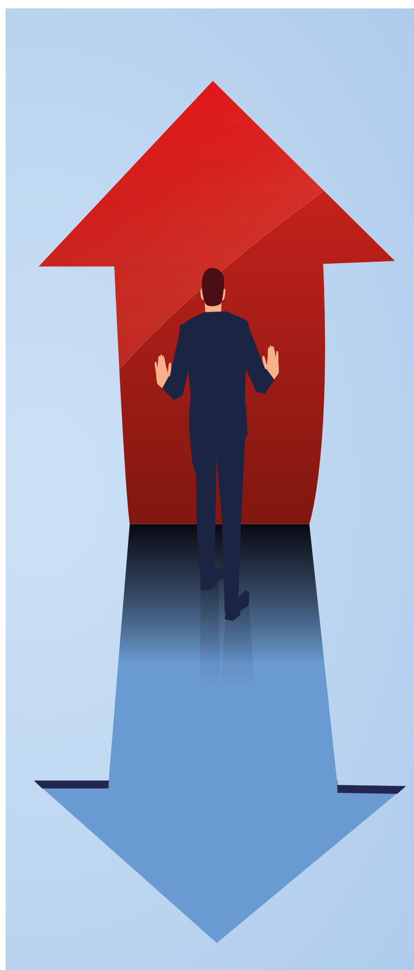
# Too low and for too long

**EUROPEAN MONETARY POLICY**

On 4 October, 2019, I was one of a group of senior former central bankers who issued a memorandum on the ECB's monetary policy. It expressed our growing concern about the ECB's "ongoing crisis mode" and, in particular, about the following aspects of the ECB`s monetary policy:

- the continuation of quantitative easing;
- the effects of very low and even negative central bank interest rates;
- extending and further strengthening forward guidance on the continuation of extremely accommodative monetary policy; and
- the central bank´s current position that 1 per cent or 1.5 per cent inflation is too low and not consistent with the mandate of price stability.

There is a wide consensus that further asset purchases by the ECB will hardly yield any significant boost to growth



and inflation. But what those actions will increase is the risk that the ECB is violating EU rules on the prohibition of monetary financing. This makes it difficult to understand the monetary policy logic of resuming net asset purchases.

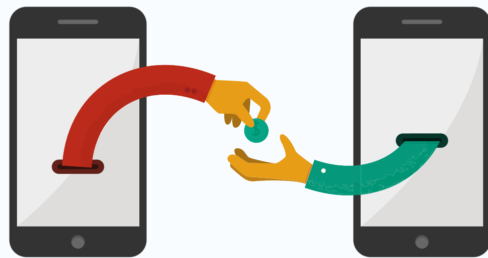
In theory, very low interest rates should lead to economic expansion. But extremely low central bank interest rates over an extended period help weak banks and companies to survive. That "zombification" of the economy is more than just a negative side effect. OECD and BIS studies indicate that it is contributing to weaker productivity growth. Moves in the direction of "normalisation" of monetary policy are badly needed if capital is to be allocated to productive companies. The timing of normalisation depends on the development of the economic situation. But the Governing Council committing, in its forward guidance, to more easing is anything but helpful. In the meantime, ultra-low interest rates are hurting the banking system, insurance companies and pension funds. ■

***Otmar Issing** – former member of the ECB executive board*

# Open banking is just the beginning

OPEN BANKING

Twenty-twenty will be a big year for open banking. In the UK, we have created a single API standard covering circa 99 per cent of payment accounts, allowing consumers and small businesses to share their data with authorised third parties in a safe and secure way. With over 180 regulated third-party providers, this will bring competition and innovation to the financial services sector and help consumers and businesses better manage and improve their finances.



If you were to turn back the clock two years, to the creation of open banking, most people would have thought it was all about setting another standard – ie something more technical than tangible. Creating an environment that is secure, but also provides consistency to customers, has been vital. However, preparing for open banking has been as much about implementation and user experience as it has about the underlying programming.

How successful has open banking been to date and where will it lead us? Open banking currently covers personal and SME business current accounts, credit cards and online e-money accounts. The major building blocks of open banking, the open APIs and the security and data standards, have been agreed and adopted by the nine bank providers subject to the Competition and Markets Authority (CMA) Order (the Retail Banking Market Investigation Order 2017); new competitors have entered the market, including third-party providers, and most of the major UK banks have themselves launched aggregators. API usage in both consumer and SME markets is growing rapidly. In June 2019, there were over 66.7m successful API calls using open banking standards, which represents around 190 per cent growth from the beginning of 2019. The balance of continuing collaboration and fostering innovation is beginning to meet the needs of customers. Our progress so far in open banking shows how it can rebalance the market in favour of the consumer. This genuinely allows government and industry to begin to look at how this approach can be applied beyond banking. Welcome to the world of smart data and open finance – where consumers are in control of their data and can use it to their own benefit.

Currently, the system is necessarily limited to current accounts because of its legal basis in the CMA Order and PSD2. This leaves out important financial products, including cash savings products, mortgages, insurance and pensions. There is a realisation that extending open banking APIs to other financial products will allow consumers to see all their financial information in one place – allowing for greater oversight by consumers and for more competition.

This is something that we will aim to build upon in the coming months. Open banking should no longer just be seen as a means of improving competition in financial services, but as a way of transforming how we interact with data across all sectors. ■

***Imran Gulamhuseinwala*** – *implementation trustee for open banking*

# A gap still to be filled

PENSIONS OUTLOOK

More and more people are now taking part in occupational pension schemes but, in a landscape of low interest rates and low expected investment returns, will these pensions live up to expectations? And will 2020 bring any significant change in the pension landscape?

Since the introduction of auto-enrolment, where workers have to opt out of occupational pension schemes rather than opting in, active pension scheme members have more than doubled from 7.8m in 2012 to 17.3m in the last Office for National Statistics survey in 2018. Yet the amounts going into these schemes remain modest: an average 5 per cent of pensionable earnings in 2018, although this is likely to rise as legal minima have now increased to a total of 8 per cent.

For a 30-year-old earning the national median salary (£27,531 a year), that contribution rate, together with the state pension, will provide an income that falls £2,500 a year short of what the Pensions and Lifetime Savings Association's Retirement Living Standards estimate

as a minimum expenditure level for a couple. Contrast this with the contribution rates required to support a defined benefit (DB) pension, where the employer is on the hook to make up any shortfall in the fund. For the 1.1m still enrolled in private sector DB pension schemes, the average contribution rate is now more than 25 per cent.

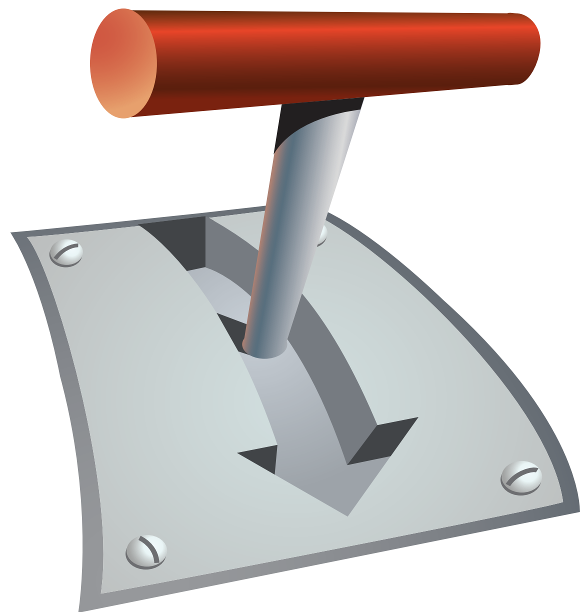
What does the government have in mind to deal with this mismatch between expectations and reality? The recent Queen's Speech included plans for a pensions bill, which would – if it ever reaches Parliament – set a legal framework for collective defined contribution (CDC) schemes. Often positioned as a halfway house between defined benefit and defined contribution (DC), CDC is common in the Netherlands and is being pioneered in the UK by Royal Mail, working with trade unions.

CDC would be expected to deliver somewhat better average outcomes than pure defined contribution, mainly because it could target investment growth for longer than a DC scheme, whose default investment option would typically derisk as members approached retirement age.

Yet there is no substitute for putting more money in: Royal Mail's modelling suggests a contribution rate of 15 per cent of salary, almost double the current DC average. In the end, CDC is likely to prove more attractive to employers seeking to reduce the cost of their existing DB schemes than to those wishing to improve the outcomes of their DC schemes. The expectations gap, meanwhile, will remain unfilled. ■

***George Graham** – financial journalist and trustee of one of the UK's largest DB pension funds*

# Technology comes under the spotlight



**FINANCIAL REGULATION**

Technology and financial services have for decades followed interwoven evolutionary paths. Technology has always been on regulators' radar, but they continually struggled to know *how* to regulate it. I have worked in financial services since 1990 and, in the 20 years before I became a regulator in 2010, I can only recall one occasion when the regulator undertook a meaningful inspection of our technology.

As the world emerged from the 2007 financial crisis, regulators were focused on ensuring that such a crisis never happened again. The rule books for prudential and conduct-of-business standards were rewritten.

This major overhaul left the regulators blind to the technology revolution. It had brought a step change in computing power and transformed financial services from islands linked by the traditional market infrastructure to firms in a fully-connected world, with complex interdependencies. These brought new opportunities but also new risks.

But it was not until 2013 that the UK's Financial Policy Committee (FPC) identified these as critical emerging risks to the financial system and required the regulators to take mitigating action.

In July 2018, UK regulators responded by publishing a discussion paper, *Building The UK Financial Sector's Operational Resilience*. Why did it take so long? The UK had prudential regulators and conduct of business regulators, but they were not technology experts. They had to invest in new skill sets to answer the questions the FPC had set them.

Since the publication of the discussion paper, the UK financial services industry has been debating the optimal way forward, but a clear public policy direction is yet to emerge. The lack of progress drew pointed criticism from the House of Commons Treasury Committee, which published *IT Failures in the Financial Services Sector* in October 2019, demanding greater action from government and regulators.

What does this mean for 2020? Whatever area of financial services you operate in, you can expect a continuous stream of technology-related policy statements, as regulators across the world catch up on

the technology revolution. You should also be prepared for regulators engaging with you on technology matters. Where in the past this engagement may have been from regulators trying to pass themselves off as technology experts, you will now be facing ones who are highly knowledgeable about the technology you are deploying.

They are going to have an opinion and, as the Financial Conduct Authority put it, "to advocate the exploration of certain areas with certain technologies…to expect the adoption of new technologies and approaches". This is not about particular vendor solutions, but it is about particular outcomes. Tech-activism has arrived. ■

***Martin Stewart*** *– visiting professor at The London Institute of Banking & Finance and director of supervision, UK banks, building societies and credit unions, Bank of England 2013-18*

# Women angels of the north set to fly

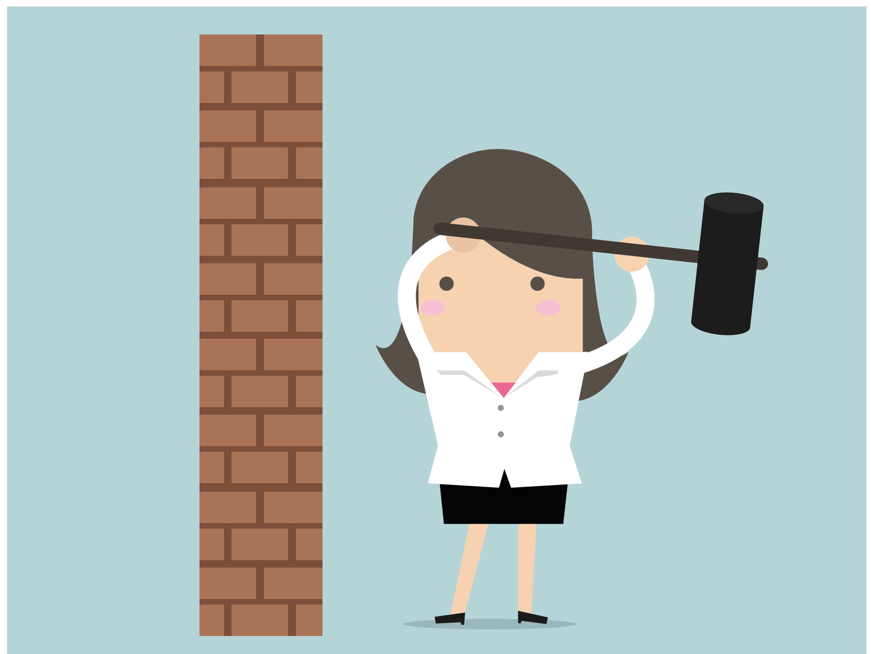
**UK VENTURE CAPITAL**

Business portfolios have always been diverse, representing an exciting array of business ventures. What I expect for 2020, and the next decade, is for business investors to become far more varied. In particular, women have to step up to the plate.

In 2019, the British Business Bank's Equity Tracker highlighted that companies with female founders represented only 5 per cent of total venture capital deals in 2018, and only 2 per cent of total investment value. Those numbers should be much higher.

Angel investing is leading the charge for investing into female-led businesses but institutional investors have a serious amount of catching up to do. Angel investments in women-led businesses represented 24 per cent of seed stage deals, although the amount women raised overall was lower and, at the growth stage of investment, only 12 per cent of deals were for female-led companies. Female angel investors are also much more likely than men to support female-founded businesses.

Given that bias, it is essential to inspire a new generation of female angel investors. At the UK Business Angels Association (UKBAA), we have made this our mission. In October, we hosted our Northern Women Angel Investment Forum in Manchester. This event



aimed to connect entrepreneurs and investors, allowing women to come together and review the landscape for women investors, to learn about latest developments, and share inside stories and experiences about angel investing. With more such events, investors can take a proactive role in increasing diversity across the investment sphere for SMEs.

Trends to be expected in 2020 include the North East fast becoming the most attractive place to invest for angel investors outside of London.

What is more significant is that, for tech-based start-ups, the North East was more popular with angel investors than London – although London as a region still takes the lion's share of venture capital. At UKBAA, we are looking towards innovative SMEs that are helping to innovate green technology. This has formed a large basis of our Future Forward scheme and the Regional Angel Accelerator fund. With empowered female investors, we could see the growth of these innovative SMEs accelerated to new heights. ■

***Jenny Tooth*** *– chief executive of UKBAA*

# Customer needs grow more complex

**FINANCIAL ADVICE**

With the world around us changing constantly, writing a "look ahead" for financial advice is like being asked to clean Big Ben with a toothbrush. But here goes...

As the industry and consumer needs change, advisers will have to update their knowledge. There will always be policy and regulation changes and the industry has coped with these. What is less clear is how quickly advisers can adapt to changing customer needs. For example, increases in demand for equity release, traditionally a mortgage broking conversation, may well need to be part of holistic financial advice in later life planning. Similarly, pension drawdown, once the preserve of the wealthy, is likely to be a much more common conversation for an automatically enrolled generation with increasingly big defined contribution pension pots.

The more that customers rely on technological solutions for simpler tasks and decisions, the more financial advisers will have to address complex needs. To provide the right levels of information and support to customers, the industry will have to be transparent and easily accessible.

Technology is changing so fast it is hard to keep up. Artificial intelligence (AI) is increasingly used in financial services but we have yet to see how it may be useful in the advice sector and what challenges (and hidden biases) it may bring. Open banking also has yet to make its mark.

We can hope that digitisation and the use of AI will transform all our lives for the better – taking the drudgery out of everyday tasks and improving customer outcomes and financial inclusion. But there are many challenges to overcome – and this the point where my toothbrush runs out of bristles. ■

**John Somerville** – *relationship director, corporate & professional learning, The London Institute of Banking & Finance*

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# The age of innocence

***Ouida Taaffe*** *introduces a series of articles looking at some of the challenges that millennial financial services consumers face, as well as some of the opportunities*

Youth is the best time to be rich and the best time to be poor, according to Euripides. That may be cold comfort to those of the millennial generation – born between c. 1980 and 2000 – who have faced a bumpy financial ride with few of the educational and employment certainties enjoyed by previous generations.

The oldest of them entered university just as tuition fees (then £1,000 a year) started. The financial crisis hit as they were getting a foothold in their careers. Now, the youngest are faced with a gig economy. They are also living in a society that needs to support increasingly large numbers of elderly and, at the same time, invest heavily in transitioning away from a carbon economy. Interest rates are at record lows, distorting incentives and keeping zombie companies alive. Yes, unemployment levels are also at record lows and investment in sustainability and increased use of technology should bring greater productivity, but that may not come soon enough to really help the pockets of millennials. Can financial services ease some of these challenges?

Young people certainly feel they need to know more about managing their money. The recent results of the Young Persons' Money Index, an annual survey carried out by The London Institute of Banking & Finance, indicated that, five years after financial education became part of the national curriculum, 82 per cent of students want more financial education in school and 60 per cent would like financial education to be a stand-alone subject.

What they want to know more about is the day-to-day business of budgeting, managing debt, paying tax and understanding what certain financial products do. They are likely to need that knowledge, and more. The defined-benefit pension schemes common until the 1990s have, for example, largely gone the way of the dodo – certainly for anyone entering the workforce now. Most young people will struggle to save enough for a long retirement, as Richard Tomlinson shows, p17. Young people also face high uncertainty in the near-term: the average price of a property in the UK, as of September 2019, was £234,370. That number hides a range from £474,601 in London to £132,769 in the North East and is entirely out of kilter with most people's earnings. Median weekly earnings for full-time employees in the UK in April 2019 were £585, around 2.9 per cent lower than the peak in 2008, even as house prices and rents have continued to rise. The salary number also hides a wide range with the median in London £152 a week higher than elsewhere. Almost everywhere in the country the average young person – unless they live in a two-income household and/or have a hefty deposit from the bank of mum and dad – will struggle to buy their own home and build up the sort of asset base that their parents could manage, as Richard Northedge analyses, p18.

What may be of help to young people – though not necessarily easy for incumbent banks – is the rise of data-driven financial services that seek to draw on information from many aspects of a customer's life. Google, for example, recently announced that it wants to provide current accounts in the US. It will not be applying for a banking licence. It is reported to have a partnership with Citigroup and Stanford Credit Union that will deal with the regulated financial side of things. Google, presumably, will be able to analyse data from products like Alexa, Nest and the fitbit to help provide new services that neither a bank nor a small credit union would not normally be able to offer, such as very nuanced and dynamic credit scoring. (Google is due to provide details of its plans next year.) As Gren Manuel explains, p21, Google is not the only tech company eyeing a role in retail financial services and those tech companies are keen to go where young people gather: to social media sites.

In the near-term, the entry of big tech into retail banking and payments may not be that much of an upheaval. It has, after all, taken open banking some time to start to gain traction. However, once consumers get used to the idea that third-party payment provision is safe, and once merchants start to offer lower-cost goods via those providers, the incumbent card companies could start to come under pressure. Open banking could also make things harder for current account providers. Certainly, the recent announcement that the c. 1.7m NatWest and RBS Reward account holders will no longer be offered cashback on bills from next February, but instead be given incentives for logging in to the account and for having direct debits, suggests that some are already moving to encourage customers to keep their current account – and its mobile app – front-of-mind. ■

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***Ouida Taaffe*** *is the editor of* Financial World

# When they're 84

*Millennials have been unfairly labelled as feckless spenders but, as **Richard Tomlinson** points out, they face serious problems in saving enough for a pension*

Ask a retirement expert about whether millennials are saving enough for their pensions and sooner or later the discussion turns to smashed avocados. "Millennials contradict the popular view that they are all avocado-smashing, feckless spenders," says Rebecca O'Connor, a personal finance specialist at Royal London, a pensions and insurance company. "They are quite a serious bunch when it comes to money, perhaps because many of them reached adulthood during and after the global financial crisis."

Royal London's own data lends weight to O'Connor's assertion. Among millennials – broadly, the generation born between the early 1980s and the late 1990s – the opt-out rate from Royal London's auto-enrolled workplace pensions is around 8 per cent for the 22-29 age group and 7 per cent for 30–39-year-olds. As O'Connor points out, it is understandable that UK millennials should have a more sober appreciation of the need to save than their carefree popular image suggests, given that their lives have so far spanned the go-go years of the early 2000s and the financial meltdown of 2008-09, followed by a decade of austerity.

> *Auto-enrolment in workplace pensions means most young people are getting a very early start in saving*

Unfortunately, this dismal economic context is also the main reason why so many millennials are not doing enough to ensure a decent income in retirement. On a daily basis, they are burdened with too many short-to-medium-term financial commitments to be in a position to save adequately for their long-term future. "This is not a generation who are turning their back completely on sensible retirement planning," says Nathan Long, a senior pensions analyst at the investment company Hargreaves Lansdown. "It is more accurate to see millennials as people who have been stretched by lower wage growth in the last decade and need to work out quite carefully what to do with their money."

At the heart of the savings dilemma confronting millennials is the difficulty of getting on the property ladder. "The biggest challenge for people in this generation is housing, especially if they live in a big city like London or Manchester, where house prices are relatively high," says Kay Ingram, director of public policy at the financial advisory company LEBC Group. The cost of buying a property remains well beyond the income of many millennials, despite low mortgage borrowing rates. Based on data compiled by the Office for National Statistics (ONS), average house prices in England and Wales are currently almost eight times average earnings, more than double the equivalent ratio in 1997. Against this background, Scottish Widows' latest annual Retirement Report found that 18-29 year olds are on average putting aside a colossal 45 per cent of their savings to buy a house. Meanwhile, they are spending over five times more on rent than they are on saving for retirement.

The only positive aspect of this housing dilemma for millennials is that they could become the first generation of adults since the 1970s with the good sense not to see their home as a reliable retirement "investment". Residential property remains a volatile asset, vulnerable to slumps as well as booms, and, as Ingram stresses, a retiree will still need a decent house or apartment over their heads, unless they want to downsize radically and rough it in a caravan.

While housing costs remain the biggest hindrance to a secure retirement for millennials, auto-enrolment in workplace pension schemes has undoubtedly improved their long-term financial prospects. "Most young people in employment are getting a very early start in saving, which is one of the key things when building a pension," says Ingram. "It doesn't matter if it is a relatively small contribution because compound interest over a period of 30 to 40 years will do a lot of the work for you."

By March 2018, around 9.5m UK private sector employees had been enrolled in workplace pension schemes, compared with around 1m in 2012, when auto-enrolment was introduced, according to The Pensions Regulator. Over the same period, the proportion of eligible employees aged between 22 and 39 who had joined such schemes more than doubled to around 80 per cent. Yet these encouraging headline figures obscure a less reassuring underlying picture across the entire pensions landscape.

One obvious worry is the self-employed, who now number around 4.9m people, or around 15 per cent of all those in work, compared with about 3m in the 1990s, according to

the ONS. The government estimates that less than one-third of self-employed individuals are saving into a private pension, even though more than two-thirds say they are seriously concerned about saving for later life.

"Among millennials, the most vulnerable group regarding pensions is self-employed mothers, who stop working when they have children," says O'Connor. The average age of new mothers is now 29 and, typically, most self-employed women who have children do not return to full-time work for at least a decade. As O'Connor observes, that is a long time to be on reduced or no earnings and unable to make significant pension contributions or any at all.

For millennials in an auto-enrolled workplace pension scheme, it is tempting to assume that their retirement plan has been sorted. This may well not be the case, even following last April's mandatory increase of the total minimum contribution from 5 per cent to 8 per cent of qualifying earnings, split between employers (3 per cent) and employees (5 per cent). According to Long, workplace pensions at the current minimum 8 per cent rate should deliver "a bedrock" of pension income. But it will probably not be sufficient for most millennials to maintain their lifestyle in retirement without an income from other sources.

> *A lot of marketing literature on pensions is still targeted at people who are in their fifties and approaching retirement*

In Long's view, many millennials are not particularly well-served by conservatively managed workplace pension schemes, which have around 70 per cent in equities and the rest in bonds and cash. "If you're younger, there is no reason why you can't put up to 100 per cent of your money in the stock market, because you have got such a long time to ride out any fluctuations," he says.

Long and O'Connor agree that millennials can hardly be blamed for making poor pension decisions when so much of the promotional and advisory retirement literature from the financial services industry appears not to have them in mind. "A lot of marketing material on pensions is still targeted at people who are in their fifties and approaching retirement," says O'Connor. Beyond the age gap, safe-and-steady retirement plans are not geared to millennials, who either through choice or economic circumstance do not share their parents' preoccupation with careers "for life" and will never own a home.

Yet millennials remain a rich potential market for the UK's retirement industry, precisely because so many of them defy their unfair stereotype as freewheeling flippertigibbets. For example, a 2019 survey of 2,000 25–40-year-olds by the personal finance app Moneybox found that around two-thirds of respondents felt they were not on course to save as much as they would need in retirement. The only people for whom this is potentially good news are private pension providers, which have yet to address satisfactorily the long-term needs of a generation born just as the UK's post-war pension system was starting to unravel. ■

***Richard Tomlinson** is an international business writer and historian who has written extensively about France. He is a former correspondent for* Fortune *magazine in Asia and Europe and the author of* Late Shift: the death of retirement *(2006), a book about the UK's corporate pension crisis*

# Parents prop up housing ladder

***Richard Northedge** discusses how hard it is for millennials to buy their first home and says this is when the Bank of Mum & Dad can come to the rescue*

The UK government's 2017 White Paper, *Fixing Our Broken Housing Market*, identified affordability as the culprit for the market's problems. The four chapters of the 100-page report cover planning, building, diversification and government policies. But nothing on mortgages. The implication is that finance, unlike the rest of the housing market, is not fractured. And evidence from the marketplace appears to confirm that.

Despite the common complaint that housing is unaffordable, statistics show that people are still climbing onto the metaphoric housing ladder. Most purchasers require a

mortgage and most loans go to first-time buyers – almost 400,000 a year. That is just as well, as first-timers support the whole market. Housing is like a giant Ponzi scheme in that it requires a constant flow of new buyers to allow existing owners to exit, thus supporting values for everyone.

Yet the market is not working quite as smoothly as it seems. The traditional mortgage model of banks and building societies is no longer sufficient to finance many purchases and a major source of alternative funding now fills the shortfall. And while first-time buyers are still the youngest group of purchasers, they are older than previous first-timers. In 1981, more than 30 per cent of under-24s were homeowners; now it is under 10 per cent. Then, less than 40 per cent of people aged 25-35 did not own; today, less than 40 per cent do. The millennial generation, which is now aged around 23-37, is either choosing to buy later or being forced to.

Buying always has been difficult. Prices were lower for the millennials' parents but they faced 15-plus per cent interest rates, low loan-to-value and loan-to-income limits, a requirement to save, no competitive choice and, often, mortgage rationing by cash-strapped lenders. In 1989, mortgage payments absorbed 55 per cent of first-timers' take-home pay (90 per cent in London). Prices are high today but payments consume less than a third of pay; there are government help schemes and 90 per cent mortgages, loans of up to five-times income or rates under 2 per cent are available.

> *Buyers without regular safe salaries are not automatically rejected but their incomes will be assessed conservatively*

But if mortgages have changed, so have the millennial buyers. Most start their working life with a student loan and, while that liability does not affect their credit score (unlike the other debts racked up at college), the 2014 Mortgage Market Review includes the repayments in affordability tests, reducing the maximum available home loan. Millennials' work is changing too: contract employment and the gig economy give irregular incomes. Low inflation also means lenders cannot assume rising wages will rapidly reduce high loan-to-income ratios. Later marriages also make joint purchases with dual-income mortgages harder. Lenders have adapted to those changes. Low interest rates permit larger loans; extending repayment, sometimes to 40 years, cuts monthly costs further. Buyers without regular safe salaries

are not automatically rejected, although their incomes will still be assessed conservatively and they may need a larger deposit. Mortgage brokers can find specialist lenders prepared to help contractors.

Mortgage-protection insurance can cover income lost through unemployment, accident or sickness but while it is cheaper for younger people, it adds roughly 3 per cent to mortgage repayments for an office worker, much more for a builder, and even more for the self-employed. Not taking it is a risk most borrowers bear. But lenders remain reluctant to compromise their own risk and much of their innovation involves protecting themselves as much as assisting borrowers. Contract workers, therefore, may be pushed towards a guarantor mortgage, with a relative or friend offering their own property or savings as security, or sometimes using their own income to guarantee the loan. The guarantor thus becomes responsible for the liability while having no share in the asset, but the lender has a second source of collateral to call on.

The average UK first-time buyer pays about £225,000 and borrows £175,000. Finding the £50,000 difference is the millennials' greatest problem. But owners aged over 50 have almost £3,000bn of equity in their properties and increasingly the property market is working only by using the owners' surplus to finance the borrowers' deficit. Guarantor mortgages do that but other loan products divert equity from owners to buyers – effectively from older generations to younger. Barclays, Halifax and Santander are among big lenders offering "family springboard" loans whereby

the buyer's relative deposits 10 per cent of the purchase price with the bank, which then provides a 100 per cent mortgage. The borrower typically pays 3.25 per cent interest, the depositor receives 2.25 per cent; the bank probably gains a customer and escapes the risk. The Bath Building Society – proudly using people, not computers, to process loan applications – offers 100 per cent Parent Assisted Mortgages by accepting the parents' home as collateral, rather than their savings. Its Rent a Room mortgage takes account of income from sub-letting.

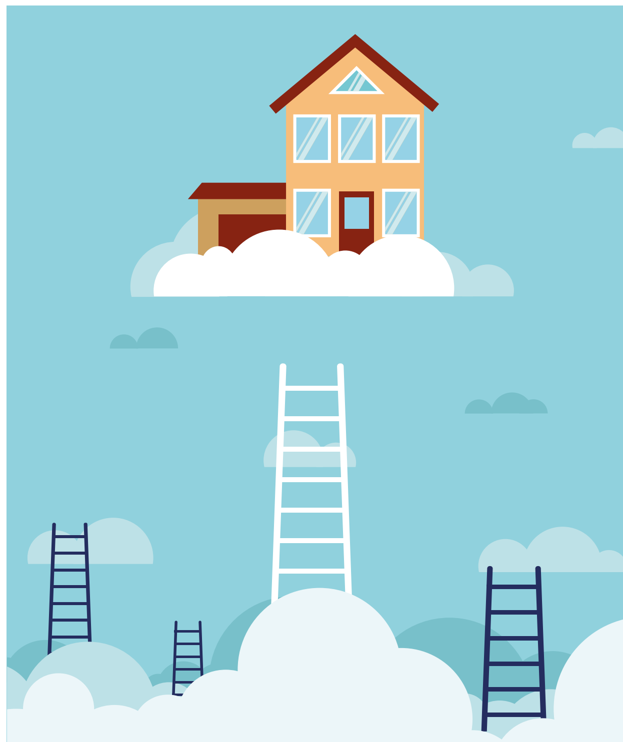
Most parents avoid such schemes by helping their offspring directly. The Bank of Mum & Dad will provide £6.3bn of finance in 2019, according to Legal & General (L&G) – enough to make it a top-10 UK housing lender and far exceeding the government's Help to Buy funding. Almost two-thirds of purchasers under 35 received such unofficial help, currently averaging £24,100.

At a macro level, this is not ideal – not all millennials have rich parents and injecting extra funds drives up property prices, exacerbating the problem – but it makes sense at the micro level: a five-year 95 per cent mortgage costs around 3.44 per cent but using parental help to borrow only 75 per cent cuts the rate below 2 per cent. Such a risky top-slice second mortgage, usually with nothing in writing, ought to attract a fancy rate but only 6 per cent of buyers pay interest to their parents, says L&G's survey. But the Bank of Mum & Dad knows its customer far better than any commercial lender, and gifting the money may be a cheap way to get adult children out of the parental home, besides cutting inheritance tax bills.

> *Gifting money towards a mortgage may be a cheap way to get adult children out of the parental home*

Parents raid savings and pensions accounts or delay retirement to get their children on the ladder – 15 per cent accept a lower standard of living, according to L&G – but not everyone with a large home has liquid assets. Some parents remortgage their own homes to generate cash, many more are using the proceeds of equity release: either way, the parents' interest rate should be below their child's marginal borrowing cost.

The Bank of Mum & Dad has rapidly become the sticking plaster for the broken housing market and lenders are keen to exploit it. So too are the millennial borrowers. Parental



help is now so entrenched as a source of finance that it is hard to see future buyers being weaned off it. But if much has changed in the housing market, there is scope too for a change of attitude by borrowers. The millennials' parents could not get a mortgage unless they saved regularly with the lender; today's buyers prefer consumption, even at the expense of their credit score.

Many buyers have lofty expectations, hoping their first step on the ladder will be as high as their parents' current position. L&G says buyers helped by parents are purchasing bigger properties, mainly three-bedroom houses, and are only half as likely to own a 100-year-old home. Aware of this, Yorkshire Building Society has reminded first-timers that they need to compromise – on size, price or location – and save.

Perhaps the managers of the Bank of Mum & Dad should talk to their customers – and to the authors of the government White Paper. ■

***Richard Northedge*** *is a former banking journalist of the year and was deputy City editor of* The Daily Telegraph

# Missing out on being social

*__Gren Manuel__ examines why banks have taken a wary stance on engaging with millennials' favourite digital home, social media*

When miners flooded into California during the gold rush of 1849, banks followed them in droves. And they made a real investment. In frontier towns of wooden shacks, the bank was often the only building of stone, a physical and metaphorical demonstration that the institution was open for business and there to stay.

But in today's digital frontier of social media, banks have been slow to move in, particularly in the UK. Social networks are perhaps millennials' biggest gift to the world, and the 25-34 demographic is still these networks' largest user group. In 2019, about 90 per cent of UK internet users were registered on Facebook and, on average, spent 23 minutes a day there, according to Ofcom's *Online Nation* report. But banks' investment in social media is modest compared with, for instance, the ongoing investment into their apps.

"The problem with social media is that every bank wants to use it, nobody knows how," says Andrew Stevens, global banking specialist at customer communications consultancy Quadient, who spent two decades at a large bank.

Yet social media can be much more than a way of getting some likes and telling customers what to do about Thomas Cook refunds. Absa Bank in South Africa allows customers to carry out a wide variety of transactions, including sending cash, paying for electricity or mobile airtime and getting a mini credit report, via WhatsApp and Facebook Messenger using a facility named ChatBanking.

Llew Adamson, head of emerging channels at the bank's South African retail business banking unit, says the project started with the realisation that WhatsApp had become the "primary digital habitat" for many customers, so Absa needed a presence there. "The uptake of ChatBanking has been phenomenal between the age brackets of 25 years to 45 years old," he says. (The median age in South Africa, according to UN data, is 26.6.)

Aupa Monyatsi, managing executive, virtual channels, at the same Absa unit, says: "The overall feedback has been overwhelmingly positive and customers are looking for us to add more functionality to the platform. And we're listening to them."

Although Absa is not the only bank worldwide to allow transactions via social media, most of the banks offering this type of functionality are in China. There, the WeChat platform integrates the functions of Facebook, WhatsApp, PayPal and Twitter in a way that makes a natural home for banks. Absa, however, shows that there is demand for banking via social media using the more diverse collection of platforms that exist outside China, especially for younger customers.

That social media is the "primary digital habitat" for many rings true for the UK. Ofcom figures showed that in 2018, 77 per cent of UK adults had a Facebook account and 61 per cent had a WhatsApp account – the two most popular platforms. GlobalWebIndex, a data provider, reports that the average Briton in 2018 spent one hour and 50 minutes a day connected to social media. That amount of

> *I don't think there's anyone who is doing a great job at social media, although the neobanks are slightly better*

data-rich eyeball time is lucrative. Ofcom's report quotes an estimated annual social media revenue per head of £45. To compare, the average personal current account revenue per head for UK banks was £21 in 2017, according to the Financial Conduct Authority's (FCA) 2018 *Strategic Review of Retail Banking Business Models: final report*. That average was taken across 15 banks, not just the incumbents, so it fudges a wide range. Business current accounts generated on average £203 per annum in revenue.

Yet, despite the lures of social media for businesses, traditional UK banks' presence here is modest. For most, social media is just a promotional tool. As for the challengers, their social messaging may be cheekier in tone, and the customer feedback is typically more enthusiastic, but, in essence, their strategy is the same.

"I don't think there's anyone who's doing a great job at social media at the moment, although the neobanks are slightly better," says Stevens. Customers who engage via social media are quickly encouraged to move their dialogue to another channel, usually phone or the secure messaging inside the banks' app.

FINANCIAL
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# Winners 2019

## Best new savings or investment product

**Tandem Bank** – Autosavings

Highly Commended:

**Cascade Cash Management** – Cascade Cash Management Excels at FinTech Customer Care

• • •

## Best new mortgage or loan product

**CTBC Bank** – Geographic Data-driven Mortgage Program

• • •

## Best payment innovation – Transactions

**Divido** – Divido's white-label lending platform continues to disrupt the payments status quo

Highly Commended:

**Western Union** – Western Union and Amazon Team up to Make E-Commerce Cross-Border Payments available to more people around the world

• • •

## Best payment innovation – Payment platforms

**Israel Discount Bank** – The PayBox App - Making Mobile Payments Viral

• • •

## Best retail banking services innovation

**Israel Discount Bank** – Enhanced Voice-Based Payment & Banking Services

Highly Commended:

**TSB Bank** - Digital ID&V Service

• • •

## Excellence in supporting business or enterprise

**CTBC Financial Holding** – Business Payment Service on Blockchain

Highly Commended:

**Santander UK** – Cloud-Based Digital Credit-Risk and Fulfilment for SME, Commercial and Corporate

• • •

## Best Open Banking initiative

**NatWest** – Payit; Pay Online & Send Money

• • •

## Best mobile banking innovation

**Sensibill** – Receipts by Sensibill

• • •

## Best multi-channel experience

**Barclays** – Creating a customer-centric, market-leading multi-channel experience

• • •

## Most effective overall customer experience initiative – Retail

**Honest.** – Halifax Flagship

• • •

## Most effective overall customer experience initiative – Business & Corporate

**Santander UK** – Cloud-Based Digital Credit-Risk and Fulfilment for SME, Commercial and Corporate

# Congratulations to all our winners and highly commended companies on your projects that are leading innovation in banking and finance.

### Customer experience/ Service team of the year

**Vision Independent Financial Planning –** Success through Service

### Best workplace transformation or employee engagement initiative

**Financial Services Compensation Scheme –** Our Journey to Engagement

Highly Commended:

**ZiraatBank –** How to turn your employee/customer feedback to disruptive gain?

• • •

### Best sustainable finance initiative

**Infrastructure Development Company Limited –** IDCOL Solar Irrigation Pump Project

• • •

### Best financial inclusion or outreach initiative

**NS&I Government Payment Services –** Help to Save

Highly Commended:

**The Mifos Initiative –** Mifos

### Change team of the year

**BPI - Full Agile –** Driving Business Transformation

• • •

### Best technology initiative – United Kingdom

**PRIMIS Mortgage Network –** Toolbox

• • •

### Best technology initiative – Europe

**BPI –** BPI GO Now – shaping the future

Highly Commended:

**Credit Suisse –** iComply

• • •

### Best technology initiative – Rest of the world

**Absa Bank Group Limited –** Unique Data initiative launch in African continent for retail and business bank

Highly Commended:

**Moody's Analytics –** Introducing Daisy

### Most promising financial start-up

**Mojo Mortgages –** Mojo Mortgages

• • •

### Best technology partnerships

**Darktrace –** Cyber AI

Highly Commended:

**HSBC UK -** HSBC UK and Vizolution

• • •

### Best FinTech partnership

**Signicat and Rabobank -** Rabo eBusiness – the world's first bank-led Digital Identity Service Provider

Highly Commended:

**Token -** Token and Almoayed Technologies Partner to Accelerate Open Banking In MENA

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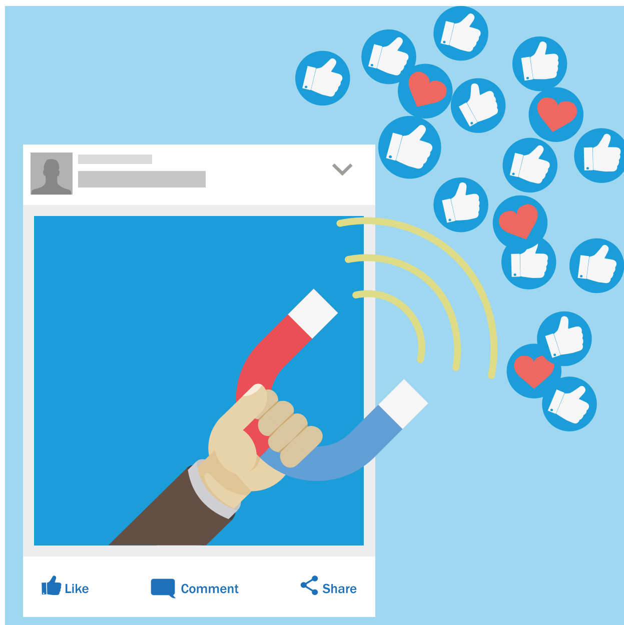



To see how two-way communication can be used to power a business, look outside the world of finance at mobile phone company Giffgaff, says Stevens. Set up as a side brand by O2 after a fact-finding trip to Silicon Valley, it not only rewards customers for recruiting customers, but it also gets them to solve each other's technical problems on a message board – all incentivised by a system of points that can be turned into cash, bill discounts or donations to a favoured charity. It may seem haphazard but in a Which? survey earlier in 2019 Giffgaff beat all other mobile networks in terms of customer satisfaction. "The community almost runs the organisation," says Stevens.

The only traditional UK bank trying to tap into this thinking is Tesco Bank, which operates a moderately busy "Your community" message board. Although most of the answers come from Tesco Bank staff, it tolerates distinctly off-message posts: one customer showed how to disable the contactless function on a debit card by making a small cut into it with a hacksaw. A bank employee recommended against it but did not remove the post.

But two-way interaction – either via social media or a bank platform that mimics the functionality – can go much further. Perhaps the most intriguing experiment was Barclaycard Ring, in which Barclays in the US took two-way customer communication to a new level. Cardholders contributed to a bulletin board about financial wellbeing and shared a profit-related bonus every six months known as Giveback depending on how well they had done, collectively, in living financially responsible lives. They even got to vote on critical business decisions such as whether to outsource customer service offshore to boost profits (they voted against, so the Giveback pool was lower).

This unique two-way communication received rave reviews, with one financial site saying it was "a very different kind of credit card experience". But Barclays' US card business has now moved away from direct-to-consumer offerings, the bank says, and the card is no longer open to new applicants. Message board activity has dwindled.

Among challengers, Fidor Bank in Germany is perhaps the boldest, with some similarities to Giffgaff. Using a social media-like platform, it got its customers to co-write a booklet offering financial advice and raises its savings rates based on Facebook likes – a way of encouraging customers to spread the word and reducing the need for conventional marketing. The model works well in its home market – it claims 310,000 users – but the bank has given up in the UK, blaming "uncertainties surrounding the UK market".

Why are UK banks loath to set up a presence where the customers live digitally and engage in a deep conversation? There are technical worries, particularly around authentication and verification. It is not encouraging that Jack Dorsey, founder and chief executive of Twitter, had his account hijacked by pranksters in August. Senior bank executives, however, regard security problems as solvable. More concerning, they say, are issues of brand and online presence. Although Mark Zuckerberg, Facebook's chief executive, said more than a year ago that "building out the business ecosystem around messaging on WhatsApp and Messenger" was a high priority, the reality is that the opportunities for banks to offer a unique service with strong branding in social media are limited. It is a similar risk to that posed by open banking, with banks fearful of losing direct customer touch and the ability to innovate around customer experience.

> *An attempt by JPMorgan to engage with customers over Twitter failed after it triggered a storm of sarcastic abuse*

Social media also seems an unpredictable place, despite FCA guidelines in 2015 that explained how financial institutions could use the platforms without fear of regulatory action. An attempt by JPMorgan in the US to engage with customers over Twitter using #AskJPM had to be cancelled after it triggered a storm of sarcastic abuse. Social media has also been implicated in recent bank runs worldwide,

including one in the UK on Metro Bank in May that was largely spread by WhatsApp.

Lastly, there is the nagging feeling at the top level of banks that one day social media firms may be direct competitors – a feeling that became much more real when Facebook announced its Libra cryptocurrency, a potential competitor to banks' payments and global remittances business. Libra may yet run into regulatory sand but it shows clear financial services intent.

One bank executive told me that banks did not like the idea that customers would become accustomed to using social media for even trivial banking tasks such as balance enquiries for this reason. But fickle consumers may be the least of banks' worries. The FCA report notes: "New payments business models bypassing costly card-based payments options could be attractive to retailers of all sizes... Social media platforms are also likely to be looking at these options."

There is also the reality that none of the experiments with social media or enhanced two-way customer communication has yet had breakout success in the UK. Customers may say they want a dialogue with their bank but a look through Tesco Bank's message board shows little evidence; the questions tend to be simple service enquiries.

What could wake them up? Someone needs to connect social media and banks in a way that energises customers, and makes money. In the UK, people are used to staying with one bank because switching brings hassle and few benefits – so why engage with that firm?

> *There is a nagging feeling at the top level of banking that one day social media firms may be direct competitors*

The FCA's report points out that new transactional services separate from the current account mean (some) better services are now available without switching. "Further, these models may not require a full banking licence with the associated costs and capital investment requirements," it says. "Unless traditional banks can match the functionality offered by these new services, it's possible that digital challengers will win the battle for customer relationships." That, surely, is a wake-up call – at least for the banks. ■

***Gren Manuel*** *has been European editor for* Dow Jones Newswires, *European executive editor of* The Wall Street Journal, *and editor of* Financial News. *He now works as an editorial and media consultant*

# The young and the advice-less

***Andy Davis*** *looks at ways to encourage millennials to save or invest because they find professional financial advice is often too expensive and not targeted at them*

Like most financial advisers, Robin Keyte does not spend much time dealing with people in their twenties and thirties. When they do show up, says the founder of Taunton-based Keyte Chartered Financial Planners, it tends to be because his clients – the young person's parents or grandparents – have sent them. Sometimes the meetings happen because they are about to be given money and their elders want to make sure they know what to do with it. Often the aim is simply to "set them off in the right direction", as Keyte puts it.

"We might typically discuss using Lifetime Isas, so they're getting the extra 20 per cent from the government, and things like Nest or other auto-enrolment schemes that they might have been offered. Otherwise it's really the age-old things, talking to them about clearing any credit card balances they might have and getting rid of higher-interest debt."

The dearth of millennials in Keyte's waiting room should come as no surprise. Delivering professional financial advice is expensive, whether charged as a percentage levy on the client's assets or at an hourly rate. Few people have amassed enough wealth this early in their working lives to make the economics of this potential relationship work.

According to the most recent Wealth and Assets Survey data, 79 per cent of households headed by people aged 16-34 are in the bottom four wealth deciles. Among

households headed by people aged 35-64, the equivalent proportion is 36 per cent.

"It's difficult to see how the cost-benefit would work out for them if they were going to get what you might call typical financial advice at that age," says Keyte. The conclusion is obvious: there is little reason for advisers and younger adults to talk to each other.

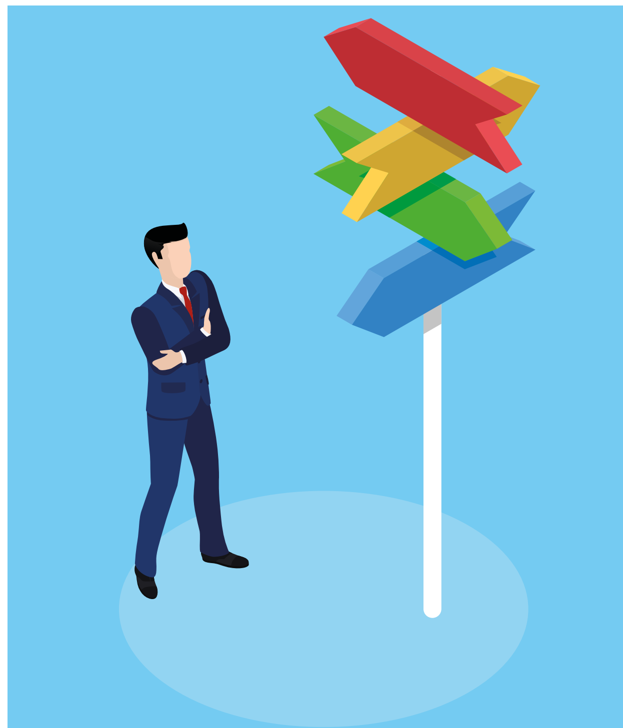
Yes and no. It is true that the people who become clients of financial advisers tend to be in their forties – by which point they are starting to build up meaningful wealth and may have crossed one of the classic "trigger points" for seeking help such as divorce, receiving a more generous work package or even an inheritance. But it is not safe to assume younger people do not need help. They may not offer a good fit for the advice services aimed at their wealthier elders, which dominate the market today, but other approaches could prove more appropriate.

Over the past few years, so-called robo-advisers have sprung up. These online investment managers aim to help people avoid the cost of professional advice by using simple questionnaires to guide users into appropriate model portfolios, based on an automated assessment of their financial circumstances and risk appetite. Robos are often assumed to target younger age groups, yet the average age of customers at Nutmeg, one of the earliest entrants, is 42, the younger end of the traditional financial advice market rather than the millennial generation in its thirties.

> *Millennials do not necessarily prefer expensive coffee and avocado toast over the hard graft of saving*

Having originally steered clear of offering regulated advice – and publicly attacking its cost – in late 2018 Nutmeg started piloting a digital and phone-based restricted advice service of its own. This was targeted at users of its own investment portfolios and priced at £575 for the initial factfind and report. In September it added a financial planning service. Tom Kieldsen, an adviser with Nutmeg, says: "All kinds of people are seeking advice, but we probably have a slightly higher ratio of customers in their 50s and 60s compared to our automated, simplified advice. Older customers are mostly seeking pension advice as they approach retirement."

The company's move into regulated financial advice is notable, but it is not about offering millennial users a budget service. It seems instead to represent a recognition that,



as people get older and need to make difficult, long-term decisions, even those with relatively modest investments – the average for Nutmeg is around £23,000 – want the option of speaking to a human rather than their computer.

As Keyte observes: "I don't think traditional financial advice, as we know it, has a solution aimed at [the millennial age group] at the moment. It's essentially trying to come up with a solution that's affordable for people with modest-sized pots in their forties and I think it's even struggling to deal with that. That will develop but I don't think it's going to offer too much in terms of an advice service to younger people."

Instead of conventional financial advice, Keyte advocates a different approach. During his time on the Financial Advice Market Review Expert Panel several years ago, he says: "We were looking a lot at nudges and rules of thumb – things to try to get younger people to think about taking steps to make provision." He hopes the recently launched Money and Pensions Service (MaPS) might pick up these ideas and develop them.

### Nudging forward

If MaPS decides to do so, it could do worse than look at some of the savings and investment tools already becoming popular among younger age groups. The idea of using the "nudge" of auto-enrolment to prompt people to start contributing to a pension is widely hailed as the key to the

UK's turnaround in workplace retirement saving. This has seen the proportion of private sector workers under 30 investing in a workplace pension rise from 35 per cent in 2012 to 79 per cent by the end of 2017, according to the Department for Work and Pensions.

Less widely acknowledged is a similar development in saving, thanks to so-called "round-ups". Many banks, particularly app-based digital entrants, let customers automatically round up every card payment to the nearest whole pound and sweep the spare change into a savings account.

Figures released last year by Revolut, a digital bank, suggest simple innovations such as this that make saving effortless are helping to reinforce the savings culture among younger people. Revolut's data showed that 69 per cent of its then 2m UK customers, whose average age was 34, were saving regularly, putting aside almost £174 a month – more than their peers in Revolut's continental European markets – although not all were using "round-ups".

Another app-based service, Moneybox, has taken the idea a step further. Users link their bank accounts to the app, round up their card payments and sweep the extra cash into their Moneybox savings or investment accounts. The investment accounts offer three multi-asset portfolios – cautious, balanced and adventurous – built from low-cost tracker funds. They can be held inside tax wrappers, including stocks and shares, Lifetime and conventional Isas, pensions and Junior Isas, as well as a general investment account. The company, which launched in 2016, has 250,000 users, with an average age of 31.

> *There is a lack of services that make it quick and easy to save or invest small, irregular amounts*

Charlotte Oates, Moneybox's head of marketing, says the typical user sets aside £75 a month through a combination of round-ups and regular payments. Around 80 per cent of funds go into investment accounts. The strength of the company's approach is that it addresses the biggest barrier most people face in investing: getting started.

By taking the round-up mechanism originally developed to make saving easier and applying it to investing, Moneybox is demonstrating that there is plenty of demand among young people with limited funds to invest as well as save. And although they may be seeking informal pointers elsewhere, using this service does not involve any formal

financial advice: in regulatory terms, the company offers only guidance.

The growth of services such as Moneybox suggests that the issue facing millennials is not a preference for expensive coffees and avocado toast over the hard graft of saving. Nor is it the expense of professional financial advice. Rather, it appears the main problem has been a lack of services that make it quick and easy to save or invest the small, irregular amounts that suit their pockets. Now that these services are starting to spread, we may well see this age group emerge as accomplished accumulators.

For traditional advisers such as Keyte, that would be excellent news. Services that remove the barriers to young people saving and investing, including auto-enrolment, will ultimately create the next generation of clients in his waiting room, a decade or more from now. ■

***Andy Davis** is a writer on investment finance and business and a former editor of* FT Weekend. *He is an associate editor and investment columnist for* Prospect *magazine and writes a weekly blog for the Alternative Funding Network*

CELEBRATING 140 1879 YEARS 2019 The London Institute of Banking & Finance

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**Sustainable finance series:** Corporate governance and the pensions industry (held in partnership with CSFI).

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**Peninsular House, London**

## Henry Grunfeld Lecture

**Behavioural Insights and Banking**

Join **Dr David Halpern**, Chief Executive, Behavioural Insights Team, as he shares his views on how behavioural insights could lead to improved outcomes for the financial services world.

**Wednesday 08 January 2020 – 6pm**

**Fishmongers' Hall, London**

## Podcast

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## Panel Discussion

**Sustainable finance series:** An overview of the ESG landscape (held in partnership with CSFI).

**Thursday 30 January 2020 – 6pm**

**Peninsular House, London**

## Lecture

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**Gary Morley,** Principal, GCMCA

**Thursday 13 February 2020 – 6pm**

**Peninsular House, London**

## Future Leaders event

**Navigating your early career**

**Ella Hoxha,** Senior Investment Manager, Pictet Asset Management

**Wednesday 18 March 2020 – 6pm**

**Peninsular House, London**

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# Cognitive painkillers

***Tim Green** looks at how the banking sector is being transformed by the needs of millennials as challenger banks offer new ways of borrowing and saving*

Autocomplete is a handy way of finding out about the world – or at least some aspects of it. Type the words "millennials are" into Google Search and you will see why. The first two autocompletions are: "lazy, entitled narcissists" and "doomed". You have to scroll down before you arrive at a factual answer: "Born between 1982 and 2000".

So are millennials the wretched cohort Google users seem to think? Probably not. They are just young. Older generations always disdain their successors. In 1976, the author Tom Wolfe called baby boomers (born between 1946 and 1965) "self-absorbed and spoiled". In 1990, *Time* magazine described Generation X (1966 to 1981) as having an attention span "as short as one zap of a TV dial".

Little changes. That said, there is one marked difference between millennials and the generations that went before them. Millennials grew up with the internet. They are "digital natives". So the question is, since money and payments are becoming digital, does this affect the way millennials bank, spend, save and pay? Many observers believe so. In 2016, uSwitch, a comparison site, looked into millennials' financial habits and found:

- 32 per cent believed their bank offered relevant products;
- 59 per cent had not visited a branch in the past three months; and
- 77 per cent did all their banking online.

uSwitch said at the time: "The banks must innovate around relevant products and services if they are to attract the custom of this generation. If they do not, someone else will."

Well, someone else has. Three years on, the UK has a swathe of challenger banks. They are all targeting younger customers. A 2019 survey by fintech software firm Crealogix found 22 per cent of millennials currently use digital-only banks (compared with 14 per cent across all age groups). The biggest neobank, Monzo, says 81 per cent of its 2m customers are under 37.

How do these companies target youngsters? It starts with "values". The challengers position themselves as the opposition to legacy banks. On its website, Monzo says: "We don't list corporate values and we've never had a brand consultancy conduct a workshop to help define our brand values." The company even has a "transparency dashboard" that hosts honest (and sometimes) critical feedback. But what about the products themselves? Generally, they meet millennials' desire for instant gratification and personalisation. For example, all the new banks use image recognition (selfie plus ID document) to reduce on-boarding time to around five minutes.

They also prioritise savings. Youngsters are cash-strapped – not least because of student debt. According to the Institute for Fiscal Studies, the most indebted university students now owe more than £57,000 on graduating. The new fintechs are mindful of this. Revolut, which has an EU banking licence, has launched a feature called Vault that automatically rounds up any purchase made via the Revolut card or app to the nearest whole number. It then puts the spare change into a savings account. This is not an original idea. Start-ups such as Moneybox offer exactly the same facility. Another start-up, Plum, analyses a user's transactions and calculates daily what amount it can safely put aside. It then moves the money into a savings account. Plum now has more than 500,000 customers, most of whom are under 35. (Plum, which is accessed via a mobile app, or through Facebook Messenger, is not a bank.)

> "We would never refer to ourselves as a bank. Why would we want to take on that negative baggage?

These services are only possible because of digital transactions; apps cannot round up a cash payment. Fortunately, millennials appear comfortable with cashless purchases. According to Worldpay's 2018 Global Payments Report, 28 per cent of millennials have already used a mobile wallet at the point of sale, and more than 70 per cent of them expect phones to replace physical wallets within five years.

As well as finding new ways to save, millennials are also discovering fresh approaches to borrowing. They are less keen on credit cards, for example. YouGov UK found that barely half of under-37s possess one. (The figure for the 18-24 age group is around 2 per cent and for the adult population overall around 60 per cent.) Instead, millennials are turning to services provided by companies such as Klarna. The Swedish firm extends online "buy now, pay later" checkout credit. The loan

is interest-free and typically allows 30 days to settle. Klarna now has 60m users worldwide and processes 1m transactions a day.

The way the new fintech banks attract customers is also millennial-friendly. They frequently use social media. Monzo has done TV advertising but it has largely relied on viral marketing on social networks to acquire new accounts. It says 80 per cent of new customer growth comes from recommendations. Monzo distributes "golden tickets" that can be sent to friends to allow easy sign-up and for nearly a year it paid a referral bonus, which was originally £10 (split between the existing and new account holder) before being cut to £5. That raises the basic question of whether those who sign up are worth having. In its 2019 report, Monzo said that around 30 per cent of active users deposit at least £1,000 a month and that "annual per-customer contribution margin" is £4, up from -£15 in 2018 and -£65 in 2017.

Others have gone further with the social media methodology. Take the US's Venmo. In a sense, it is a social network. PayPal-owned Venmo lets users settle small debts via its mobile app. Early on, it sensed that users' transactions could be the starting point for conversations. It decided that every exchange had to include a note. Essentially, it designed chat into the app.

Ben Mills, head of product at Venmo, says: "By adding in chat, we could make it become more about what you are doing than what you are paying. Ultimately, if you need to pay someone $5, doing it with a note or an emoji makes it less awkward." It worked. Today, 90 per cent of Venmo transactions are viewable by the entire community. There is no direct Venmo equivalent in the UK. Thanks to Faster Payments, Britons can easily settle small debts via any bank app. But many new fintech challengers do admire Venmo's success in positioning itself as "not a bank".

For good reason. Multiple studies have shown millennials' preference for tech firms over traditional financial service providers. In 2018, business intelligence group RFI found that most 18 to 24 year-olds put Amazon and PayPal above banks by how much they trust them to "hold and maintain the privacy and security of personal information".

This might explain why Revolut does not call itself a bank. Chad West, head of global marketing and communications at Revolut, says: "We would never refer to ourselves that way. Why would we take on that negative baggage? We think of Revolut as a tech company that's disrupting finance in the same way that Airbnb is disrupting travel."

West's comments reflect the sense in which financial services – driven by the digital-first millennial generation – are escaping their roots. Money is no longer physical, and financial products

are being "unbundled" away from the single providers (banks) of old.

As younger people explore new digital channels, some services are even escaping the confines of "traditional" web page and app. For example, most users of Plum access the service through a bot that lives inside Facebook Messenger. As such, they view their accounts and transactions via chat sessions with a virtual agent. According to Victor Trokoudes, Plum's chief executive, this user interface (UI) is a good fit for millennials. "The aim with Plum was always to give young people in particular a way to make saving happen in the background," he says. "To succeed we had to reduce the cognitive load, and the best way to do that is through a chat bot."

> *"Most of our customers are young and on the move. They don't want to make a call and listen to opera for 10 minutes*

Plum's experience demonstrates the importance of the UI to younger customers. Millennials prioritise speed, clarity and, far more than older groups, a sense of self-direction, however illusory. This is why Revolut makes its app the hub of its customer care activity. It does not take phone calls. West explains: "We just don't think voice is effective. Most of our customers are young and on the move. They don't want to make a call and listen to opera for 10 minutes." ■

***Tim Green** is a journalist who has been writing about mobile technology for 13 years, first with* Screen Digest*, then* Mobile Entertainment*. He now watches the mobile payments space carefully via his* Mobile Money Revolution *blog*

# An open account

*An interview with **Daniel Schmand** – global head of trade finance at Deutsche Bank and chairman of the banking commission at the International Chamber of Commerce. He talks to* Financial World *about some of the trends in trade finance*

The headlines are full of trade wars; of how central banks in developed markets struggle to spur growth even with negative interest rates; and how big tech looks set to conquer retail financial services. *Financial World* steps back to take a look at what is happening in trade finance – the ultra-dependable, bank-led underpinning of global commerce – in an interview with Daniel Schmand. (His full title is: global head of trade finance & lending and head of corporate bank EMEA, ex Germany & UKI, at Deutsche Bank, and chairman of the banking commission at the International Chamber of Commerce.)

### Digitalisation of trade finance – why is it still a work in progress?

If you want to fully digitalise trade finance, the entire ecosystem needs to be geared up to support it. For example, in most jurisdictions, including Germany, you currently need paper-based evidence at trial. Then, in a lot of emerging markets, customs officials still use rubber stamps. The day rubber stamps cease to exist, we will be in a digital world. That day will come, but reaching agreement on the way forward, between 183 countries, with multiple parties in each, who can have many bilateral and multilateral agreements, is not easy. Most of the talks focus on the technology, but distributed ledger technologies are here. The cloud is here. What we need is a proper use case and a business model for the technology.

I am not that obsessed about whether we use blockchain, hyperledger or route it all through outer space, any more than I really care about how the gearbox of my car works. I care about the use case and how to apply it. For the business community, the technology just needs to work – flawlessly, with no outages and no breakages.

### Why do some jurisdictions still use rubber stamps?

Would it be economically much more efficient to do away with the rubber stamps? Absolutely, yes. Can you afford to lay off twenty thousand people in emerging markets? That is a very different question. That rubber stamp is held by a human being. What is interesting is that, though many emerging markets use a rubber stamp for customs, they all use mobile payments systems like Alipay or M-Pesa internally. It is just much easier to build a digital system on a greenfield than it is to take a traditional banking system and digitalise that.

### Tech platforms, trade finance and regulation: what role will the platforms play?

Is it important for trade finance to work with large retail platforms and other big tech platforms? Absolutely. They connect SMEs. If we help them with a trade finance solution, that makes the platform even more attractive. That is not a threat to banks – it is a huge opportunity. Platforms are enablers. But if you do not have the underlying ecosystem in place it can be hard for the platform to be trusted, as they are vulnerable to misuse.

> *Distributed ledger technologies are here. The cloud is here. What we need is a proper use case*

It is in the interest of all platform owners to self-regulate, but external regulation is what would really enable them to work as businesses. Regulation would help to bring confidence and, if platforms are operating a financial services business, they should be regulated like any other financial services business.

### Trade wars and supply chain finance

Even in trade wars, trade flows usually find a way. Are trade wars good? Absolutely not, but they often mean that trade just takes a different route. What is bad for China, for example, can be good for Vietnam.

Supply chain finance is the fastest-growing part of the trade finance business. Traditional trade finance is stable, rather than shrinking. However, in markets affected by trade wars we do see more demand for the traditional trade finance instruments. When economies are not bright and shiny, there is a lot of focus on keeping capital liquid, which means people can still be drawn to open account.

### The Trade Information Network and open account financing for SMEs

The Trade Information Network (TIN) aims to address the unmet demand for financing earlier in the supply chain by helping corporates communicate trade information directly with the banks of their choice. In order to develop a new industry standard in trade finance, the TIN has validated its approach with extensive corporate and bank engagement.

The TIN clearly has the potential to transform international trade. In addition to the seven founding banks, more than 20 additional banks from around the world are actively participating in developing the TIN and it is now in launch mode with the first customers.

We want to keep the platform as attractive as possible for as many businesses as possible so, technically, it could handle a transaction for a single euro cent. Of course we have to ask ourselves if it makes sense to run orders of a size that small. That said, the handling costs should be irrelevant to the decision to use the platform as it will be closer to what is charged for payments. That is the proxy. Also, funds should be exchanged on an instant basis once all the necessary checks have been carried out.

> *There is now a much better understanding of how important trade finance is in fostering prosperity*

### Artificial intelligence in trade finance

At Deutsche Bank, we have AI carrying out optical character recognition (OCR) and intelligent data recognition (IDR). Intelligent scanning enables us to digitalise paper documents. As things stand, the machine can deal accurately with around 82 per cent of the information it encounters. When the AI started out, a rubber stamp or a logo on an invoice were just "data noise". Once it started training, it could insert them into a logical system. Equally, it struggled at first with the references on an invoice because they can be anywhere on the page. Now, it knows how to find them.

### Correspondent banking and the 'trade finance gap'

The trade finance gap is a dilemma. Banks take a risk-based and economic approach in deciding whether to maintain certain correspondent banking relationships or not, so closing the gap also depends on the efforts of countries themselves to deal with problems like corruption. Banks can police what flows over their networks, but sorting out the fundamental issues comes down to the jurisdiction concerned. I share the concerns regarding correspondent banking, but the question is how to solve it. As an example, rules like the International Chamber of Commerce's UCP 600 ('uniform customs and practice for documentary letters of credit') work because they are accepted by everyone internationally. The Wolfsberg Standards – which are frameworks and guidance for managing financial crime risks such as money laundering and financing terrorism – are a practical way to solve some of the problems, but not all of them.

### Changes in the regulation of trade finance

The level of dialogue and understanding between trade finance banks and regulators has improved. It is not perfect, but there is a good dialogue and an open dialogue. In particular, working through Basel 3 and Basel 4 has intensified an open discussion over the past 24 months. There is now a much better understanding of how important trade finance is in fostering prosperity and that over-regulation can have unintended consequences.

### Sustainability

Sustainability is very close to my heart and very important for Deutsche Bank. We work with a lot of banks and clients on the taxonomy for sustainability and on getting the tracking and tracing right. Some things are clear and easy, such as financing wind farms and solar panels. Others are a harder call. We have, for instance, been financing using flare gas on oil fields to generate electricity. Would solar power be better? Yes, it would. But that would not solve the question of what you do with the flare gas in the oil industry. It is clearly better to use it to generate power than to just burn it off. Banks need to be very clear and very mindful, about the whole carbon footprint, industry by industry, end to end, and not just look for superficial wins.

European countries have been behind driving the massive change in awareness of sustainability and, in particular, young people are very much on board. This new awareness can lead to binary decisions for businesses. But if something is not sustainable, at some point, a firm may find that it has no buyers any more. ■

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*As told to* ***Ouida Taaffe*** *who is the editor of* Financial World

# Service with a datafile

*Paul Wallace shows how behavioural economics is being used by regulators and banks to improve financial services and help consumers*

Behavioural economics is a boom industry, especially in finance, with regulators drawing on its findings to help consumers. Banks must cope with this supervisory attention but they are increasingly recognising that behavioural economics is good business, too. It provides a framework for thinking through how they can improve their service to customers and rebuild the banking sector's battered reputation.

Based on psychology and experiments, behavioural economics breaks with textbook orthodoxy by revealing how people make decisions in practice rather than in theory. It shows how consumers fall short of the hyper-rational and far-sighted optimising creatures that inhabit conventional economic models. Once regarded as little more than an intriguing byway, behavioural economics has gone mainstream. Work in this area has won Nobel economics prizes for Daniel Kahneman, author of the acclaimed bestseller *Thinking, Fast and Slow*, and more recently Richard Thaler of Chicago University, co-author of *Nudge*.

Applied to finance, the new discipline shows how people are susceptible to the way that choices are framed, such as whether the choice is to opt into a course of action or to opt out, or if there are reference points, say expensive products in a price comparison list that make what a company actually intends to sell look cheap. People are "loss-averse", meaning that they care more about prospective losses than potential gains of the same amount. Behavioural economics spells out how and why many tend to procrastinate about saving and other good resolutions (the technical answer lies in "hyperbolic discounting"). And it shows how we tend to use rules of thumb and other shortcuts to manage our finances.

By grasping these predictable patterns of behaviour, the new school of economics offers fresh ways to guide better decision-making through "nudges". This appeals to policy makers because it allows them to steer people into doing the right thing while avoiding annoying them with compulsion. The showcase for behavioural economics in the UK has been pension auto-enrolment, which crucially makes opting into a retirement plan the default setting. The policy has been a resounding success since it was introduced in 2012, with 10m people automatically put into a workplace pension scheme and a huge jump in participation among young private sector employees.

Since the Financial Conduct Authority (FCA) was established in 2013, it has been in the regulatory vanguard of drawing upon behavioural economics. Relevant findings from the new discipline have informed market studies, such as that on credit cards, that the FCA has undertaken as part of its duty to promote competition, says Reinder Van Dijk, who heads the financial services team of Oxera, an economics consultancy. A theme running through these overviews and ensuing policy remedies, he says, is the importance of the "three As": that customers can readily access, assess and act upon information.

The FCA has also carried out or commissioned original research, such as investigating the effectiveness of alerts and prompts. In 2015, for example, it revealed that while annual summaries had no effect on consumers incurring

> *“One compelling reason for banks to take an interest in the new discipline is to ward off the attention of regulators*

unauthorised overdraft charges, real-time text alerts or updates on mobile banking apps reduced them by between 5 per cent and 8 per cent, and for those signing up to both services by 24 per cent. A subsequent study established that the most effective communication strategy was to notify customers just before they were about to go into the red, whereas early warnings of low balances were not heeded. Other research showed that prompts to encourage switching had little effect.

One compelling reason for banks to take an interest in behavioural economics is to ward off the unwelcome attention of regulators. The FCA exists, among other things, to ensure that "financial markets [are] honest, fair and effective so that consumers get a fair deal". Lenders have to show their homework on this. For example, as Van Dijk points out, banks need to identify behavioural patterns that might have adverse outcomes for customers and be able to demonstrate that they take this into account in designing and communicating their products. Disclosing a welter of information about products no longer suffices; the key points must be clearly brought to the attention of consumers.

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But there are broader reasons why banks are now keen to use the tools of behavioural economics. They provide one of the ways for an industry whose image was tarnished in the financial crisis and by the payment protection insurance mis-selling debacle to show that it can do better. Banks can use the findings of behavioural economics to improve the service they offer to consumers and small businesses, points out David Faro, associate professor of marketing at London Business School.

The data revolution is crucial to the application of behavioural economics in banks. Contactless cards are providing a plethora of information about our spending habits, which can be used to give more assistance for customers as long as they agree to such tracking. The high-street banks are investing heavily to upgrade their IT systems to allow them to offer such personalised services, says Faro.

Sharpening the challenge to the big lenders, new digital contenders are already offering services that help customers budget and exercise greater self-control over their finances. The customers of Starling can, for example, "ring-fence" money in their current account, for, say, bills or everyday saving. They can track how much they are spending each month in nearly 20 categories such as eating out, transport and holidays; and also with which shops or service providers. A further facility allows people to fend off the temptation to gamble, by blocking any payment to a betting firm.

Starling also offers a means for customers to save more, by in effect putting "loose change" from each electronic transaction into a savings pot. A purchase, say, of a coffee for £2.30 is rounded up to £3 and the difference is allocated to the savings pot. According to Alexandra Frean, head of corporate affairs at Starling, this is a popular feature and customers can add to their efforts by doubling or otherwise multiplying the round-up amount. Among the older names in banking, Halifax also offers a "save the change" feature.

New technological advances, particularly in machine learning, are likely to create further opportunities for other services. Among nearly 800 bank business and IT executives surveyed by Accenture for its *Technology Vision 2019* survey, AI was tipped as the technology expected to have the greatest impact on their organisation over the next three years, easily trumping blockchain for example. The bankers overwhelmingly thought that they could use their customers' digital data to understand them better and assist them more. Banks will be able to help customers "optimise their spending, giving them preferred access to better deals and nudging their behaviours in ways that create better long-term financial health", said the report.

Behavioural economics can be used for good and for ill. As a joint paper on data ethics from UK Finance, the industry trade body, and accountancy firm KPMG pointed out in March 2019, behavioural tools such as choice architecture and nudges can help individuals make good, well-informed decisions. But "these techniques should be managed carefully to minimise the risk of restricting the information customers have access to, which in turn can prevent them from making informed and independent decisions in their own best interests", the report added.

Despite this danger, banks have much to gain from the insights and techniques of behavioural economics. As Van Dijk says, it gives banks a good framework for understanding consumer behaviour, enabling them to design products and communications that deliver better outcomes for their customers. At a time when the traditional pattern of retail banking is being disrupted and the big lenders are abandoning the chain of branches that used to be their trump card in fending off competition, offering a good service is the best defence. ■

***Paul Wallace** is the former European economics editor of* The Economist *and author of* The Euro Experiment, *published by Cambridge University Press*

# Nothing new under the sun

*Ouida Taaffe looks at some of the first issues of the* Journal of the Institute of Bankers *and finds that many of the banking issues raised then could also apply now*

Banking is not usually associated with tension and excitement – for good reason. In *Three Men in a Boat*, for example, which was published in 1889, the narrator says: "George goes to sleep at a bank from 10 to four each day, except Saturdays, when they wake him up and put him outside at two." (George was based on George Wingrave who rose to become a senior manager at Barclays.) Banking aims to be boring because it is about managing risk, but what is often underestimated is how often banks and their clients have to tackle the same risks in different forms. That is why the *Journal of the Institute of Bankers*, founded in 1879, the same year as the Institute itself, is not the dusty relic it might be taken for. A look inside the first few issues of this forerunner of *Financial World* shows that some issues in financial services – and the need for society to discuss and tackle them – never go away.

One of the first papers the journal published, 'On Ancient Systems of Weight', by Barclay V. Head (*Journal of the Institute of Bankers*, January 1880) sounds arcane and, in some respects, it is. Head was assistant keeper of the coins at the British Museum and a corresponding member of the Imperial German Archaeological Institute. At the time, Heinrich Schliemann was still in the process of excavating what was thought to be the site of Troy – and a lot of golden treasure had been found there. The gold standard was in use.

But the article is not really about ancient civilisations, as the journal's report of the discussion that followed its publication shows. One of the discussants, a Mr Cazalet, argued: "It is my unshaken belief that the different governments of Europe will find it necessary before long to come to a definite arrangement for a bi-metallic international currency. The times are not, at present, propitious for such a change. It would involve the earnest desire of all governments to maintain peace, whereas every government in Europe is arming to the teeth."

The underlying issue – which remains a hardy perennial as the current trade wars and the global reliance on the dollar show – was trade and foreign exchange. Just as now, unilateral decisions by a jurisdiction could have painful consequences for trade partners. Another participant, Mr Langley, noted: "Hitherto, up to 1876, all the balances of trade due by silver-using countries to this country, and all the balances due by this country to silver-using countries, were settled through the instrumentality of France. If a merchant in London owed silver to a house in India, France was the source by which it was mainly supplied... It is the suspension of the law for the unlimited coinage of silver in France that has caused the disorganisation of the whole Asiatic trade...all trade with the East is falling into absolute gambling." He went on to worry that the US would cease silver coinage, which it did, but in 1964, and called for some "international agency to settle this question", which is still a work in progress.

The issues of the journal for 1879 and 1880 make clear how important international affairs were to the work of the Institute (as they still are), and how many discussions – such as those on bankruptcy law – were examined within an international context. In May 1880, for example, the journal looked at "some points of difference between the English system of law and that prevailing on the continent regarding 'negotiable securities'". The article calls for "a uniform system of law and practice, universally recognised in Europe...because these negotiable instruments are the carriers of the accumulated capital...the ultimate resources of families, the reserve to fall back upon in the hour of need."

> *"Suspension of the law...has caused the disorganisation... All trade with the East is falling into absolute gambling*

The Institute was part of a wider discussion – much of which still founds familiar today (UCITS anyone? Or banking union?). As the article points out, the sixth conference of The Association for the Reform and Codification of the Law of Nations was held in Frankfurt on Main in 1878 and London, then as now, did not always see eye-to-eye with its neighbours and trading partners. "With reference to...the practice in Austria and other countries...it is not part of the policy of our government, and I hope never will be, to interfere with private enterprise. Serious as may be the losses on the part of the investors, we must come back to the doctrine of caveat emptor," it says.

Ten years later, the same topics were still a live issue. In 1888, in 'The Monetary Union of the Great Trading Nations: an inquiry into its practical objects and the conditions to which its formation is subject', its author, H. Chevassus, a fellow of the Institute, argued: "If it be of advantage to have…a

legal tender unit between the traders of one nation, the presumption is, to say the least, very strong that there would equally be an advantage in the existence of one between the traders of one nation and those of another nation."

He goes on: "No one, last of all at the Institute of Bankers, will pretend that it is the proper primary function of currency to stimulate the imports or check the exports between different countries... A stable rate of exchange – the more stable the better – is what commerce really requires." The ensuing discussion – parts of which could be reprinted today in discussions of the euro – does not, as anyone who has listened to the news recently will guess, all go Chevassus's way. One objector argues: "The circulation of identical coins in different countries...[would not] do away with the differences of exchange between different countries."

If all of that sounds painfully familiar, it is because the fundamental problems that banks help clients solve – such as smoothing income streams, managing credit risk and guaranteeing payment – always need tackling. But surely banks themselves have changed so much that the small institutions of the late nineteenth century have nothing in common with the IT-heavy behemoths of today? Not so. In fact, greater efficiency through the use of computing was very much on the minds of nineteenth century bankers. In 1888, calculations were done by "mental or by...clerical process" and exams to ensure that members of the institute were up to

> *A stable rate of exchange – the more stable the better – is what commerce really requires*

scratch were important, which is no longer the case. But, then as now, there were bankers looking for efficiencies. The article in volume ix, 1888, by Edwin Guthrie, 'The Development of the Art of Numeration', discusses how using Arabic numerals makes running a bank possible and calls for decimalisation. "In every direction, the advantage of such a reform would be simply immeasurable," it enthuses. (Decimalisation came to the UK in 1971.)

Guthrie also brought some exhibits with him, including part of the original difference engine made by Charles Babbage; an example of the first digital mechanical calculator robust enough for office use, the "arithmometer", by Thomas de Colmar – a calculating machine suitable for all kinds of arithmetical calculations; and a circular calculating machine with detached reckoners that "will work the four fundamental rules of arithmetic, its range in multiplication being up to a product of 20 figures… It will multiply together two factors,

and, at the same time, add them to, or subtract them from, a third…square root can be worked on the machine, but the operator must insert each digit of the divisor..." There was a wide selection of slide rules, including one by Graets that "besides usual lines, calculates sines, tangents and logarithms. Has a sliding index for setting. Accuracy about 1/2,500".

The discussion was lively and not completely supportive of Guthrie. One entry said: "As to the various machines before us, all I can say is that they are exceedingly interesting, and I sincerely hope the time will come when they will be made available for the operations of the Clearing House. As to the... decimal system...is it not easier to add £3 17s 10d to £3 18s 6d than it is to add the equivalents of those in decimals?" Another person noted: "He says that with the use of the arithmometer the work of calculation becomes rather an amusement than a labour, especially to all those who are fond of ingenious and beautiful mechanism...I have found very great satisfaction in using it [as an actuary]...but the machine does not carry beyond a certain number of places, and one has to be very careful that errors do not creep into the calculation from this cause..."

More than130 years later, calculating machines in banks are infinitely more powerful than anything Babbage or de Colmar could have dreamt of, but the people using them still need to ensure that "errors do not creep into the calculation".

The lesson from the *Journal of the Institute of Bankers* – as from much of history – is that the problems that business people, and the firms that help them, face will constantly recur. In 140 years' time, there may not be banks, but there will almost certainly still be banking – as well as discussions about how to do it best. ■

***Ouida Taaffe*** *is the editor of* Financial World

# A mid-life money MOT

*Pauline Skypala suggests some ways to make sure your finances are in a healthy state if you are planning for retirement, even if it is some years away*

Do you need a mid-life MOT? The UK government is encouraging people to take a look at their work, health and finances and to plan ahead actively for their retirement. It launched a website, *yourpension.gov.uk/mid-life-mot*, this year to help people take stock. This is useful if you do not have the time to sort out your finances, or prefer to ignore problems rather than deal with them.

The question is where to start. Here are some ideas.

### Work out your priorities

You are likely to be juggling competing priorities, so take a holistic view and think about what you most value, when and why. This is the advice of Stuart Fowler, founder and managing director of Fowler Drew, a wealth manager. "Imagining yourself in the future looking back is a good way to do this," he says. If you are raising a family, providing for them may be a top priority ahead of maximising pension funding, for example. It is helpful to have thought this through before you start looking for a financial adviser, if you decide you need one.

### Pay down debt

This is always top of the financial tip list. Paying off expensive debts such as overdrafts or credit cards is the best investment you can make. There is no point saving while you are paying interest on costly debts. If you have problem debts, there is a lot of help on the debt and borrowing section of the government's money advice website (*moneyadviceservice.org.uk*), including information on where to get free debt advice. Never use a commercial debt consolidation service.

### Set a budget

It sounds basic but if you do not know where your money is going, you need to take action. Add up your essential outgoings each month, then look at what else you are spending on and what you can cut back. Shop around every year for home, contents and car insurance. You are likely to be paying over the odds if you just renew without using a price comparison website to check the competition. The same goes for your broadband package, utilities and mobile phone. Any savings you make can go into an Isa or other savings vehicle if you have no debts to pay off.

### Manage your mortgage

If you have an interest-only mortgage, consider changing to a repayment loan. Few people have credible repayment vehicles in place to cover the debt when it comes due on these mortgages, says Jade Williams, of Cardiff-based JLW Financial Solutions. Those with a repayment mortgage can consider making overpayments. "This can significantly reduce the total amount of interest they pay and should mean their mortgage is paid off quicker," says Patrick Connolly, chartered financial planner at Chase de Vere. Always check with your lender before overpaying. Most allow you to overpay 10 per cent a year and some allow unlimited overpayments, but you may be penalised if you pay too much.

### Check your state pension

The state pension is an important part of your retirement provision. You need 35 years of National Insurance (NI) contributions to receive the full state pension, currently £168.60 per week.

> "You should try to pay 10-15 per cent of your earnings into a pension in order to build up the pot

To find out what you will get, when you will receive it and how to increase it, if you can, use *www.gov.uk/check-state-pension* or call the Future Pension Centre on 0800 731 0175, says Connolly. If you stay at home to raise children, make sure you claim child benefit, even if your partner earns more than the tax-free limit of £50,000, as you will get NI credits until your youngest child is 12.

### Increase your pension payments

You get a tax boost to any payments you make into a pension scheme, and a contribution from your employer if you are in a workplace scheme. For higher-rate taxpayers, it is generally worth paying in as much as you can within the limits allowed. There is a lifetime allowance, currently £1,055,000, and an annual allowance of £40,000 (including the employer's contribution), which tapers down for those

earning more than £150,000 to reach £10,000 for incomes of £210,000 and above.

You should try to pay 10-15 per cent of your earnings into a pension, says Williams. "If done from an early stage, the pension pot built up could be substantial."

### Align your finances with your principles

There is no point making lifestyle adjustments to reduce your carbon footprint if you are funding fossil fuel companies through your finances, says Lee Coates, managing director of Ethical Investors, an independent financial adviser. Start by switching to a building society or ethical bank for your current account. Ethical Investors' clients mostly use the Co-operative Bank, says Coates. Use the website *yourethicalmoney.org* to check how your current providers measure up on the green front.

### Watch out for high investment costs

Keeping costs low is the best way to maximise investment returns. There is a big difference between paying 2 per cent a year in management fees and 0.2 per cent, or even between 0.5 per cent and 0.1 per cent. Cheap index tracking funds are a good choice for investors able to make their own investment decisions.

### Get financial advice

Make use of free advice, such as the government's Money and Pensions Service. If you subscribe to Which?, you can use the Money Helpline available to members. For more complex needs, consider consulting an independent financial adviser, preferably one who is chartered. You can search for an adviser near you on *unbiased.co.uk*.

Restricted advisers, those who only recommend particular products (eg just pensions) or product providers, can also be helpful as they typically get good background support and knowledge development.

> *If you don't believe in funding fossil fuel companies, start by switching your current account to an ethical bank*

Choosing an adviser can be time-consuming and you will need to make sure you know how much it will actually cost and what you are paying for, over what timeframe.

Some of the potential pitfalls are shown by the FCA's decision to consult on a ban for contingent charging for pensions advice. As things stand, some advisors are offering "free" advice on moving out of defined benefits schemes. Their fee is contingent on the client transferring the pension and the FCA sees this as an obvious conflict of interest. A ban is expected early next year. ■

***Pauline Skypala** is a freelance financial journalist. She worked at the* Financial Times *from 1999 to 2015, including as editor of* FTfm *and deputy markets editor. She has won many awards, including the Harold Wincott award*

# They'll be watching you

*Keyur Patel discusses how insurance companies are using new technology to monitor personal behaviour and evaluate risk, but warns that there are privacy concerns*

If you are a young driver, the world of car insurance might leave you feeling rather aggrieved because by far the biggest determinant of what you pay is your age. You are grouped together with other 18 to 24 year olds who, on average, are much more likely to be involved in an accident than older drivers. That means you will probably hand over a hefty chunk of money compared with those older drivers until you reach your mid-twenties – regardless of your own skill and attentiveness behind the wheel.

Is there a fairer way to price car insurance? Over the past decade or so, more insurers have encouraged applicants – especially younger ones – to use telematic devices that monitor their driving performance. This might be a black box with a GPS system and motion sensor installed in the car, or, increasingly, an app on a smartphone with similar capabilities. These devices can detect customer habits. For example, they can know whether customers tend to drive during the day or night, use motorways, or take breaks on long journeys. They can also assess driving style – average speed on different types of road, and how sharply the car accelerates, brakes and corners. Each risk factor is weighted and combined to produce a score (typically out of 100) that is used to inform insurance premiums.

Recent research by MoneySuperMarket, a price comparison website, found that the average 17 to 24 year-old in the UK could save £151.25 a year by buying telematics-based car insurance. The insurer Direct Line estimates that young drivers opting for one of its black box policies have saved a total of £50m over the past five years.

This is one example of a wider trend in the insurance industry. Emerging technologies enable companies to evaluate risk at a much more granular level than was previously possible. As internet-connected sensors become ubiquitous, orders of magnitude more data is being collected about how we live. And while previously much of this data would have been too expensive to process or simply unusable, companies can increasingly draw insights from the information using machine learning – the "engine" that powers most kinds of artificial intelligence.

Pricing life insurance, for example, used to be about putting together actuarial tables. They could answer broad questions such as "what is the probability of death of someone of *x* age?". Now, the questions and answers are no longer just about someone *like* you: that someone *is* you. Wearable devices, for example, can be used continuously to monitor health indicators such as blood pressure and exercise habits. In 2018, John Hancock, one of North America's largest life insurers, said it would stop underwriting traditional life insurance and instead only sell "interactive" policies that track fitness and health data.

> *“In-car devices can detect driving style, such as average speed and how sharply the car brakes or corners*

People might expect a certain amount of monitoring on a treadmill, but surely the domestic sofa is sacred? Not so. "Smart homes" offer an opportunity for property and casualty insurers to improve their underwriting all round the house. For example, sensors can help bolster home security by detecting whether a window or door has been tampered with, or left open. Internet-connected devices attached to water pipes can warn customers if there is a leak – anticipating damage before it becomes more serious. Some underwriters are offering free sensors to customers as part of their home insurance policy – banking on the ensuing reduction in claims more than making up for the cost of providing the technology.

In each of these cases, the potential benefits are twofold: not only can insurers more accurately price risk, but they can also play a role in helping to reduce it. This might require no action by the customer, other than installing the device, but insurers can also encourage policyholders to adjust their behaviour in order to qualify for better deals. Telematic devices in cars, for instance, can be linked to an online dashboard to make automated recommendations on improving safety.

### The cost of knowing

Cheaper insurance in return for more transparency on risk sounds good, but it could also be a slippery slope to something altogether more dystopic. How much personal data about our behaviour are we comfortable handing over to insurers – and should we be compelled to share the data to obtain a good deal? To what extent should insurers be in

the business of determining what, say, constitutes healthy behaviour? And, while lower-risk customers may enjoy better prices, should customers who might be perceived as riskier bear additional costs, rather than benefiting from overall risk pooling as they would have in the past?

These concerns are among those laid out in a new report by the Centre for the Study of Financial Innovation (CSFI), *It's Not Magic: weighing the risks of AI in financial services*. One of the risks flagged is whether monitoring personal behaviour could cross the "creepy" threshold – yet still be normalised. We might be comfortable with installing a telematic sensor in our cars for cheaper insurance but what about, for example, the prospect of AI-powered facial detection technology that scans our faces in real time for signs of distraction?

Even if people are willing to share behavioural data for a particular purpose, many are deeply uneasy about who might subsequently gain access to it – legally or not – and how they might use it. In itself, the data might not be particularly valuable, but when mapped to other information about them, it might reveal more about their lives than they were willing to disclose – or perhaps even realised themselves. Some fintechs, for example, say that they can use data from open banking to predict when someone is planning to file for divorce.

Another risk is that greater personalisation might come at the expense of the social benefits of some forms of insurance. One concern is that high-risk individuals, who often need insurance the most, are priced out of the market. As Ermir Qeli, director at Swiss Re, says in the CSFI report: "A key question from a consumer perspective is how far you should go with machine learning and related technologies in assessing and pricing risk? You can argue that this isn't a problem when the pricing of the policy is based on behavioural factors. If you are a reckless driver, why should others cross-subsidise you? But what about when risk factors aren't behavioural? If you are born with certain medical conditions, you'll incur high costs regardless of your behaviour."

> *Many people are uneasy about who would have access to their behavioural data and how they might use it*

Such questions will invariably come under scrutiny as insurance companies press ahead with personalised policies. For now, there is plenty of evidence that some customers are willing to trade data for lower prices. For example, in a recent survey by the consultancy Accenture, of 47,000 consumers in 28 markets, two-thirds of respondents said they were interested in receiving modified car insurance premiums based on safe driving and half were interested in life insurance premiums linked to a healthy lifestyle.

Insurers are not limited to using just the data that their customers elect specifically to provide. One potentially valuable source of information is from data posted publicly on social media websites. At the moment, the technology that can transform unstructured social media posts into inputs to machine learning models that can automatically evaluate risks is still relatively immature. For example,

there are problems with scalability – and there is not much evidence yet that this kind of analysis has any great predictive power. Nevertheless, it is an issue grabbing the attention of regulators. In January 2019, New York became the first US state to release guidelines that allow life insurance companies to use data from customers' social media posts to determine their premiums – on the condition they could prove it does not discriminate on the basis of a person's race, sexual orientation or any other protected class.

With technological advances over the coming decades, could fully personalised insurance make the practice of risk pooling obsolete? A report last year by the Geneva Association, an insurance research group, noted that: "As long as individual risks retain some level of uncertainty and are not predictable with certainty, risk pooling has a role to play, even when big data allows a much better assessment of the risks. It is true, though, that the better individual risks can be predicted, the lower the value of insurance for policyholders and hence the lower an individual's willingness to pay."

What is clear is that new technologies are fundamentally reframing insurance business models, not merely tinkering around the edges. According to a joke, which has apparently become popular in fintech circles, the insurance company of the future will have three employees: a computer, an actuary and a dog. The computer runs the company, the actuary feeds the dog, and the dog bites the actuary if he or she attempts to touch the computer. ■

***Keyur Patel*** *is co-author of the new CSFI report,* It's Not Magic: weighing the risks of AI in financial services*, and principal author of the CSFI's Banana Skins surveys of risks facing the banking, insurance and financial inclusion sectors. See www.csfi.org to view reports*

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# Time to trim the banking fat

***Ross Tieman** examines the need for bank consolidation in the EU, which has more than 6,000 credit institutions, and looks at ways this goal may be achieved*

Consolidation is back on the European banking agenda. Although high-profile deals are hard to pull off, the number of banks in Europe has declined. Policy makers and bank chiefs concur that the eurozone needs fewer, bigger banks. On the policy front, both Mario Draghi, the former president of the European Central Bank (ECB), and Andrea Enria, the chair of the ECB's supervisory board, have argued publicly for consolidation as a tool to create more efficient banks, earning enough money to invest in their businesses.

Among bankers, Frédéric Oudéa, chief executive of French bank Société Générale, has repeatedly called for obstacles to consolidation to be removed, and José Viñals, chair of Standard Chartered, has lamented the many small institutions underlying overcapacity in the European banking sector.

To fully understand the mounting pressures on eurozone banks today, we need to cast back to the 2008 financial crisis. The impact was similar on both sides of the Atlantic but the

> *Consolidation in the past decade has mainly focused on cutting costs at banks and within national markets*

US quickly cleaned up its banks' balance sheets and closed or merged failing institutions. A decade on, many European banks are still struggling with high levels of non-performing loans. This is at the same time as they have higher funding costs under Basel 3 and, thanks to the inverted yield curve, compressed net interest margins.

The result? At the end of the second quarter of 2018, according to the European Banking Authority (EBA), European banks' average return on equity (RoE), at 7 per cent, was lower than in 2017. And that is for the cream of Europe's banks. The EBA's Quarterly Risk Monitor is based on a sample of 150 banks, comprising more than 80 per cent of the EU banking sector by total assets. Behind the leaders is a long tail of small financial institutions that are far less profitable. At end 2018, Europe's best-performing banks averaged a RoE of 8.6 per cent, according to the ECB. But at the worst-performing banks it was just 3.4 per cent. According to Enria, the cost of funds for many banks remains above their RoE, while the banks' average cost/income ratio was a hefty 64.1 per cent. That is about four percentage points higher than during the second quarter of 2015.

Regulators want banks to start to deal with those realities – particularly as Europe may be facing a downturn that will put further pressure on its banks. Felix Hufeld, the president of BaFin, the German financial regulator, said in an October interview with *WirtschaftsWoche*, the German business news magazine, that "it won't be enough to perhaps trim some fat and leave the muscles and skeleton unchanged". He argued that German banks need to examine critically which activities and products really make money. "That leaves a lot of room for manoeuvre," Hufeld added.

Some of that manoeuvring will surely include consolidation. European banking is still highly fragmented. According to the European Banking Federation (EBF), there were 6,088 credit institutions in the 28 countries of the EU at the end of 2018, of which 4,599 were in the eurozone. Germany had 1,584 credit institutions, more than Italy (508), France (409) and Spain (200) combined – and it is in Germany and Italy that numbers are falling fastest. But in seven countries, the number of credit institutions rose last year, most notably in the UK (390), which also has a dynamic fintech sector.

It is important to note that there has already been a creeping, although largely unremarked, restructuring of the EU banking sector. Since 2008, the number of financial institutions has fallen by 2,437, or 29 per cent. During 2018, another 10,000 bank branches closed, making a total of 65,000 branches since the financial crisis, a fall of 27 per cent.

But the principal focus of consolidation in the past decade has been to cut costs at individual banks and within national markets. This has been most obvious in Germany, where intense competition from cooperative and state banks is driving sorely needed domestic consolidation.

### Are the right cuts the deepest?

The question for both banks and regulators is knowing what cuts to make to shape a competitive banking sector. Political factors play an important role. In a speech in early 2019, Enria set out some of the obstructions to cross-border mergers in Europe. These included the difficulties around cross-border management of bank capital and liquidity; the lack of a common European deposit insurance scheme; a need for common supervision rules and processes among member

states; and the absence of a common framework for bank liquidation. These, he said, should be a priority for the next five years.

In the near term, consolidation often means job losses, which is one reason why a government-backed attempt to merge Deutsche Bank and its chief rival, Commerzbank, was abandoned in April. But Germany knows it needs to do something about having more bank branches than petrol stations. In October, a different merger plan was unveiled, involving the combination of one of the country's five regional investment banks (Landesbanks), Helaba, with DekaBank. Supporters of the merger point out that, while the mutuals get by with one central institution, the roughly 400 savings banks allow themselves five Landesbanks in addition to DekaBank, which is the asset management unit of the savings banks. But because the Länder and municipalities own the savings banks, the path to a leaner system may not be smooth.

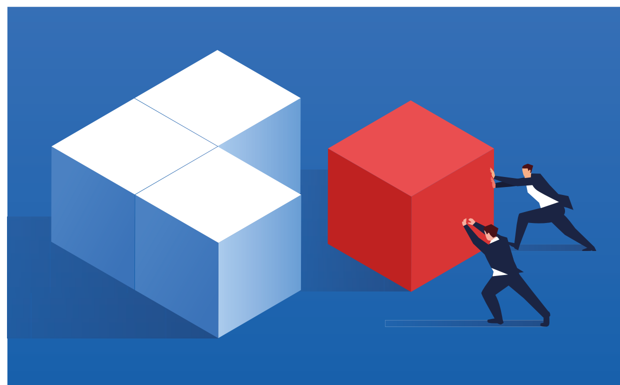
It can be done. There has been progress in over-banked Italy. The two biggest cooperative banking organisations, Iccrea and Cassa Centrale, have become fully fledged banking groups. According to rating agency Moody's, this could pave the way for consolidation among Italy's 268 cooperative lenders and make them stronger competitors for its commercial banks.

### A single market

The bigger question is whether there is now scope for substantial mergers in other more concentrated domestic markets, or across borders to create pan-European champions. In theory, the case for consolidation is strong. It enables banks to spread fixed costs across a larger client base. That is especially valuable at a time when banks are investing heavily in online banking platforms and have to meet intensifying competition from new, digital-only banks. Customers are migrating from branches to their mobile phones. At end 2018, 54 per cent of Europeans were using internet banking, up from 29 per cent in 2008, according to the EBF.

But the disincentives should not be ignored. Making a success of a large-scale merger is a daunting management challenge. Integrating legacy IT systems can be complicated. Politicians like to have national champions. And the bigger a bank becomes, the more attention it is likely to attract from regulators keen to contain systemic risk.

But scale derived partly by international mergers underpins the efficiency of some of the eurozone's most successful banks. Banco Santander of Spain, with operations in Brazil, Mexico, the UK and elsewhere, reported a return on tangible equity (RoTE) of 11.7 per cent for 2018, and a cost/income ratio of 47 per cent, amply outperforming the EU averages.



BNP Paribas of France, which also has major retail operations in Belgium, Italy and the US, is also in good shape. Its quoted rival, Société Générale, has strong positions in Romania, Russia and the Czech Republic. But it is not certain that they, or other eurozone cross-border players such as Italy's UniCredit, will choose to take part in a new round of European banking consolidation in the near future.

> *Digital banking can build a pan-European customer base but with lower costs and fewer risks than mergers*

Nonetheless, cross-border competition is already intensifying within the eurozone. The rise of digital banking has created an online free-for-all in basic banking services. And the success of ING, a Netherlands bank, in rolling out its ING Direct internet bank across Europe has provided a model for other banks and fintech firms such as Revolut to copy.

Building a pan-European customer base in this way may be slower and less spectacular than a merger or series of acquisitions, but it also entails lower costs and fewer risks. And as the earning power of a new generation of digital natives increases, so does the range of products and services that online banking customers may be willing to buy.

This can only increase the pressures for cross-border banking consolidation. For Europe's underperforming lenders, banking union cannot come too soon. ■

***Ross Tieman** is a France-based freelance journalist specialising in economic development and competition issues. Earlier in his career he was UK companies editor at the* Financial Times *and industrial correspondent at* The Times *newspaper in London*

# What makes CEOs go bad?

*John Thanassoulis discusses why misconduct happens and concludes that the greater the competition between companies, the greater the risk of malpractice*

It is not clear when exactly the payment protection insurance (PPI) scandal began: Citizens Advice thinks before 2001. But by 2003, a quarter of the market may have been affected by mis-selling. Throughout this time, interest rates on new mortgages were at or below 100 basis points above the Bank of England base rate (see graph). It was only after the whole industry was referred to the UK competition authorities that spreads on new mortgages rose, eventually settling more than three times higher than their average over the early years of the millennium. Until now that is – but more of that later.

Does competition lead to misconduct in financial markets? Casual empiricism does not seem to help us answer this question. In 2008, there were 6,619 regulated firms active in selling mortgage default insurance such as PPI: a very competitive market structure. But the Libor (London Inter-bank Offered Rate) scandal offers a different example. Libor rates were set by between seven and 18 member banks, a world away from the 6,000 competitors in PPI. Yet here too misconduct occurred between 2005 and 2007 (and probably before) when banks were habitually gaming the rate, perhaps to profit from the trillions of dollars of derivative contracts linked to the rate or maybe to flatter the balance sheets of their institutions.

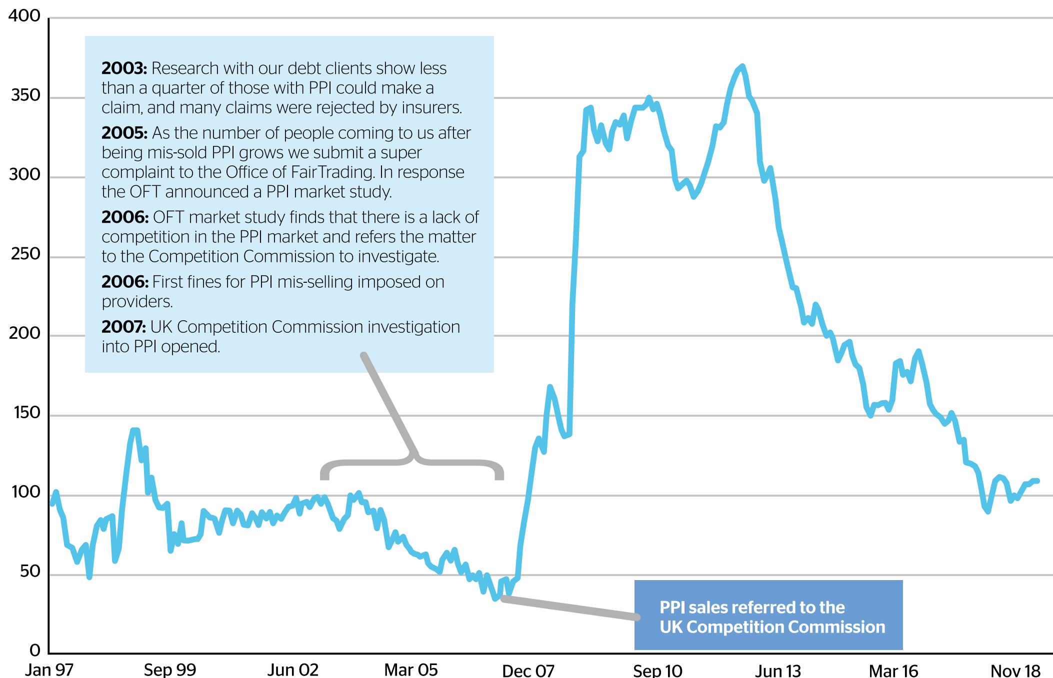
Both these examples of misconduct have led to billions of pounds of fines and the chief executive of Barclays, Bob Diamond, ultimately lost his job over the Libor affair.

> *It may be that the scale of a company provides the perfect environment for wrongdoing to flourish*

### The more the murkier?

Research at the University of Warwick is trying to determine which form of market structure is most conducive to misconduct. Adding to the difficulty in answering this question is that financiers, like the rest of us, are human, with moral qualms. Most do not feel good about setting up systems to mis-sell PPI or rig Libor so as to swindle investors.

### Overall spread on new mortgages




*Source: FPC housing core indicators, Citizens Advice and Which?*

Indeed, even chief executives at the centre of the storms, such as Barclays' Diamond, made clear that their sense of personal integrity was critically important to them.

Bad people can be bad in any situation but if we knew whether competition makes misconduct by otherwise honest people more or less likely, then regulators would know where to spend their limited resources. The problem is that there are seemingly compelling arguments in either direction.

Perhaps large firms with big market shares are most vulnerable to misconduct – as in the Libor case. For them, even a small amount of misconduct can increase profits hugely which makes it tempting. Also what, for individual customers, are small infringements are hard for a regulator to spot and punish. So it may be that scale provides the perfect environment for misconduct to flourish.

On the other hand, maybe intense competition among many firms is the breeding ground for malpractice. Such firms may be making exceedingly small profits on the straight and narrow, and so they may almost feel compelled to mis-sell. As each firm has a relatively small market share, they might console themselves that their misconduct harms only a few people and so morally they are not so bad after all.

It turns out this tension has a clear resolution. When a chief executive or senior financier considers the pros and cons of misconduct, such as creating incentives they know will encourage a little mis-selling, or submitting some misleading data, they are motivated by at least four things.

> *The larger the firm, the bigger the fine the regulator will impose if malpractice is proved*

First is the profit motive. Misconduct raises profits – that's its attraction. For example it allows insurance to be sold without incurring all the underwriting costs, or false data can encourage the share price to rise and so the cost of capital to fall.

Second is the moral anguish caused by the misconduct. Philosophers have explored how people can and should resolve ethical tensions and we can bring some of those insights into our analysis. Setting up processes to defraud consumers cannot feel good – unless the person behind those processes has no social conscience. The more customers are affected, the worse it gets. One's sense of personal integrity takes a battering in such cases.

Third, misconduct and malpractice involve practices that are dubious if not illegal. That is why they are conducted in secret. There is a chance that the regulator will find out, and, if it does so with enough evidence, there will be fines to pay. The larger the company, as a rule of thumb, the larger the fine. That should be a deterrent.

Fourth, any chief executive taking this step is gambling with their reputation. If malpractice is discovered and proved then this is likely to result in an end to that person's career at the company, as it did for Diamond.

The first and second of these effects push in opposite directions: profit incentives encourage misconduct, ethics considerations deter it. Within the chief executive's decision calculus, both of these effects, under natural conditions, are proportional to the volume of business. The more consumers served, the greater the ability to profit from bumping up costs to each one and the more it hurts one's sense of what is right to be defrauding the client base. If increased competition cuts volumes, the incentive to boost profit by cutting corners shrinks – there are fewer customers to diddle. Equally, the incentive to be ethical shrinks. These incentives dwindle at parallel rates, so there is no overall change in the incentive for malpractice from these two.

The situation is different for the third and fourth effects: the risk of regulatory sanction and the reputational cost. These forces both act to restrain misconduct. If a chief executive is forced out of their position because of misconduct, then they will lose the benefits of running the firm and these are likely to be proportional to the net present value of current and future profits. Likewise, if a regulator discovers evidence of malpractice, it will levy a fine: the more profitable the firm, the larger the fine. Therefore, the strength of sanctions and reputations in the chief executive's decision-making process is linked to profits.

As competition increases profits shrink, as do volumes. But profits equal volumes times margin. And as competition increases, margins typically shrink. In a deep sense, profits shrink more rapidly than volumes do as competition increases. So we see that the brakes provided by reputation and sanction effects weaken more rapidly than the motors of profit and ethics as competition rises. As a result, when competition increases the balance tilts towards more malpractice.

To sum up: misconduct can happen anywhere. But as competition increases, the environment becomes more vulnerable to malpractice. This is especially so as the margins that firms can charge shrink. Hence the environment from which the PPI scandal sprung was more predictably problematic than the Libor case.

Which brings us back to today's mortgage market. When PPI was a problem, the spread on mortgages hovered around 100 basis points (see graph), and the spread rose when PPI was tackled. In recent months, the mortgage spreads have collapsed to levels not seen since the days of PPI. And the cause of this price war? Competition between many UK mortgage providers.

This all suggests that the mortgage market has turned into a powder keg. Regulators must be vigilant that no chief executive comes up with an unethical way of preserving their margins that strikes the match. ■

*John Thanassoulis is professor of financial economics at the University of Warwick*

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# Banking with bottle

*Alexander Hoare, a director at the UK's oldest private bank, tells **Ouida Taaffe** why the partners still operate with unlimited liability and explains the bank's business model*

When Lombard Odier, a venerable Swiss private bank, gave up being an unlimited liability partnership in 2014, Patrick Odier, the senior partner, told the *Financial Times* that the unlimited liability model no longer worked because of the "size and complexity" of the firm. As that suggests, banking is not just about managing market risk, or helping mitigate the financial risk of clients. There is risk in running the business itself: in the challenge of really knowing what is going on in a large and complex organisation, and managing a lot of money, where the interests of shareholders, managers and clients are not necessarily aligned.

Unlimited liability partnerships were the only model open to the first bankers in the City of London. However, the first bank to have *limited* liability was the Bank of England, which was founded in 1694. The idea quickly caught on. "Before long, any number of commercial firms were appealing to the crown for similar liability protection and monopoly rights to trade either certain goods or in certain areas of the world"[1].

There are obvious advantages to not being personally liable for losses, but unlimited liability bank partnerships survived until well into the twentieth century and, indeed, still exist. C. Hoare & Co., the oldest private bank in the UK, was founded in 1672. Nearly 350 years later, and more than 150 years after the advent of joint-stock banks, its partners still have unlimited and several liability. Why?

"In the early 2000s, when I was chief executive, people said 'You are mad, what are you doing trading in this litigious world as an unlimited liability bank?'," says Alexander Hoare, a partner and director at C. Hoare & Co. "But the partnership model has been proven to be good in risk-taking businesses. Corporates are not very successful at using other people's money, not really." Hoare argues that you only really need a joint-stock bank to deal with a multinational company.

C. Hoare & Co.'s focus is resolutely domestic. It has two main branches in London: one in Fleet Street, where it has been based since 1690, at "the sign of the golden bottle"; and one in Lowndes Street in Knightsbridge, which accounts for around 20 per cent of business. An office in Cambridge has just been launched.

1. Noel T and Smith S (1997), 'The Buck Stops Where? The role of limited liability in economics'. *Economic Review*, 82 (1), 46-56, 53.

"There is a niche that values our business model," says Hoare. "Entrepreneurs like to talk to entrepreneurs and families like to talk to families." He says that the bank turns away "around half" of the people who want to become customers. This is partly because the bank only wants to be in business with people who share its values – which he describes as "Christian with a small c" – and partly because it wants to be able to maintain oversight.

After the financial crisis, Hoare says, the balance sheet doubled in a couple of years because "people were worried about the return of money, not the return on money", but the bank did not take on nearly as many customers as it could have.

> *People said 'You are mad. What are you doing trading in this litigious world as an unlimited liability bank?'*

That there are plenty of willing clients might come as a surprise in a world of "free if in credit banking" because banking with C. Hoare & Co. is not cheap. The fee for a current account, for example, is £60 a month, before transaction charges. The bank's corporate structure is also not quite as timeless as it seems. The original partnership model was changed in 1929 and the partners are now the sole shareholders in a private unlimited liability company.

Asked whether personal liability concentrates minds, Hoare says that the fact that the partners – there are six, all of them family members – are ultimately liable for losses "permeates everything about the bank". They are not looking for short-term profit but for "long-term quality outcomes for the next generation".

"You don't want to be the generation that screws it up," says Hoare, who is the 11th generation of his family to work in the bank. "Though you have to assume that sooner or later someone will." Asked about the rule of thumb that many firms go from "clogs to clogs" in three generations, Hoare says that it takes his family around seven – the bank went through a rocky period in the second half of the nineteenth century when, having amassed great wealth, some of his forebears put a lot of energy into squandering it.

## Keeping it in the family

Hoare says there are two things that can sink a family business: the family and the business. Add unlimited liability to that mix and choosing the next generation to lead the bank looks challenging. "Hiring family is nepotism, but within that nepotism there is a certain meritocracy," says Hoare.

The idea of meritocracy raises the question of what merit is. "That is true," says Hoare. "You can look at academic qualifications and business credentials, both of which have bearing, but we also look for shared values and we use outside psychometric assessments."

He says that the bank spends a lot of time getting to know the younger family members and assessing who – from among the about 2,500 descendants of the founder – would be interested in, and capable of, becoming a partner. "We have been advised by our outside assessors to shy away from some people. They accept that," says Hoare. "It's not like it comes out of the blue."

He says that when he was first approached, he said "no thank you". "I was perfectly happy doing management consulting. Banking looked pretty dull – especially in a small bank in what I thought was an unexciting niche." He finally joined when he got tired of management consulting. What makes partnership attractive for some people, of course, is the prospect of cashing out.

Did the Hoares ever consider winding up their partnership? "There was a partner who did ask for an amalgamation. The others said 'no'. We enjoy our independence," says Hoare. "And, then, taking the money would amount to a huge betrayal of past and future partners, customers and staff. Also, would a whole lot of money make my life better? From what I've seen of money, probably not."

Still, banks are regularly accused of putting their own interests above those of their customers ('Where are the customers' yachts?' is the famous Wall Street cartoon). Hoare says that his bank's partners are not paid enormous amounts. "Huge salaries are very poor governance," he says. But the proof of whether the C. Hoare & Co. model works must surely lie with the customer. Does the bank have any clients who have prospered down the centuries alongside it?

"Descendants of Felix Calvert [the London brewer] – one of the bank's first customers – still bank with us," says Hoare. He adds that one family gave them a bookcase as a present after banking with them for two centuries, and that the longest single relationship is more than 345 years. "They stick with us for that relationship," says Hoare. "To get cared for in an empathetic relationship is very hard and, the richer you get, the more suspicious you get. Perhaps with reason."

Hoare says that the partners' mission is "to perpetuate a profitable family business", so sustainability is baked into their model. The stated purpose is to be "good bankers and good citizens" and he says that they "do not see a good future in which we do not take citizenship seriously – we would end up with neither staff nor customers".

C. Hoare & Co. takes a careful approach to its balance sheet too. According to its report for the year ending 31 March 2019, its common equity tier 1 capital ratio rose from 21.5 per cent to 22.4 per cent over the course of the year. Its cost/income ratio was 67.6 per cent.

*Would a whole lot of money make my life better? From what I have seen of money, probably not*

## Going online

"I spent my first 15 years at the bank saying 'Don't go onto the internet'," says Hoare. "Then, the day came when we had to provide online banking. We did it for defensive reasons, but it turned out to be immensely positive." The bank had two-factor authentication of online accounts from the start and "in no time" 90 per cent of its transactions were running over its app.

Hoare says the firm puts a lot of effort into educating customers about online risks – if only because it is much easier to get money out of clients than it is out of the bank itself. "Privacy as a service is a very smart strategy for a bank," says Hoare. "I do think it is in the job description of the bank of the future to try to protect a client's data as well as you can."

C. Hoare & Co. has just set up its first open banking experiment – Hoare did not want to disclose the details. "Open banking has made no difference to our business yet, but I think it will," he says. "Small banks do not have scale, but if we can team up with the right ecosystem, open banking means we can very quickly get exciting business." ■

***Ouida Taafe*** *is the editor of* Financial World

# Stick to your values

*Nadim Choudhury advises on what to do if you move to a new job but then find that the company has a toxic workplace culture*

Dear Nadim,

I recently graduated from the part-time BSc Hons Banking, Practice and Management course at The London Institute of Banking & Finance. I had been working at a large retail bank for the past two years and the company sponsored me to do the degree. But, a few months ago, I decided to leave the large organisation and join a much smaller private bank, working in a relationship management role.

I cannot give too much away, but I have been in the role now for the past three months and feel I have made a terrible decision in joining this bank. Its culture is really toxic. As a young woman, I feel that some of the "banter" goes a bit too far. There is a lot of sexism and there are crude comments by many colleagues, including those who are senior. Among these bantering senior colleagues are women, which I find strange. I feel like my values are compromised.

Do I stay with this bank for another year or so or do I leave now? I enjoy the client side of the work but the social aspects and the people I am working with are terrible. What are your thoughts?

Anna, 24, London

**Dear Anna,**

That sounds awful. I am sorry to hear that you are having a difficult time. Even when a new role is what you were expecting, moving from one culture to another can be a hard transition. If you find the new workplace less than congenial, it is likely that both you and your work will suffer.

One reason for this is that people can be reluctant to admit that things are wrong. They may expect a "stiff upper lip", or suspect that someone (particularly someone young) is being overly sensitive. But, unfortunately, many organisations still have toxic work cultures. When that is the case – as you have noticed – expecting colleagues to embody the values that one would assume are in their own best interests can lead to disappointment. For example, women will not necessarily call out sexism in the workplace – and may take part in "banter" that is offensive to other women.

People like to conclude that bad behaviour is a result of "bad" people – those who demonstrate extreme psychological conditions such as narcissism or psychopathy. The reality is more banal – and much more common: people who would otherwise behave perfectly reasonably will do unpleasant things when they find themselves in the wrong culture.

Being complicit in maintaining a hostile environment is usually a result of what is called "moral displacement". In this, people typically, and typically unconsciously, apply four strategies: justification; trivialisation; denial of responsibility; and dehumanisation of the victim.

Justification is when you hear things such as "it's just a bit of fun". Trivialisation includes using euphemisms for abuse – bullying could be called "joshing" – and downplaying its impact. Then, in the workplace in particular, people can push responsibility onto the culture and the need to "get along". In a context such as that, blaming the people who have been hurt for "bringing it on themselves" by, say, wearing a short skirt, or "not having a sense of humour" will not be seen as dehumanisation – but it is.

What you need to ask yourself is whether what you see in your workplace is "moral displacement" by most of the staff. If that is the case, there could be worse problems

> *If you find that the new office is less than congenial, it is likely that both you and your work will suffer*

with the people who are ultimately in charge: they may actively harass their subordinates and foster a toxic environment. If so, it may be a good idea to start looking for a new role. But you should move only if there are good reasons to do so. Here are my top five tips to gain more clarity about what is really going on:

1.Take some time out to think about what really offends you about your workplace and what is fundamentally important to you in terms of professional relationships. Is it respect, empathy for others, cooperation? Think about a time previously when you have been upset with a work situation that you felt you could not tolerate. It is likely that this may have had an impact on your core values and can help you work out what they really are. Once you know what your core

values are, you can judge if they are being compromised by working in your current role.

2. Find a confidant/friend in the bank whom you can speak to. That can be easier said than done, particularly if you have not been there long. But if you do not trust anyone around you,

> *Companies do understand that people can end up as a square peg in a round hole through no fault of their own*

ask yourself why that is. If you *can* talk in confidence to someone, you may find that senior management is already aware of the culture and is working behind the scenes to rectify it. It is not uncommon for organisations to change culture, especially if there is a concerted effort by senior management in driving that change. But if the atmosphere prevents you from airing your feelings, it may be that senior management has no interest in fixing the culture.

3. Is the culture affecting on your wellbeing and your emotional health? If the answer is yes, then the environment is probably not suited to you. In that case, it would be a good idea to start looking for a new role before too much damage is done to your self-esteem.

4. Bear in mind that starting any new role can be stressful. It may also be that, as yet, you have a limited view of the company overall. Do some due-diligence on Glassdoor, the jobs review website, to see whether ex-employees say anything about the issues you have seen. If not, it could be that this problem is limited to your particular department and could be fixed – at least from your point of view – by moving to another. But if former employees have reported the same problems that you see, you are right to be concerned.

5. If your final decision is to leave, do not worry about taking that step. You have not been there long. Companies do understand that people can end up as a square peg in a round hole through no fault of their own and see the value for everyone in remedying that quickly. More importantly, good employers will see it as a positive that you have strong personal values and are willing to make difficult decisions. When being interviewed for new roles, though, you should take great care not to disparage anyone personally – no matter how emotionally bruised you may feel. Sensible employers will understand when you say you want to find a better fit for your values and that you are looking for a role in which you can make the most of your skills and energy with a longer-term contribution.

I hope you find a speedy resolution. If you want coaching, please contact me directly on the email below.

Nadim ■

***Nadim Choudhury** is head of careers and employability at The London Institute of Banking & Finance. He is a career coach with more than 14 years' experience of working with leading business schools. Members of the institute are welcome to contact Nadim for free one-to-one coaching by email at nchoudhury@libf.ac.uk. Problems that they would like addressed in the column can also be sent directly to Nadim*

# Rest in digital peace

*Deborah Sabalot explains what happens to a person's online accounts when they die and how beneficiaries can access these digital assets*

Fifty-two per cent of the UK adult population recently told a YouGov survey that no one else would be able to access their digital accounts if they died. Over the past 25 years, technology has created digital banking and social networks but the law is still analogue. What does that mean for our digital assets, including those with financial value such as online banking, PayPal, online shopping accounts, or cryptocurrencies, as well as those with personal or social value such as Twitter, Facebook and LinkedIn and those with sentimental value such as Flickr, YouTube and iTunes? What happens to these digital assets after you are gone? The posthumous treatment of digital information is important and is an area crying out for better understanding and treatment under the law.

The law does not deal directly with how, or whether, you can pass ownership of your digital assets to your chosen beneficiaries. This is usually a contractual matter and depends on the policy of the particular internet service provider (ISP) or app. But your digital assets are not likely to have been on your mind when you clicked "accept" to the terms and conditions. That means you may need to check your responsibilities as an account holder and your rights on death, particularly as regards to keeping your usernames and passwords private.

Lawyers are now advising on "digital wills", which basically identify the accounts you may have and the relevant passwords that can be passed on to your executors. This may involve appointing a separate "digital executor" or ensuring that at least one of your executors is sufficiently computer literate to deal with those assets. This digital will should not be part of the will itself as, in Scotland for example, wills are public documents. Commercial services are also available to provide digital "safe deposit boxes", but these must be kept up to date. The digital will could take the form of allowing the executors to decide who should benefit from any digital assets, including photographs or posts with monetary or sentimental value, or you may wish to be more prescriptive and leave certain digital assets to named beneficiaries.

A copyrighted work, such as a blog, may be protected for a long time – up to 70 years after death in the UK. Copyrighted material is personal property, so the person who has created the "work" could choose to pass on ownership in their will. If there is no will, the rights can pass in accordance with the applicable intestacy laws. It is also possible that heirs to the author may have a right to regain ownership of transferred copyrights under certain circumstances.

The holders of iTunes and Kindle accounts may feel they should be able to pass on "their" content but, as the content is effectively leased, it does not "belong" to them. Even if you leave your digital beneficiary your favourite playlist and share the account details and password with them, this could result in a breach of your ISP agreement and/or the ISP could suspend your account if they became aware of your death.

## Show me the money

In almost all circumstances, a bank will freeze a deceased customer's individual accounts when notified of the person's death. This will include transactional accounts, brokerage accounts, term deposits, credit cards and loans. ISAs and certain other investments also terminate or are frozen on the investor's death.

When a bank customer dies, all signing authorities on that person's accounts and any power of attorney authority, including lasting powers of attorney, are also no longer legally valid. If a deceased customer had a joint personal account, the account will usually be transferred into the remaining account holder's name. This can be more complicated if there is debt (particularly a loan secured by a mortgage over a property) over which the bank may have a lien.

Most financial services firms will not know that a customer has died unless they are explicitly notified. To help streamline this, a "death notification service" has been set up, which covers the main clearers and some other financial institutions, and provides a "one stop" service to notify a customer's death. Notification would typically be the responsibility of the next of kin or the estate representatives but all banks may ask for identification from the person notifying the bank, as well as a copy of the death certificate and, in the case of representatives, the grant of probate. This can result in substantial delays in being able to access the deceased's accounts and/or assets.

The EU's General Data Protection Regulation also has a role to play in this because the bank's duty of confidentiality to customers does not end with the customer's death. A bank can take instructions about a deceased person's accounts from, or provide information about the accounts to, only someone authorised to act on behalf of the deceased's estate.

That is why the next of kin and estate beneficiaries cannot give instructions to a bank or require a bank to give them information about a deceased person's bank account.

Having obtained probate or letters of administration, an executor or administrator will typically set up a separate account in the name of the estate into which the bank transfers the funds before closing the individual's accounts. In limited circumstances, if the deceased has no will and the estate is worth less than £15,000, the bank may forward money in the deceased's accounts to the next of kin. But the bank must be satisfied the person is dead and that no application has been made to the High Court to administer the estate.

The process and ease with which funds can be transferred depends upon the bank's or payment services provider's terms and conditions. PayPal, for example, has a process to allow an estate's executor to close a user's account. Remaining funds will be liquidated by cheque made out to the estate. Most of the challenger banks do not even recognise death as a possibility and have scant advice on how to notify or deal with online accounts other than to share passwords with your loved ones.

## Social media

Not everything we value is financial, so people should also consider whether they want their social media accounts – and the data they hold – to be shut down or "memorialised" after death. An important factor in this, apart from the sentimental value of the data, is that data *does* have monetary value – social media companies, after all, exist to monetise it and they are also showing increasing interest in providing at least some financial services.

Facebook, with more than 2.4bn registered users, now allows them to choose whether the page will be deleted on their death or frozen in time. Facebook users can also nominate a named person to manage the account so that when the time comes a legacy contact can manage tribute posts on their profile, which includes deciding who can post and who can see posts, deleting posts and removing tags, requesting the removal of the account, responding to new friend requests, and updating the profile picture and cover photo. But the legacy contact cannot post as "you", or see your messages.

Instagram asks that friends or relatives contact them via email to notify them that a user has died and provide proof in the form of a death certificate, obituary or official notification. Instagram will memorialise the accounts upon the user's death, but memorialised profiles cannot be changed or accessed, and there is no option to nominate a new contact. The deceased's Instagram posts will stay on-site, but not appear in public spaces such as user searches. It is important to appreciate the difference between "deactivated" and "deleted" in this context. If the account is merely deactivated, it will no longer be searchable but the information will stay on the system. Even "deleted" data may stay on the ISP's servers for some time after the death until internal data policies and/or local laws require it to be removed.

Twitter's policy provides that on a user's death it will "work" with a person authorised to act on behalf of the estate – or with a verified immediate family member – to have an account deactivated. Again, proof must be provided. A third party can request that a deceased user's account is deleted entirely. Twitter will not give a third party access to a deceased user's account, regardless of relationship and there is no memorialisation option. Other providers, such as LinkedIn, have less formal policies and any user can request the removal of a deceased person's LinkedIn page. So a company could, in theory, request deletion of an employee's account. LinkedIn does, however, have a security vetting process and the requesting party must know key information, including the login and password details of the deceased.

Google accounts cover a wide range of information and personal material, including email and storage in the cloud or even monetary balances on certain accounts for services. It says it will cooperate with immediate family members or representatives following a death but they will have to have the deceased's login details and password, as well as proof of death, to access these accounts. Google also allows users to set up their own post-death preferences through its help section. If the estate is seeking to release funds that are locked in a Google account, a court order will be required.

Like Google, Apple provides a range of services, programs and media to its users. Apple's terms and conditions provide that the account is non-transferable and that any rights to the Apple account – and all content therein – dies with the user. Its position is that it will never give out passcodes to phones, passwords or any login credentials, except in the rarest of occasions – usually involving requests from the courts and legal enforcement. On receiving notification of a death, Apple will terminate the account and all content will be deleted. Account users should, therefore, make sure they have given their passwords to a trusted person, or risk the irretrievable loss of photos, music and video, etc. So there is plenty to think about in terms of one's digital legacy and whether you are going to be in that number that leaves it to your loved ones to sort out your digital assets after death. ■

***Deborah Sabalot*** *is a consulting lawyer who advises financial sector clients on UK and international regulatory and compliance issues*

# Money, but not as we know it

*__David Birch__ says the US dollar's dominance in the global monetary system will come under serious threat if China's central bank issues its own digital currency*

The way that money works now is, essentially, a blip. It is not a law of nature. It is a temporary institutional arrangement and it must necessarily change as technology, businesses and societies change. Many people think it is about to change right now, in fact, as we come to the end of the current era of international monetary arrangements. As *The Economist* observed recently, it is not clear what is coming after this "Bretton Woods II" era.

These sentiments are not restricted to technological determinists of my ilk. As the former governor of the Bank of England (BoE), Mervyn King, wrote in his book *The End of Alchemy*: "Although central banks have matured, they have not yet reached old age. But their extinction cannot be ruled out altogether. Societies were managed without central banks in the past."

If central banks will no longer have a monopoly on the creation of currencies in the always-on, interconnected world in which we are now living, who might issue digital currency in the future? I set out a "5Cs" framework for thinking about this in my book *Before Babylon, Beyond Bitcoin*, where I examined the potential approaches of commercial banks, central banks, companies, cryptography and communities.

This framework may have seemed to some readers a trifle speculative, to say the least. Yet Mark Carney, the BoE governor, recently gave a speech in the US at Jackson Hole, Wyoming, in which he said that a form of global digital currency could be "the answer to the destabilising dominance of the US dollar in today's global monetary system". The problem he is alluding to is the dollar's global electronic hegemony, which "made sense after the second world war", as *The Wall Street Journal* noted, because then US trade was 28 per cent of global exports. Now it is only 9 per cent, according to the IMF. Yet the dollar still dominates.

Carney went on to talk about the international monetary and financial system (IMFS) using some kind of "synthetic hegemonic currency"(SHC) instead. That is a big deal because it means that a proportion of the world's financial transactions stop being dollar denominated and the demand for dollars falls. As Robert Kaplan, president of the Dallas Federal Reserve, said recently: "The dollar may not be the world's reserve currency forever, and if that changes, and you tack on 100 basis points to $20tn, [that is] $200bn a year, and all of a sudden we've got a tremendous problem."

A globally acceptable SHC in the form of digital cash denominated in a synthetic unit of account sounds a little like Facebook's much-discussed Libra. While Libra dominates the headlines now, it will undoubtedly be only the first of many attempts to create a global digital currency. The historian Niall Ferguson stated plainly in *The Sunday Times* that "if America is smart, it will wake up and start competing for dominance in digital payments".

He is concerned about hegemony and argues that a good way for the US to rival Chinese initiatives such as Alibaba and Tencent is to support Libra, an argument repeated by David Marcus, the head of Libra. At present, Alipay and WeChat wallets store renminbi exchanged in and out of bank accounts but, as the People's Bank of China (PBoC) has made clear in recent pronouncements, these will soon store the "DC/EP" (digital currency and electronic payment) version – the Chinese digital currency.

> *"If America is smart, it will wake up and start competing for dominance in digital payments*

From a payments perspective alone, Libra seems a little underwhelming. I think that a frictionless Facebook payment system would be beneficial and I stand by that. As a community currency (in the "5Cs" categorisation), Libra means the ability to send money around on the internet. This would be useful to the Facebook, WhatsApp and Instagram crowds, and there are all sorts of new products and services that it might support. But a currency has more far-reaching implications. What if, for example, the inhabitants of some countries abandon their failing inflationary fiat currency and begin to use Libra instead, as some of them use the dollar now? The ability of central banks to manage the economy would then surely be subverted and this must have political implications.

It is not surprising then that both the international Financial Stability Board and the UK's Financial Conduct Authority have said they will not allow the world's largest social network to launch its planned digital currency without "close scrutiny".

It was noticeable, incidentally, that when the Libra Association launched in Geneva in October 2018 the membership did not include most of the payments organisations that had been identified in initial discussions, such as PayPal and Visa, but did include the organisations that are users of payments such as Uber and Spotify.

While Libra is still due to go live in 2020, many industry observers are already saying that it may never launch in its current form. Indeed, David Marcus, head of the Libra project, has said recently that they may not use SHCs at all but digital fiat currencies. So let us switch attention to what is, in my opinion, the most important current initiative in the world of digital fiat. The PBoC has been looking at digital currency strategy to replace cash for some years. Three years ago, the then-governor of the bank, Zhou Xiaochuan, clearly set out its thinking about digital currency saying that it should be issued by the *central bank*. He went on to state that he had "plans for how to gradually phase out paper money".

What would be the impact of phasing out paper money? Yao Qian, from the PBoC technology department, wrote on this subject in 2017 noting that digital currency would have consequences for commercial banks so that it might be better to keep those banks as part of the new monetary arrangement. He described what has been called the "two tier" approach, noting that to offset the shock to the current banking system imposed by an independent digital currency system, and to protect the investment made by commercial banks in infrastructure, it is possible to incorporate digital currency wallet attributes into the existing commercial bank account system "so that electronic currency and digital currency are managed under the same account".

A Chinese digital currency is a big, big deal. If the Alipay and WeChat wallets become widely used by a couple of billion people, starting with those along the "belt and road" trading corridors, they may well begin by using their own currencies but will pretty soon shift to the digital renminbi if it does indeed offer speed, convenience and person-to-person transfers. A trader in Africa may soon find it more than a little convenient to order goods from a Chinese partner via WeChat and settle instantly with their Chinese digital currency (or, to be fair, Libra or something similar) and then they will soon find themselves accepting the same in payment.

This is not necessarily a bad thing for some countries. In an interesting recent paper on this topic, Max Raskin, Fahad Saleh and David Yermack highlight "the potential for private digital currencies to improve welfare within an emerging market with a selfish government" (*How Do Private Digital Currencies Affect Government Policy*?, SSRN, August 2019). Along the belt and road trading corridors then, not only might digital currency be acceptable, it might be highly beneficial.

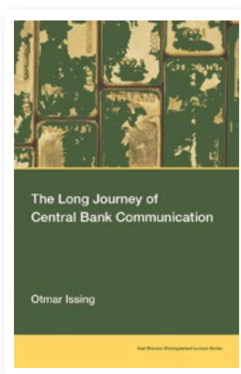
We could see a new Cold War, with Calibra, the digital wallet for Libra, facing off against Nick Ogden's RTGS global interbank liquidity network initiative, facing off against Alipay on the one hand but, more importantly, the renminbi facing off with the US dollar, facing off with "Facebucks" on the other hand.

It is a phoney war for now, with the next generation of digital currencies announced but not yet in situ. But make no mistake about it: there are important battles to come. Replacing the existing IMFS with one based on digital currency means no clearing and settlement, which means no transactions going through the international banking system, which means that the US's ability to deliver soft power through the IMFS disappears.

This means that the virtual money debate is no longer about hash functions but about hegemony. Whether you think it a good thing or not, the dollar's dominance gives the US the ability to use the international payments system as an arm of its foreign policy. This is an ability that other countries have found, as Ferguson put it, "increasingly irksome". Well, perhaps not for much longer. ■

***David G W Birch*** *is a director of the secure electronic transactions consultancy, Consult Hyperion, and a visiting lecturer at the University of Surrey. He is an internationally recognised thought leader in digital identity and digital money, one of* Wired *magazine's top 15 global sources of business information, and a CSFI research fellow*

# The transparent hand




**TITLE**
The Long Journey of Central Bank Communication

**AUTHOR**
Otmar Issing

**PUBLISHER**
MIT Press (£25)

This slim volume comes at just the right time. The temperature of the debate about the role of central banks in policy making, their degree of independence and their accountability is rising rapidly. Discussion about decision making and communication in a world of zero interest rates involves ever more convoluted analysis and prescription. Otmar Issing brings us back down to earth by effectively reminding us that monetary policy is not in essence very complicated. It is about changes in the central bank balance sheet, fixing short-term rates and influencing longer-term rates in a world of constant uncertainty.

He brings us a succinct and clear account of the story of central bank communication from the point of view of a former practitioner. It is difficult to avoid a suspicion that he feels that less might be more. He quotes Karl Brunner, the Swiss economist, as saying: "The political mystique of Central Banking…thrives on a pervasive impression that Central Banking is an esoteric art…confined to the initiated elite." Issing's lucid analysis seems to imply that central banking communication often serves to create complexity around matters that are relatively straightforward. He refers to "overambitious attempts to make central bank communication a kind of applied science based on formal models".

There is a clear explanation of the not always clear terminology in central bank communication and a useful annex listing all the many potential practical channels involved, plus an impressive array of sources. Issing discusses the difference between practice and theory and when and how communication can make a difference to the effectiveness of monetary policy. There are also sections on accountability and transparency.

The importance of segmenting your audience is discussed – are you addressing the man in the street or the academic or the trader? – as well as the consequent challenge of delivering consistency. The section on forward guidance is particularly helpful in distinguishing between pure qualitative guidance; qualitative guidance conditional on a narrative; calendar-based guidance; and outcome-based guidance that will see policy change based on numerical conditions.

The book is interesting on feedback loops and independence, such as when market "dissatisfaction can be expressed quickly and loudly and so may get inappropriate attention" and the central bank risks taking its orders from the bond traders rather than politicians.

What is perhaps a failing is that Issing deliberately confines himself to communication and monetary policy, clearly uneasy even when a central bank has a dual mandate. As a result, there is little discussion about the rather different communication challenge when there are responsibilities for both supervision and "financial stability". The case for entrusting central banks with supervision in part rests on the scope to take a more holistic view of the interface between the financial system and the economy. An analysis of the additional communication issues this raises could have been interesting.

> *As Alan Greenspan once said, it requires a great deal of effort to say nothing*

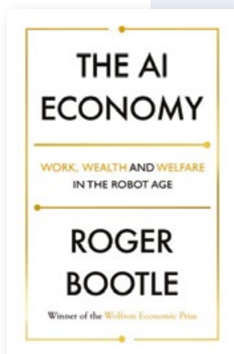
Avoiding giving an inadvertent signal is tricky. I recall Alan Greenspan, the former Fed chairman, in a private conversation describing how in a congressional hearing he suddenly heard all the chairs on the journalists' benches behind him tip over as they rushed out. He realised he had, without knowing it, said something that must have been thought to constitute breaking news.

It took five minutes to work out what might have generated this unwelcome result and another 10 minutes to find a way to work round to unsaying

what might have led to the misapprehension, even as he continued to give his testimony to the congressional hearing. As Greenspan said, it requires a great deal of effort to say nothing.

Fortunately, this volume says a great deal in a short space. Anyone reading it will feel much better equipped to understand when they really are being given a message by a central banker and they will be better able to translate what it might mean. ■

***David Green** – former Bank of England official and the co-author of* Banking on the Future: the fall and rise of central banking




**TITLE**
The AI Economy: work, wealth and welfare in the robot age

**AUTHOR**
Roger Bootle

**PUBLISHER**
Nicholas Brealey (£20.00)

Unless you are a technology geek, you may be either running scared about the onward march of artificial intelligence (AI) or taking cover to avoid the hype around it. Or simply be bored with the subject.

As I would tend to fall in the last two categories, it is with some relief that I discovered that this book is about economics, history and analysis of the human condition, not about technological details. Bootle's thesis is that, yes, advances in AI and robotics do represent a new industrial revolution, but it will play out much like the last one. Not only is this more convincing than the shroud-waving for human capability, but it also makes the issues amenable to conventional analysis.

Comparisons with the industrial revolution of the eighteenth and nineteenth centuries suggest that this latest push towards automating work will end up improving living standards and enabling humans to enjoy more leisure time. It also means that the spread of new software and machines will be a cold hard matter of capital investment, not some costless invasion from the ether. Indeed, it is the cost – in human supervision and constant technological upgrades – that might make driverless cars a damp squib, according to Bootle.

He is firmly in the camp that humans will remain able to do many things better than machines – at least for a very long time. At the banal end, this includes folding a towel; at the cognitive end, it involves dealing with uncertainty and the logically ambiguous. This is in addition to empathy and other human qualities that make us prefer to interact with, well, humans.

The key thing, as with previous technological advances, is to adapt: to be able to seize the opportunities when new jobs – such as providing personalised education over a lifetime, for instance – replace old ones, such as routine white-collar tasks. For it is on services that Bootle reckons this revolution will have the most profound impact.

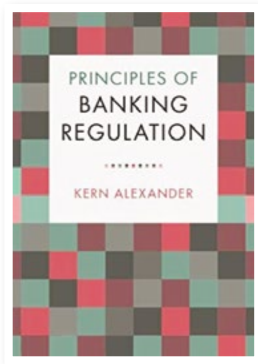
As in previous revolutions, the transition is likely to be tricky. Bootle's optimism sometimes glosses over the issue of those "left behind" – he is no hand-wringer about inequality. While he is sceptical about one suggested palliative, universal basic income, and tut-tuts over high executive pay, the bottom line is that redistribution of wealth is not beyond the wit of man.

> *The cost – in human supervision and upgrades – might make driverless cars a damp squib*

All of this is in the foreseeable future. He places the "singularity" – when artificial intelligence matches and can learn to surpass the human variety – in the epilogue, along with God, whom he does not much believe in either.

This book will probably annoy technophiles, not only because of its lack of technological detail but also because it is finely written by a polymath. It will be a long time before a computer can mesh the thoughts of Voltaire, Malthus, Keynes, Dawkins and Harari. ■

***Jane Fuller** – co-director of the CSFI*




**TITLE**
Principles of Banking Regulation

**AUTHOR**
Kern Alexander

**PUBLISHER**
CUP (£74)

Over the past decade, financial markets have faced a plethora of new regulations and enhanced regulation, together with fresh codes of practice and conduct, that affect banks and other financial institutions, particularly in the UK, US and EU. Such regulation strives to address weaknesses in market structures and practices, to plug regulatory gaps and to enhance regulation at micro- and macro-prudential levels – all to reduce risk at individual and systemic levels.

Anyone who wants to understand the rationale for the dramatic transformation in banking regulation since the financial crisis of 2007-08 can find succinct explanations in this ambitious book. Indeed, it is likely to become a bible for many students who want to learn about banking regulation.

Alexander estimates that there have been 14,000 new regulations since 2011, but the book goes further than just detailing and explaining the regulatory shifts. It helps the reader to appreciate why banking regulation has developed along different paths in different countries, by taking into consideration the patterns of power, rule of law and authority. The reader is initially provided with a snapshot of banking over the millennia. Alexander then drills down into the post-1970 period of greater and greater globalisation and financial innovation, deregulation and then re-regulation.

The book has been structured around models and theoretical underpinnings. That allows the reader to consider the rationale for regulation and why it has developed in various ways, with some economies being more capital markets driven while others have been more focused on universal bank lending.

Attention has been given to both ex-ante and ex-post crisis regulation and resolution. Alexander has considered the failures of Basel 2 and whether the steps subsequently taken to increase and improve the quality of capital, the introduction of liquidity requirements, the setting up of ring-fencing in the UK, the application of the Volcker rule in the US, greater international coordination to help identify contagion risks, etc will actually be sufficient. He also gives prominence to the intangible side of regulation concerning conduct, culture and the implications that it has for trust.

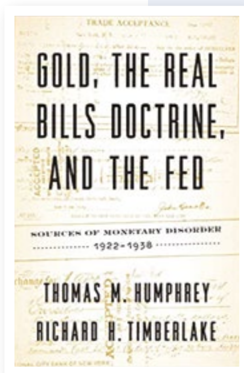
Alexander does still see gaps in the regulatory landscape, especially when it comes to the bigger picture of macro-prudential regulation. He considers that some changes have been too focused on micro-plus incremental steps rather than on the development of overarching tools that have been tested and where the benefits have been fully understood.

Alexander also considers how regulation will need to be mindful of innovation and change. Some of the later chapters are particularly relevant here, such as the growth of shadow banking sitting outside the scope of banking regulation; the increasing importance of financial technology innovations (fintech and regtech); and the newly hot topic of environmental sustainability.

> *The book could become a bible for students who want to learn about banking regulation*

The book provides a comprehensive coverage of modern-day banking regulation, is well grounded in theory and brings in interesting strands where regulation might need enhancing. It does not delve deeply enough to try to answer any questions about that enhancement. This is not a criticism. The book "does what it says on the tin": it provides the principles. For the more inquisitive reader, it also provides signposts for further research and reading. I would highly recommend it for anyone wanting to understand the principles of banking regulation. ■

***Simon Ling-Locke** – MBA, FCIB, senior lecturer at The London Institute of Banking & Finance*




**TITLE**
Gold, the Real Bills Doctrine and the Fed

**AUTHORS**
Thomas M Humphrey & Richard H Timberlake

**PUBLISHER**
Cato Institute (£19)

The Real Bills Doctrine sets out that the central bank should expand, or contract, the money supply in accordance with the volume of trade, as represented by the availability of real bills based on production and trade, as contrasted with finance, or speculative, bills taken out for the purpose of asset market activity. The central bank would do so by checking the quality of bills offered to it and only discounting the real, rather than the finance, bills. Monetarists, and those espousing the "quantity theory", such as this book's authors, have hated this doctrine. As they emphasise, it had a major flaw: whenever there was a demand shock, the amount of real bills would rise in line with it, or more so. In such circumstances, the doctrine accommodated, or even exaggerated, demand-side cyclicality.

But the authors so hate the doctrine that they ignore its various virtues. First, it did provide stabilisation in the face of supply shocks. Primarily agricultural societies, such as the US prior to 1914, had regular supply-side seasonal variations in the demand for credit, money and interest rates – with tightness at harvest and crop-moving time, and an easing during the slower-moving periods. The authors never mention such seasonal variations, which had several adverse effects, nor that the advent of the Federal Reserve, to provide an "elastic currency", got rid of them entirely.

The doctrine also provided a unified structure for thinking simultaneously about price and financial stability. Real bills would get automatically paid off from subsequent sales. As long as the central bank controlled the quality of bills discounted by it, it could simultaneously achieve both objectives. Nowadays, there have to be separate monetary and financial policy committees, with differing analytical and informational structures.

Again, before about the 1920s, government deficits usually only became significant during wartime. So central bankers had a big inducement only to provide finance in line with trade, rather than to buy war-related government paper. We tend to forget how the overall economic situation felt then.

Conventional wisdom, ever since Milton Friedman and Anna Schwartz's *Monetary History*, was that adherence to the Real Bills Doctrine, and reluctance to discount government paper, had been one of the main factors worsening the Great Depression of 1929-33. But Humphrey and Timberlake go much further. They argue that the Fed Board, and in particular Adolph Miller, were so opposed to speculative activities that they refused to discount even perfectly proper real bills for those banks that had seemed to have been involved in financing any speculative activity.

The authors say: "Since most banks could not get help from Fed banks after 1930, because of the quarantine on speculative 'credit', commercial banks were failing by the hundreds – and still with no gold standard." This is a strong statement and I would have liked to have seen much more micro-evidence that such "direct pressure" prevented banks with eligible real bills from accessing support from the Fed.

As the preceding quote suggests, the authors hanker after the gold standard, as a quasi-automatic, market-based mechanism. In particular, the procyclical response of the Real Bills Doctrine to a demand shock is strongly mitigated under an effective gold standard. So, the authors claim that it was the combination of that doctrine, plus the absence of a properly working gold standard, that did the damage. Nevertheless, their concentration on the discounting policy of the Fed means that they, in my view, underestimate the adverse effect of the collapsing international finance and trading system. Therefore, for example, there is no mention of the 1930 Smoot-Hawley Tariff Act that raised duties to protect US farmers and businesses, putting further strain on the international economic climate.

To summarise: the authors are strongly opinionated and, although one-sided, their opinions are basically correct. ■

***Charles Goodhart*** *– emeritus professor of banking and finance at the London School of Economics*

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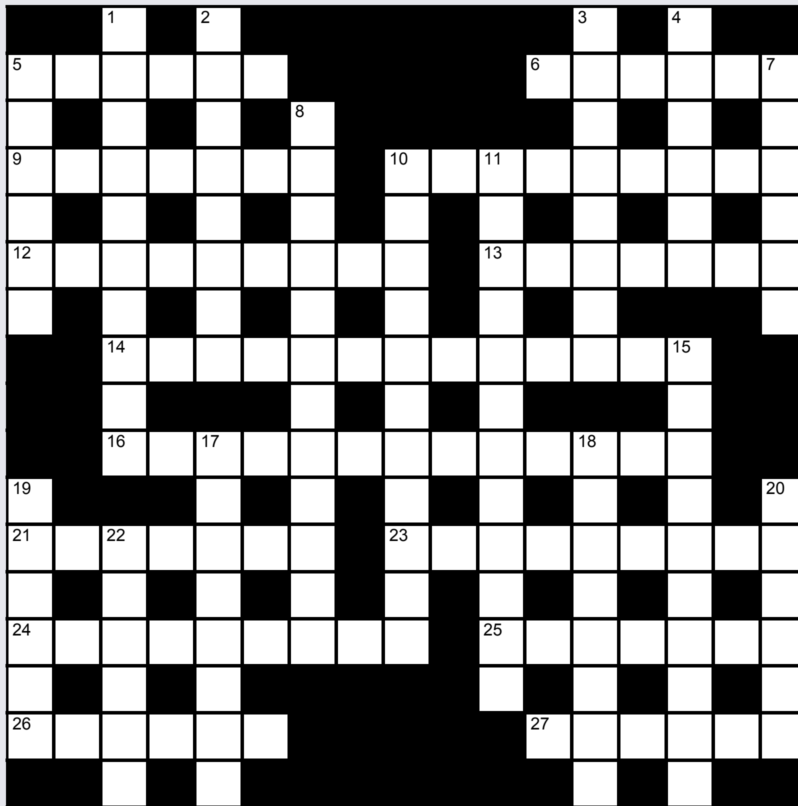
# The FW crossword No. 77, set by Falcon



***Send solutions by 3 January to: FW Crossword, First Floor, 73 Leadenhall Market, London EC3V 1LT.***

***First correct entry wins a bottle of champagne.***

## ACROSS

5 Departs after famous English captain tied up vessel (6)

6 Gold discovered in extensive marsh (6)

9 National emblem shown in the list wrongly (7)

10 The very same dialect in broadcast (9)

12 I hunt down criminal in murder mystery (9)

13 Rough terrain for a coach (7)

14/16 Anxiously silencing us all, Ivy overheard an optimistic remark (5,5,3,1,6,6)

21 Posh wearing suit where lots go (7)

23 See man in charge bagging runs (9)

24 Unwell, a guy is uncomfortable (3,2,4)

25 Do like friend entertaining Italian on island (7)

26 Bringer of bad luck in gangster circles (6)

27 The old lady and I study horse that's never won (6)

## DOWN

1 Company and I compare changes in The Mikado, for example (5,5)

2 What convalescent home offers others accompanying parish priest in France? (4,4)

3 Way to pay for course (8)

4 Bird's loud – a large rook (6)

5 Record label millions love, Tamla's first to admit (6)

7 Humid and oppressive in South, truly bad (6)

8 Pa's name protected by writer, a name concealed by Plath? (12)

10 At rebellion abroad, beyond the pale (11)

11 Keen? The Tuscan is, I suspect (12)

15 The old man who bestows gifts as a sweetener? (5,5)

17 TV showing fool fight (5,3)

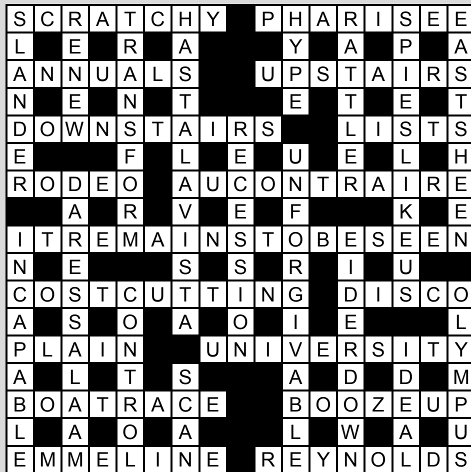
18 Wryly amusing, coming from golf club I visit endlessly (8)

19 Drive away one's husband following disqualification (6)

20 Show shield (6)

22 Green, everything eaten by female elephant (6)

## Solution to FW crossword No. 76 set by Falcon



**Across:** 1 Scratchy, 5 Pharisee, 10 Annuals, 11/12 Upstairs Downstairs, 14 Lists, 16 Rodeo, 18 Au contraire, 19 It remains to be seen, 21 Cost-cutting, 23 Disco, 25 Plain, 26/29 University Boat Race, 30 Booze-up, 31 Emmeline, 32 Reynolds.

Down: 1 Slander, 2 Renew, 3 Transform, 4 Hasta la vista, 6 Hype, 7 Rattler, 8 Spies Like Us, 9 East Sheen, 13 Recession, 15 Unforgivable, 17 Dar es Salaam, 19 Incapable, 20 Eiderdown, 22 Control, 24 Olympus, 27 Ideal, 28 Scan.

Congratulations go to Martin North of Nuneaton, the winner of the October/November crossword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## In our next issue...

The next edition of *Financial World* will mark the end of our 140th year with a wide range of topics. They include a close look at some of the most pressing issues around financial sustainability, including the drive to define what 'sustainable investing' actually is; an analysis of whether there are sufficient green assets to really move the needle given that EU alone needs additional sustainable investment of c. €270bn a year to meet the UN's 2030 objectives; and how banking and regulation will intersect on sustainability.

In fintech, we will have an overview of the pros and cons of using AI to assess credit risk; put the spotlight on the business model of Ripple, which is active in FX; find out what is happening in facial recognition technology; and ask whether payments made via mobile phone bills could get traction. We will also find out whether responsibility for IT failures could become part of the senior manager's regime.

Given that much of the developed world faces ongoing ultra-low interest rates, we will consider how low yields affect pension funding. Low interest rates also have very real consequences for the mortgage market. What, for example, does the current price war mean for the mutual building societies? And what about people who seek financial advice in a confusing world? We ask some psychologists to explain what some of the underlying needs are.


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*Banking on Change* is published by Wiley. All the proceeds to the Institute will be put towards our 140th anniversary appeal.

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