

CFA UK Annual Dinner
Roger Urwin Keynote Address
14 October 2014

Ladies and gentlemen. Distinguished guests. My theme tonight looks in on the central issue of investing as a profession and develops how the CFA Institute and the CFA Society of the UK can and will play key roles in its sustainable future.

1. Investment professionals

It was Sir Francis Bacon – a City man - in the 17th century, who said that every man is a debtor to his profession and spelled out the two ways to repay the debt: through ethical and effective professional practice and develop the art and science which provide the foundations of the profession.

These principles were enacted in the CFA Institute's strategic opus from 2012 with broader mission, bolder voice and bigger community ambitions writ large and with the Future of Finance perfectly shaped to develop that art and science of understanding the investing challenge – more on that later

The distinguishing mark of a profession from other respectable occupations is that it involves adherence to standards of conduct which cannot necessarily be enforced by law or markets. Membership of a profession entails privileges. The conferring of privilege and the acceptance of responsibility are two sides of the one coin. As Dwight Eisenhower said "A people that values its privileges above its principles soon loses both."

Of course, human nature being what it is, not all members of professions live up to these ideals. This is conspicuously true of finance. The problem is age-old, Francis Bacon himself was shamed in a pay to play scandal, there have been continuing drip drip of bad unethical practice in our industry in 2014.

There is a trend issue to deal with on two counts here. The first is that the priority setting principle - ultimate client first – employer second – self third – that troika – the professional sees their priorities strictly in that order – is under pressure. By the way, the UK Society's excellent publication on fiduciary duty is one of a number of strong thought leadership examples they have delivered.

But the trend I see has been a self-centring trend of many asset management firms over the last 20 years which have involved a rise in commercial self-interest over professional interest as evidenced by declines in client trust and a lot of sub-standard outcomes.

There is also the time compression trend in which shorter pressure on financial performance has been at the expense of longer term value adding actions. Significant value adding activities often have lags and uncertainty in their pay-offs, both of which are all too easily discounted in a quarterly capitalism world. The short-termism human gene, described by Andy Haldane at the Bank of England, is pervasive and insidious. It carries a toxic impact in politics. It does so in both the practice and business of investing.

If we allow these two trends to continue we are in trouble. I am convinced that if we abandon the idea of our profession, and accept that pursuit of fundamentalism in markets is our North Star the public and our investment professionals will have lost something of substantial value.

Better to light a candle, than curse in the dark, we should not overlook the successes, often unpublicised, that are achieved, and the good work that is done, day by day, by women and men honourably pursuing their professional practice- many instances in this room who do so as volunteers, I feel very cheered up to be in your presence.

2. The CFA

I have had a six year journey on the CFA Board - a long and winding, cultured and classy journey. Dan Pink in Drive describes three motivational forces driving our most ambitious work in autonomy, mastery and purpose. I think the list is a good one but incomplete, leaving unsaid the motivations that come from having great colleagues.

The CFA Board delivered me good measures of all these four values. It has been one of the most rewarding segments of my career.

Organisations like the CFA – Institute and UK Society - must build change readiness such that change on the outside, fast as we know, is consonant with change on the inside. I do look back at a number of strategic change accomplishments initiated by a highly strategic talented Board that I'm proud to have played a part in.

The two big contributors to that progress were culture and process.

The CFA culture is core strength and is deeply defined and driven by the power of collaboration it unleashes through its value system and sense of purpose.

The strategy process at the CFAI was built on revisiting first principles in a mission, vision, values and beliefs narrative. All soft factors explored in a long socialising process in the context of the new landscape that was emerging post GFC. The Board saw ahead the onset of massive inter-connectedness and globalisation, you could put the word complexity against that; and the significance of changing geo-political dynamic with multi polar politics, and represented these as unleashing a tsunami of good and bad new things.

While in my view finance can aspire to be even more of a force for good it now has three deep flaws lurking: systemic risk, agency capture; and non-inclusiveness – is it really finance for the few; or the many or the all.

As the most critical guardian of the practice and profession of investing, The Board decided to mount some defences to these traps – this line of defence was the Future of Finance initiative.

My first Board year contained the GFC - the first great inter-connected tightly coupled cascade crisis of the 21st century. We could well encounter a number more unless we can put finance into a more adaptable, resilient and inclusive form. In short one that serves society nobly, not the term I would use for it at present.

I have high hopes for the Future of Finance becoming a thought leadership tour de force. "The significant problems we face cannot be solved at the same level of thinking we were at when we created them." Let's go figure.

3. The Future

That takes me to some commentary on the future. For this adaptable, resilient and inclusive form of capitalism and its analogue in an investment profession that transports savings affordably, securely, fairly into better lives we need some change

I see three legs to the sustainable future of investing: the rise of universal owners, powerful new forces driving our effectiveness, soft forces; and the rise of the professional focused firm – the asset management firm of the future that is more sustainable than its fore-runners.

First we need to move on from the dominant place of the agency financial capitalists whose purpose is too self-centred to be legitimate to the fiduciary capitalists whose purpose is to transport savings across time, in bulk – affordably, securely, fairly.

This describes 'universal owners' whose reach is very long term; who are very large – large enough that their actions influence markets and companies; and who recognise that through their portfolios they own and will always own a slice of the whole economy and adapt their actions to try to help the whole economy/ market to a more prosperous and sustainable future.

Universal owners have a long-term wealth creation not zero-sum alpha chasing mentality.

CalPERS has an interesting roadmap for this shift from a zero-sum culture to a fiduciary culture. It begins again with strong mission, vision and beliefs narrative - the clear statement of principles that apply throughout an organization. The CalPERS investment beliefs have the purpose: "to provide a basis for strategic management of the investment portfolio, inform organizational priorities, and ensure alignment between the Board and CalPERS staff and wider stakeholders."

There is profound understanding of the relationship between the generation of wealth, sound institutions, and a sustainable environment captured in the belief "a long time investment horizon is a responsibility and an advantage." And that segues to good strategy and my favourite mantra, performance with purpose.

Investment has to increasingly take on and master softer less measurable factors. Not everything that counts can be counted. This is why the finance world must be described in ecosystem terms – with its multiple strands and interdependencies.

The first of our softies - are the extra financial factors lurking in the sustainability challenge.

Investors have choices. An investor can simply do the short-term pay-off maths in their decision – next quarter, next year whatever - I'll call that Plan A.

Or investors can do this allowing for the idea that the future won't be the same as the present and so do your strategy in the present and allowing for changes – new operating conditions, new prices, new reflexive responses – and allowing for these future changes to adapt your strategy. Plan B.

But Plan B is increasingly critical because of the changes we face in sustainable growth; resource scarcity particularly the water food energy nexus, overlapping with climate change; and that other resource mega challenge, demography and aging in the West.

So to invest as though these can be confronted tomorrow and not get into today's strategy – plan A thinking – can't make sense. And yet most people do it – either they don't get it (it's hard); don't have time for it (busy agenda); can't measure it (and nothing that can't be measured gets respect). Now that can change and I think it will. The charter holder of the future will be a class sustainability player.

The other great softie here is the entry of culture. It's clear it's mission critical in the investment world. We have culture and risk as a new pairing. Richard referred to the "culture and conflicts" conference theme and the desire of regulators to regulate on the basis of culture.

There is no single best practice for culture. It's soft. Excellent culture can take different forms but its complex DNA generally groups into a number of factors that make up the *culture signature*: four biggies here:

- purpose and drive – this is often highly reflective of ownership and incentive structure – its client-centricity versus self-centricity factor is critical
- people ethos – where respecting personal development wishes, encouraging maximum creativity and facilitating collaboration opportunities are critical
- integrity – where innate respect, openness, support for diversity and ethical orientation should all be present
- long-termism and sustainability – where preparedness to forgo current gains for better future outcomes well down the track is critical

Surely we should be encouraging greater attention to culture as a key performance indicator and studying ways for culture to be developed. Culture is the binding agent by which the soft power of individual motivation is channelled – think autonomy, mastery, purpose, colleagues again.

My particular focus is on incentives – intrinsic and extrinsic. *People respond to incentives, the rest is commentary* - someone's one line economics definition.

We need better cultures in our industry. We need our incentives to nurture that culture.

This culture takes me to ***the professionally focused firm***. In brief, and I hope for a lot of further discussion on this there is a huge business and professional opportunity for firms in our industry that reflect much more deeply on doing these things better and are able to turn those reflections into practice:

- a deeply felt culture signature, sustainable, with a deeply empathetic client value proposition, and integrated with the employee value proposition including comp
- a model of how they can compete successfully based on self-awareness and comparative advantage, based on good strategy, hope is not a strategy
- investment design informed from a new finance framework, much of our finance theory is deeply outmoded
- their contribution to client value add through understanding of the value chain (the 'value chain' – the system by which the multiple agents contributions to asset owner value are configured) – there should be is no point in having products that don't stand a realistic chance of crossing the gain line – here's the rub, irrespective of whether you are currently making money from them
- and last not least adherence to ethical and excellence practice as captured I would suggest in the CFA Asset Manager Code.

Prescribing a better future is not easy. The CFA in Future of Finance is combining a let 100 flowers bloom approach with some landscape design. I ask of you do one of two things; watch this Future of Finance space; or engage in it. Better still do both.

You should need no reminder that finance, suitably configured, is an immense force for promoting the well-being and fulfilment of the good society. We have the necessary technology part of the process – training, methods and tools. We now need the human bits: courage/leadership; some imagination/vision and some long term organisational culture.

Thank you.