Instilling greater professionalism and ethics in advice

Paul Smith of CFA Institute believes that an ethical cleansing of the asset and wealth management industries is essential – especially as technology-enabled, self-service investing makes it more important for professionals to be able to prove their worth.

It should be incumbent on any professional to sell a service rather than a product. Yet the main frustrations many observers have with the investment and wealth management industries come down to the product-pushing mentality that breeds conflicts of interest – not least as a result of fees being embedded in the product rather than the service.

As a result, front-line practitioners need to remodel the way they operate.

"Whether they can do that is the US$64,000 question," says Paul Smith, president and chief executive officer of CFA Institute. "I can't see how they can because it goes back to the fact that they are generally poorly trained."

PAUL SMITH, CFA
CFA Institute

"The challenge largely stems from the fact that both... industries have been victims of their own successes."

Technology is driving an important change by taking the fees out of products. Through robo-investing or allocating more money to passive instruments, institutions on both the buy and sell sides make much less money from individual products.

"The challenge," he adds, "largely stems from the fact that both the wealth and asset management industries have been victims of their own successes."

In the last 20 years or so, they have become sexier and more rewarding than many other industries and have attracted some people who ultimately care more about themselves than the needs of their clients.

This is unsustainable, he explains. "These practitioners do a job that society needs, so if they can't be trusted to do it the way it should be done, then the regulators will step in."

BRIDGING THE SKILLS GAP

Moving to a service model requires more than just a mind-set shift. To do it successfully and create a sustainable wealth or investment management business requires highly-qualified and well-trained staff who behave in a professional way.

This is more than Smith talking his own book. While a CFA charter is a logical starting point to get a relevant qualification, institutions must first allocate the proper time and resources to a combination of technology and staff training.

he adds, by overlooking the core skill-set required – trying to advise from the perspective of the client.

Practitioners should think about it like this: their relationship with a client is not about maximising their own profit; it should be about maximising their service to the client and the profit comes later as a consequence.

"Essentially, what the investment and wealth professional has done very badly is selling that idea," says Smith.

Using an analogy of visiting a doctor, he says that although many patients know in the back of their mind that the doctor might be recommending a certain drug based on financial incentives, patients want to believe that the

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"They need fewer numbers of high-value people, working with good technology, to run client relationships, because margins are wafer thin," he says.

Ultimately, being relevant is the key to achieving this. "People need to keep themselves continuously educated," urges Smith. "The mistake many people make in life is resting on their laurels and not pushing themselves to learn new things and stay abreast of what's going on in the market."

The wealth and asset management professions have largely gone wrong,

treatment is given with their best interests at heart. By contrast, the challenge Smith sees for the investment or wealth management professions is that it is not the way the end-clients enter into a conversation about products.

A CLEAR MANTRA

Smith is well-placed to judge the scope and implications of the wrong approach. In leading CFA Institute globally since January 2015, he now spends around 40% of his time in Asia, 40% in North America, and the rest in Europe. This involves promoting high standards of education, ethics, and professional excellence among 127,000 members of the investment profession worldwide, who work in 31,000 firms.

By taking a clear stance on key topics that will influence the future of the

Making the investment management industry more sustainable

One of Paul Smith's key goals as the leader of CFA Institute is encouraging the investment industry to adopt more sustainable business models by proving to 'Main Street' the value that it can bring.

There are two levels to this, he explains. Firstly, from a societal perspective, the industry needs to address the broader danger of getting such a bad name that growth is impaired and capital re-allocated. "Especially for investors who live in the developing world, the absence of a functioning financial services industry is a terrible thing," explains Smith. "We have to start from a better understanding of the role of finance and investment in the development of the global economy."

Secondly, on an individual level, the focus needs to be on helping investors determine the fair fees for services provided, and what they actually require. "The debate here should be much more about how to embrace technology and innovation, and turn this to the industry's advantage by proving its skills in providing financial and investment strategies, whether at an institutional or private client level."

investment management industry, Smith is very conscious that he is carving a path he wants CFA Institute as a whole to go down.

He wants more for the organisation than just being perceived as a provider of exams. "We wish to be known as the professional body to the investment management industry. That is our mission and we are striving for it."

His goal is for CFA Institute to be responsible for investors as well as industry practitioners, driving positive change for society at large.

"My role, and the job of CFA Institute more broadly, is to help engage the debate," explains Smith. "It is very hard for a publicly-owned asset management company to stand up and say certain things. As a result, the gap between public and private conversations in this profession is far too wide today."

PROVING THEIR WORTH

One of the biggest challenges for asset and wealth management firms today is proving and differentiating their individual value propositions.

This is partly because of the many years it generally takes over the investment lifecycle to show the outcome of the advice and strategies given. The temptation that some clients have, therefore, is to do the equivalent of self-medicating. And technology will make that even easier – based on suggested asset and portfolio allocations to meet automated financial plans.

"Financial advisers are going to have a much harder job to prove how they are adding value for their clients," says Smith. "Unfortunately I can't see a way out of that, because if 90% of the heavy-lifting is being done for them by technology, how much can they charge for what they are doing for the client?"

This comes back to his key point about them striving to work and act as a professional. And ethics will form an important part of this, given the need for trust in the client relationship.

In Smith's view, this will inevitably lead to far-reaching consolidation within asset management in particular, especially those firms involved in manufacturing products. But even where passive investing plays a more important role within a portfolio, Smith doesn't discount the need for advice. "It means clients need a CFA charterholder to do different things for them. For instance, which passive investment they should buy, which asset class they need to be in, how long they should own it for, and how that changes through their lives."

TRYING TO TEACH ETHICS

Regulators have become more prescriptive in a bid to do more to further professionalise the wealth and asset management industries. Certainly in more developed markets such as Hong Kong and Singapore, mandatory training on "ethics" is now the norm.

Although a good starting point, this only goes some of the way to address the issue. What is not completely clear, is what needs to be done to ensure practitioners fully understand what being ethical in practice really means and what they need to do to achieve that. "Can you change someone who is in their 20s?" he asks.

As a result, Smith throws the responsibility back into the court of the senior management of each organisation.

"It is the culture at the top that sets the expected behaviour more than anything else," he says, "and this is what we should be striving for as a framework."

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Moreover, discussions about ethics cannot be disconnected from the role they play as part of building a sustainable business model.

"We have to put those two pieces back together," proposes Smith.

"In the future, if firms don't run a business that places clients' interests at heart and don't prescribe the behaviours of their staff and compensation philosophy, they are unlikely to succeed."

This means it must be less about trying to increase the percentage of honest people working within the organisation; most important is implementing policies that reward the behaviours of the most honest people. ■