



FUTURE STATE OF THE INVESTMENT PROFESSION

PURSuing BETTER OUTCOMES—FOR THE END INVESTOR, THE INDUSTRY, AND SOCIETY

Benefits to Society



ENVISIONING THE INDUSTRY OF THE FUTURE

The actual impact of disruptive forces facing the investment management industry as described thus far in this report is inherently uncertain. It will, after all, reflect the changes made by the industry itself. In addition to the strategies and tactics put in place to best position firms and individuals to take advantage of most likely potential future states, there are changes that might be made to benefit society's wealth and well-being.

A commitment to enlightened self-interest is one direction of travel to consider. This philosophy demonstrates that under certain conditions, persons who act to further the interests of others will ultimately serve their own interests. Advocates of enlightened self-interest believe

Key Takeaways

- In return for living up to society's expectations, investment institutions receive from society a license to operate—a tacit approval to exist and function. But it can be revoked, and investment organizations must act responsibly and professionally to avoid that happening.
- We have outlined four possible future states of the investment management industry, with a mix of benefits accruing to the industry and/or to society. The highest aspiration of these scenarios is to become more professional, with significant benefits to both the industry and society.
- We suggest that trust and value in the investment industry are inextricably linked, and we describe a model for trust and value, bringing together credibility and professionalism.
- We provide further practical suggestions for building organizational trust, combining transparency, realistic measures, united values, sustainable and fair rewards, and time-tested relationships.
- There is a role for industry associations, such as CFA Institute, to help build professionalism within firms and with individuals.
- We promote the development of a road map by which the industry can navigate itself toward higher standards of professionalism.

that companies will increase in value if they identify and respond to the needs of society. The following discussion reflects a vision of how enlightened self-interest on the part of the investment industry could benefit society more broadly as well as investment industry participants. It reflects the potential of the industry to serve its clients better and at the same time provide more significant and evident benefits to society. As more of an aspiration, the direction of travel we describe in a more purpose-driven industry might set the stage for an evolution in the investment management industry to reach the potential to operate with the status of a *profession* with the attendant obligations (and benefits) that such a status confers.

This distinction is important. There are many industries; the MSCI and Standard & Poor's Global Industry Classification Standard (GICS) identifies 157 sub-industries, one of which is asset management within the capital markets industry. But professions are a rarer breed and are characterized by

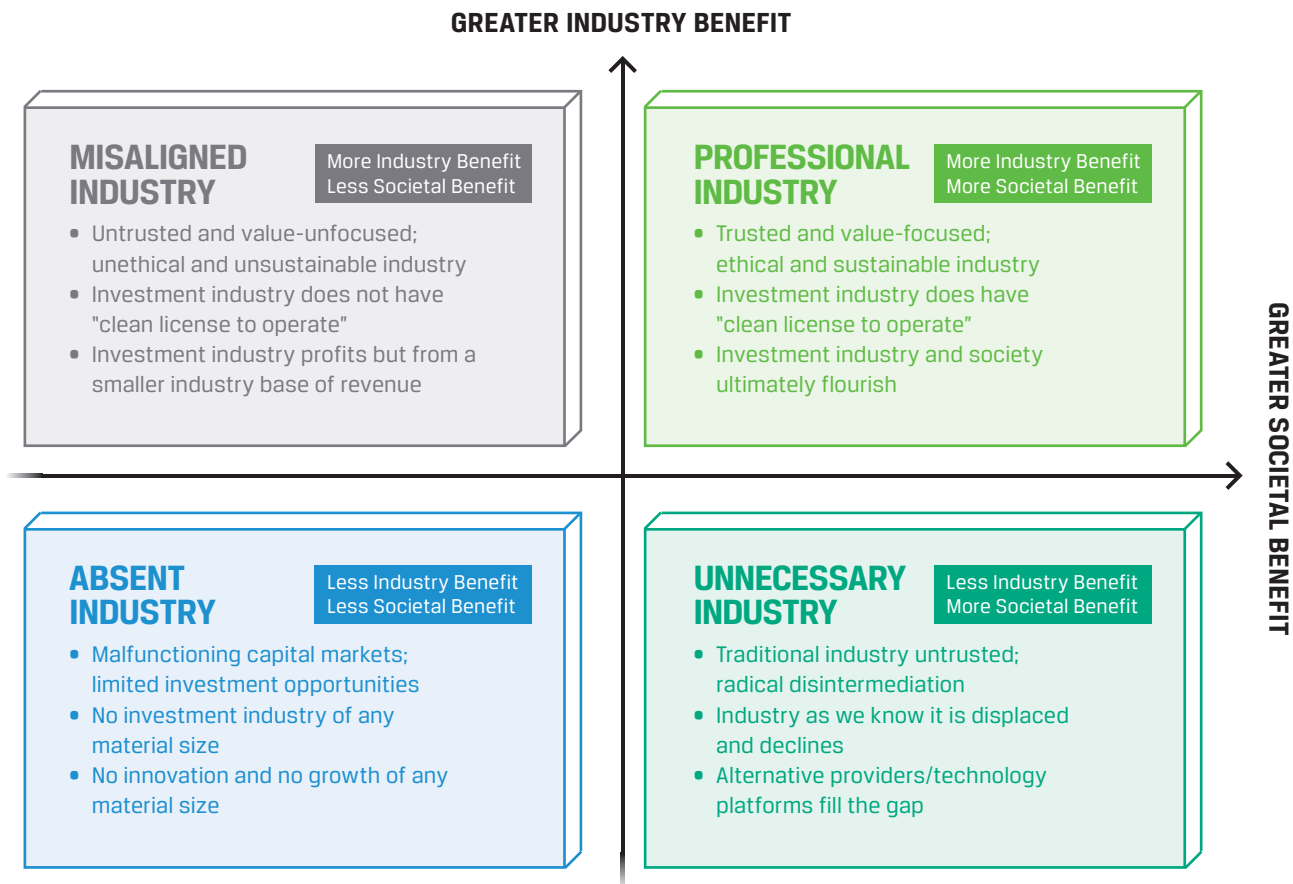
- a common body of knowledge that is widely accepted;
- certification that individuals possess such knowledge before practicing;
- a code of ethics and code of professional practice, with compliance monitoring;
- a code of discipline with sanctions;
- a requirement for its professionals to be subject to continuing professional development; and
- a commitment to use knowledge for the public good.

It can be argued that investment management has some of these components, particularly the first four, which are provided by CFA Institute, but it lacks the last two components. The development of the CFA designation, in fact, was prompted by Benjamin Graham in 1945 when he advocated for such a program, writing in the new *Analysts Journal*: "The crux of the question is whether security analysis as a calling has enough of the professional attribute to justify the requirement that its practitioners present to the public evidence of fitness for their work."¹

Here, we are putting forward versions of the future under business-as-usual (assuming some continuity in industry behaviors and conditions) and business-beyond-usual (assuming some interventions and changes of behavior to create better conditions).

There are two fundamental questions about the business-beyond-usual picture. Is it a vision that those in the investment industry will embrace? And exactly what actions and effort will produce such a transformational change? On the first point, the data are encouraging. Our survey asked three related questions about how the investment industry benefits society:

FOUR STATES FOR THE RELATIONSHIP BETWEEN INVESTMENT MANAGEMENT AND SOCIETY



- When asked to evaluate the *current* impact of the investment industry on society, just 11% of senior level investment professionals think the impact is very positive.
- When asked to evaluate the *potential* future impact of the investment industry on society, only a few more (14%) expect it to become much more positive.
- Finally, when asked to evaluate the potential impact of investment management on society *contingent on incorporating higher principles*, 51% of senior level investment professionals think it can be very positive.

On this last point, it is worth noting that CFA Institute members were more optimistic than non-members, with 94% of CFA Institute members saying the impact could become somewhat or very positive, versus 84% for other respondents. And, perhaps indicating that the professional ethos of the industry may have slipped over time but could be recovered, the longer the respondent's tenure in the industry, the more positive he or she was on this point.

A New Model: Benefits to Society and the Industry

Recognizing the backdrop of the scenarios and megatrends described in the "Investment Industry Ecosystem" chapter, we offer a model for a healthy investment industry by looking at the potential outcomes from the interaction of differing levels of the industry versus societal benefit.

The diagram above is fairly simple, and in reality, the industry should be segmented by country and investor type to provide meaningful labeling. In practice, we believe the investment management industry in most countries, and in most capital markets and segments, is in an area more than halfway up the vertical and somewhere toward the center in the horizontal. There is, however, the potential to go in any direction from here.

What are the distinguishing characteristics of each quadrant?

The Absent Industry

In this quadrant, without access to any healthy capital markets, there is an absence of both an investment industry and the innovations that produce growth. The absent industry describes an environment where there is little societal, investor, or industry benefit being produced.

This set of circumstances most closely maps to the preindustrial world, although some emerging economies have until recently had elements of this picture. It would be hard to point to any place currently where there is an absolute absence of financial or investing activity. However, there are places where there is significant dysfunction in the markets that impedes the development and utility of both the industry and the societal benefit. These represent situations in which the negative effects and externalities resulting from the lack of a functioning market are evident, reinforcing the point that the industry serves a vital role in a healthy economy and society.

There is one other dimension in this set of circumstances: The absent industry could also describe the results of an extended Lower for Longer scenario, which was presented in the "Investment Industry Ecosystem" chapter. Continued periods of very low returns, which cannot support the weight of fees, may significantly reduce the utility of investment activity for both the industry and society. This situation could prompt some investors to simply disengage from the capital markets altogether and pursue alternative ways to create income or utilize capital. There is a thought experiment that if the return from a sensible amount of long-term risk for a pension saver produces a negative real return after costs, the rationale for pre-funding pension liabilities is brought into question.

Turning this issue around, the virtuous association between pension funds and the deepening of an economy's markets, which shows up in positive growth, cannot be expected to be as positive in an era of financial repression in which returns to savers are held below "fair" levels.

The Unnecessary Industry

In this set of circumstances, there is diminished value, perceived or real, in engaging with established investment organizations (what we might term the "industry as we know it") because they have been made irrelevant by new firms and solutions. In this model, the new challengers are able to win the majority of investment activities and to provide the promise of significant financial and social returns through the substitution of alternative solutions.

This situation presents a potential disengagement from traditional investment organizations, with the disintermediation carried out by new types of firms that deliver the new required services. Basically, new entrants provide substitutes in terms of investment methods and solutions and disrupt the ecosystem. Traditional financial institutions cease to be seen as necessary or relevant. This situation, and its potential impact, are mentioned in the Fintech Disruption scenario presented in the "Investment Industry Ecosystem" chapter.

In this quadrant, we see organizations with excellence in digitization and digitalization applying formula-driven investment practices to produce attractive investor experiences and outcomes. The following are some examples:

- Using an investment model that incorporates crowdfunding, the Chinese saving and investing platform Yu'e Bao (a subsidiary of Alibaba, a new-style internet retail platform) is disrupting traditional bank savings, and consequently, potential state-supported investments, by offering a much higher rate on deposits than competing banks.
- Robo-advice firms, such as the US firm Betterment and the UK firm Nutmeg, have business models markedly different from traditional firms. Their way of working is fundamentally different from traditional investment firms, their vehicle of choice is significant portfolio allocations to passive strategies and exchange-traded funds, and their ability to provide a credible and reliable substitute service to tech-savvy Millennials provides perceived better experiences at a lower cost.

Currently, asset management is ripe for disintermediation by the Millennial generation because, as CFA Institute CEO Paul Smith, CFA, believes, "The investment profession has a robust and compelling proposition to offer these younger investors, yet it often fails to articulate it."² At present, there may well be an appeal gap between the technological solutions (personalized, simple, and speedy) and the ponderous style of more traditional investment services.

Wealthfront, an online investment service, estimates that Millennials will control more than \$7 trillion by 2019. Disintermediation is also possible because investors look for people they know when they select financial service firms, but fewer Millennials are choosing investment management as a career. In 2015, 36,000 US-based adviser trainees entered the industry—but nearly 30,000 who entered as trainees over the preceding five years opted out of the industry.³

The traditional segments of the investment industry also face leakage to substitute or nontraditional methods of financing. The three-year average growth rate of the European alternative finance market, which includes crowdfunding and peer-to-peer activities, is 115%.⁴ Since the global financial crisis, unregulated shadow banks, or nonbanks, have been providing liquidity while the increased regulation and balance sheet issues have required conventional banks to curtail lending. The Chinese shadow banking sector grew at an average annual rate of 35% from the beginning of 2010 through the end of 2012, attaining an equivalent of 50% of the total bank loans and 70% of China's GDP.⁵

Based on data from the Financial Stability Board, the total assets of nonbank financial intermediaries as of the end of 2013 equaled \$75 trillion, or approximately 120% of global GDP and approximately 56% of total bank assets.⁶

In summary, in the Unnecessary Industry, there are several ways that traditional investment practices can be made irrelevant.

The Misaligned Industry

Many view the investment industry this way: too much self-enrichment and not enough societal benefit.

Within traditional capitalism, there is a figurative accord between institutions and society; a social contract that is guided by the public's expectation of an institution's role in society. In return for living up to society's expectations, institutions receive from society a license to operate—a tacit approval to exist and continue their work. In the common parlance, the license needs to be "clean," and each scandal tarnishes it to a degree.

University of Chicago Professor Luigi Zingales summarizes it this way: "The positive role that finance can play in society is very much dependent on the public perception of the industry. Without public support, the best form of finance—the competitive, democratic, and inclusive finance—cannot operate."⁷ The financial ecosystem and its institutions cannot be expected to endure unchanged if they continuously face significant public opposition. As resentment increases, investors will begin to disengage from the capital markets or shift to alternative services or approaches they trust and believe will still help them reach their financial goals. This disengagement is a consequence in the Parallel Worlds scenario, presented in the "Investment Industry Ecosystem" chapter, in which we see some segments of society already rejecting the investment industry's license to operate. The investment industry has had natural associations with the elite segment of society—after all, money management requires money—and all elites have generated considerable discontent among the younger segments and particularly in class segments. Whether this discontent grows or not will be affected by the actions of the industry going forward.

There are a multitude of reasons for the strained relationship between finance and society. The nearly continuous media coverage of regulatory fines and misdeeds of the participants in finance (banks being principal among them) reminds the public of the break in trust that can occur, and forms the basis for perfect Hollywood villains. The private and often guarded nature of financial firms adds an element of mystery and suspicion, especially when approximately 15% of the *Forbes* list of billionaires are from the financial industry.⁸

In large part, the investment industry can be seen as being faint-hearted in its communication of and even its commitment to the purpose of linking end investors and savers to opportunities. The industry loses some credibility when the system does not function as intended and does not do enough to support jobs, growth, and well-being.

We see a number of examples that provide evidence of this situation today. There are limited capital allocation opportunities in the primary listed market because corporations now rarely use it as a means to secure capital. The IPO market, initially used to attract capital for growth and expansion, is now the preferred exit strategy of entrepreneurs looking to settle terms with venture capitalists and maximize the value of their ownership shares. Many corporations also seem to lack innovative strategies to create wealth, and they

have fewer opportunities to utilize their least expensive source of capital: internally generated funds. Some have begun multiyear share buyback programs or increased dividends to put cash back into the pockets of shareholders, sparking criticism by investment industry leaders who see this move as being contrary to long-term value creation. In 2016, BlackRock CEO Larry Fink wrote in a letter to corporate CEOs, "We certainly support returning excess cash to shareholders, but not at the expense of value-creating investment. We continue to urge companies to adopt balanced capital plans, appropriate for their respective industries, that support strategies for long-term growth."⁹

We can expect that unlisted markets will do more to fill these gaps in innovation and growth capital. But we have described in our scenarios the improved conditions and practices needed for this to be effective.

Meanwhile, the rise of financial engineering, increased use of derivatives, and access to private markets have offered new ways to manage risk and produce better returns. But the complexity of these products can make them opaque and difficult to explain to clients and investors.

Trust in the financial industry is difficult, due in part to the fact that the main product of the industry—making money—is less tangible and slower to experience than almost any other product that influences our daily lives. There is a big contrast with the highly trusted technology industry, for example, in which trust is earned when a product instantly works the way it is expected to work. All investment management roles require an ongoing relationship versus a transactional relationship, so sustained trust is important. Again, finance is a means to an end.

Without addressing its issues, what can a Misaligned Industry expect over time? First, it likely faces increased regulation on unfavorable terms. Regulators are increasingly focused on topics of culture and conduct, which have always proved difficult to regulate but obviously matter a great deal for an industry that is not aligned-to-purpose. Governments across the globe are enacting new investor protection regulations. If implemented in their original form, two of the more recognized regulatory programs, the fiduciary rule of the US Department of Labor and the EU Markets in Financial Instruments Directive (MiFID), would triple the assets in individual portfolios worldwide that are subject to stricter fiduciary standards.¹⁰

Second, capital market disengagement would also be a result of the continued erosion of investors' and the public's confidence in the industry, reducing the sources and uses of capital. Flows into institutional funds have been slowing worldwide as defined benefit pension funds decline in use. With reduced saving, we have the associated longer-term issue of where future growth will be generated.

In the Misaligned Industry, a lack of purpose and ethical focus produces a weak value proposition for both industry participants and society.

The Professional Industry

We believe that the Professional Industry, in which the industry and society benefit, is attainable with much dedicated work. In the following, we outline how this might occur through a combination of actions and circumstances.

According to the Edelman Trust Barometer, 80% of citizens worldwide agree with the statement that "A company can take specific actions that both increase profits and improve the economic and social conditions in the community in which it operates."¹¹

This statement does not mean profits are not a prime focus, but rather expresses a general belief that economic growth and societal well-being are positive spillovers of healthy companies. This thinking aligns with the mantra that an undue preoccupation with profit is unlikely to be the mark of long-lasting, sustainable firms. The idea that there is a form of enlightened self-interest in which for-profit firms work to multiple shared values¹² has become established and has diminished the fundamental capitalism ethos in which shorter-term shareholder value is dominant.

Many of the factors associated with a professional investment industry connect with the Purposeful Capitalism scenario, presented in the "Investment Industry Ecosystem" chapter. To achieve its ultimate potential to serve the interests of society, the investment industry must not only regain the trust of investors and the public, but retool institutions and services to demonstrate significant value in fulfilling society's needs. The fundamental requirement is to address the *value* of the industry and re-establish *trust* in the industry.

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Changes in this direction of travel must surely include changes to industry structure. We believe four areas will be important.

Asset owner influence: The relative influence of asset owners compared with asset managers needs to rise. Asset owners have two natural advantages in advancing a stronger-principled industry. They work under a profit-for-members business model, and they can claim legitimately to be close to being a "principal" in status and alignment. These attributes enable the exercise of a longer-term orientation to capital allocation and to ownership rights and responsibilities. Large asset owners have become increasingly effective in allocating capital effectively in private markets, resulting in more attendant growth. And although they are certainly involved with the reshuffling of property rights in public markets, their actions are increasingly concerned with using their ownership interests responsibly and productively. We have drawn attention to the universal ownership principles as a promising new influence in the Purposeful Capitalism scenario.

New business models: The second area of opportunity lies in investment industry organizations shifting their business models toward new organizational superstructures, as described in the Parallel Worlds scenario. These models include the mutual model successfully used by Vanguard and the B-Corporation model used by some private wealth firms (see, for example, Veris Wealth Partners in the United States and MASECO Private Wealth in the United Kingdom). We see new design of organizational superstructure being an adaptive mechanism to help financial institutions address the Millennials' wish list in investment products, combining digital personalization, simplicity, speed, and trusted engagement.

Better regulations: Well-conceived regulations—which take costs into account—should have more potential to act as a structural route to improved behaviors. The enactment of new investor protection regulations in the United States and Europe is significantly strengthening fiduciary protections for end investors. Considerable attention is being given to advancing other protections in costs and transparency. Quite naturally, the robo-advice model will need appropriate measures aimed at creating a sweet spot where these streamlined innovations work effectively for investors under the Fintech Disruption scenario. Regulations are agreed and applied in national settings and rarely move in lockstep, but in general we see a consistent philosophy around these matters. In addition, many governments are seeking routes to streamline capital markets for long-term innovation and infrastructure requirements, although efforts to date have not proved especially successful. Yet, there is considerable support for the principle of a public-private partnership to bring private goods to investors and public goods to society in innovation, energy, and particularly, infrastructure.

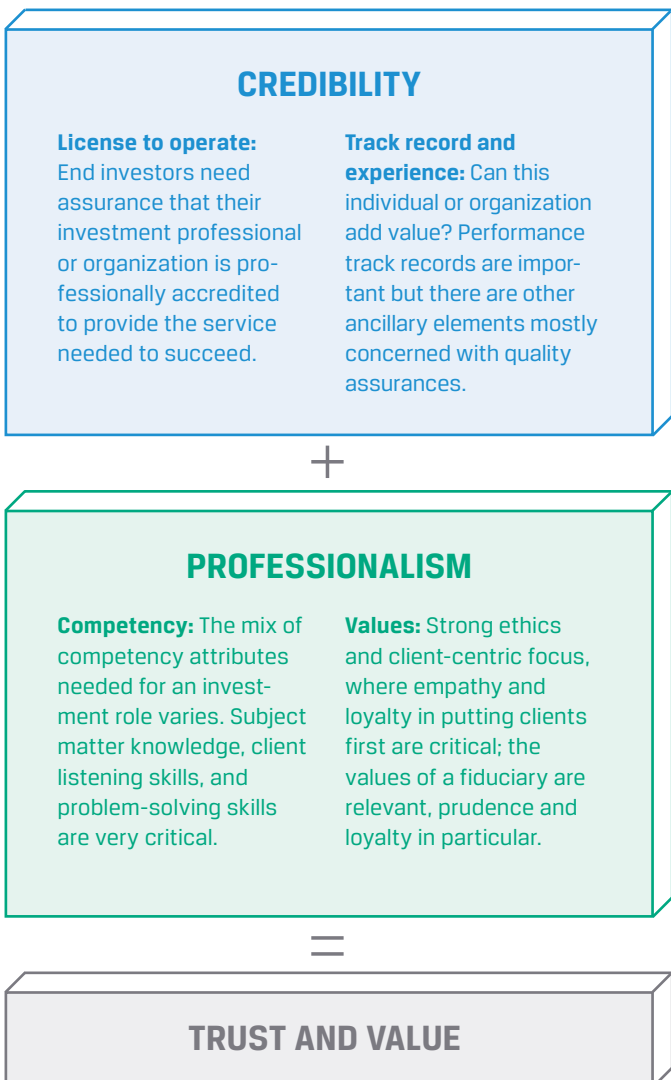
Stronger leaders: Finally, this change will occur only with the right people, particularly in leadership. We need more people in our professional ranks who have strong ethical values and a sense of purpose—people who see the investment management career as a way to do a lot of good, as well as a way to earn a good living. We need people in the investment industry who are motivated by doing good in the world far above the cause of making money.

THE TRUST EQUATION

Trust from an end investor is the *dependency on a service provider in a situation of risk over a prolonged period*.

The type of trust expected by an end investor is far more complex and tacit than the trust expected by the end user of most any other product, regardless of its type or business sector of origin. Its importance grows with the size of risks taken and the length of the term of the relationship—making it core to investment service delivery.

Trust and value in investment are interconnected. For the end investor, value will relate to perceptions of outcome relative to expectations. (In other words, do not think first of performance versus benchmarks as these do not represent particularly relevant expectations for most investors.) Value and trust are developed by an individual or an organization by building **credibility** and demonstrating **professionalism** as captured in the **"Trust Equation."**



The Trust Checklist for Organizations

At a simplistic level, a highly professional firm is filled with many highly professional individuals. To achieve this across an entire organization, however, a complex coordination challenge must be met, and its solutions require good culture and an appropriate business model to secure alignment to the necessary attributes of credibility and professionalism. Trust in the context of the investment organization spans a spectrum of critical attributes.

T Transparency

Organizations should display "glass door transparency" of all things, including business processes, limitations of the investment process, risks, performance reporting, fees and their impact on portfolios, and potential conflicts of interest. They should be candid about the mistakes they have made and explain what steps they are taking to correct them.

R Realistic Measures

Firms and their employees need to be realistically measured in relation to financial and non-financial goals over relevant time horizons. End investors are concerned with outcomes.

U United Values

Alignment of values between firms and all of their stakeholders is critical. Organizations build their strongest trust by being aligned in their purpose, objectives, and way of working with those they serve.

S Sustainable and Fair Rewards

Fees and rewards need to be fair and reflect the value clients receive. Trust will best be secured when there are incentives for agents to do their absolute best for their clients.

T Time-Tested Relationships

Good relationships develop over time and allow the client to develop confidence. Research shows that people are much more trusting when working with consistent partners—a situation that offers a chance to build a good reputation through repeated interactions.

Steps to Trust and Professionalism

Asset managers, institutional asset owners, industry associations, and academics must develop ways to demonstrate value and integrity to help regain credibility and trust. The following describes considerations for each of these institutions for building trust and value to support the investment industry and aid it in rehabilitating its position with investors and the public.

There are three key things that leaders of the investment industry can do to support the highest standards of professionalism—address the business model, improve the culture, and seek collaboration across the ecosystem.

Business Model Alignment, Agility, and Adaptability

The leaders of an organization need to understand, buy into, and implement a mission and strategy, and then direct resources accordingly. They need to be well-versed in the organization's comparative advantage and the ability to lower opportunity costs. Through knowledge of comparative advantage, the organization can achieve coherence and consistency in its thinking and actions.

Being professional and developing trust require a business model and a strategy that are in synch. This will vary, but it is likely to be easier if

- the organization has relatively few conflicts of interest and manages those conflicts well.
- motivations to create profits are well-integrated with purpose-driven motivations to meet client expectations.
- time horizons that matter in decision making are appropriately balanced between the long term and the short term.

Alignment

Performance evaluations of asset managers against a quarterly benchmark for both individuals and organizations are at odds with the need to think long term. A longer investment horizon could be seen as a fairer basis for assessments and may be preferred by investment professionals. A recent study reported that 39% of investment professionals would be pleased to have performance bonus incentives based on a two-to-five-year cycle versus the typical annual bonus.¹³

Rethinking monetary and non-monetary incentives are part of the same picture. Most short-term contingent rewards conflict with long-term client and organizational objectives. The economics 101 is "people respond to incentives."

Professionals should understand how their rewards relate to long-term client and organizational goals. Improved transparency concerning the incentive structures of asset managers will also go a long way toward guaranteeing investors that the interests of their managers correspond to their own.

In addition to integrating integrity and the primacy of client interests into the DNA of investment firms, fiduciary duty also relates to understanding expected client outcomes and committing proper resources to achieve them.

Outcomes must also be evident in the client experience, which requires the development of specific key performance indicators that describe observable and measurable characteristics or changes in related outcomes. Identifying performance indicators and setting targets for performance based on progress measures and outcomes help organizations to determine the impact they have had on clients.

The goal of developing a firm-wide customer-oriented mindset and culture is to be aligned in goals, objectives, and actions. To ensure a true alignment with customer needs, asset management firms and institutional asset owners need to create an environment that encourages long-term investing and trains professionals as managing fiduciaries and where all business processes and functions endeavor to put investors' interests first when making decisions. That encompasses integrating different interests. Giving primacy of interests to the client is clear, but that cannot be to the exclusion of the interests of the firm or the associates in the firm—organizations achieve sustainability through balance.

As soon as customers are confident that their incentives align with those of service providers, trust increases. A true customer orientation should also demonstrate value over the long term by reinforcing both competency and reliability. Unlike faceless companies that have few real interactions with customers, the personal relationships built between investment professionals and clients provide asset management firms with a unique opportunity to build trust.

Agility and Adaptability

Agile organizations can identify issues with strategy and then adapt or change direction as needed. Ultimately, the quality of leadership will determine how well organizations adapt. Leaders must take the time to listen to employees and other stakeholders to determine the effectiveness of decisions and to adapt plans that are not achieving desired outcomes.

Increased agility suggests greater simplicity in the way organizations are governed and operated. The investment industry values complexity and does not always appreciate the merits of strategies and tactics that are easier to communicate, understand, and implement. By limiting transparency and candor, there is a danger that overly complex or bureaucratic organizations can keep key participants, including the CEO, from understanding what is happening at all levels of the business.

The organization that effectively adapts to changing circumstances, trends, environments, and client objectives should be in a position to produce better client outcomes. In the pursuit of greater trust, adaptable firms are more credible and reliable.

Build Stronger Cultures

The most common definition of culture is norms of behavior or "the way we do things," but the concept should extend to *why* things are done that way (mostly about values and beliefs) and *how* things are done that way (mostly through the influence of leadership and incentives). When it comes to trust and professionalism, the presence of good culture and leadership is enormously important.

Asset management firms have an opportunity to foster greater investor trust by demonstrating integrity. They must also substantiate a value proposition that does not simply argue benefit for fees charged, but one that is evident through the firm's focus on improving investor outcomes and designing services to fulfill client objectives. For many firms, the objective of demonstrating value and building trust will require a radical transformation in corporate mentality, especially for those that have been overly focused on short-term profit goals and have developed the culture to achieve them. The process of moving from a profit-focused to a client-centric business model will also require a firm to reconceive and reorient its purpose, its culture, and the environment in which its employees work, all toward fulfilling long-term investor needs.

The changes necessary to achieve a truly customer-oriented business require the new corporate mentality to be internalized by individuals at all levels of the firm, and at all positions within the value chain. Although certainly not solutions in themselves, there are several essential cultural changes that leaders need to consider in order to reorient their organizations toward greater customer alignment. Among them, fiduciary culture is the most important.

Fiduciary Culture

Building a professional organization goes hand-in-hand with a fiduciary mindset. At an organization in excellent fiduciary condition, employees take their fiduciary role seriously, and not just because it may be mandated by regulation.

To achieve this, leaders must develop and communicate a compelling vision of the future that centers on fulfilling client objectives. Leaders who openly and passionately communicate such a vision can motivate employees to act with passion and purpose, thereby ensuring that everyone is working toward shared goals.

Surprisingly, only 15% of professional investors strongly believe their leaders articulate a compelling vision.¹⁴ Although many investment professionals have great passion for what they do, it is also clear at some asset management organizations that professionals either do not have a sense of purpose or have a purpose that is geared toward something other than adding value to clients.

Similar to vision, firm-wide beliefs and values must be developed, communicated, adopted, incentivized, and then reinforced through shared experiences. A set of core beliefs that everyone in the organization supports and is accountable for creates a framework for how

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decisions are made, how people interact, and their attitudes and actions toward clients.

The State Street Center for Applied Research and CFA Institute collaborated on *Discovering Phi: Motivation as the Hidden Variable of Performance*, which advocates for leaders to rebuild the culture of their firms toward greater purpose-driven motivation. This type of motivation contributes to long-term organizational performance, client satisfaction, and employee engagement. "Phi" is derived from the motivational forces of purpose, habits, and incentives that govern behaviors and actions.

To help develop a client-serving culture in which the organization's professionals "do things right and do the right things," it is essential that leaders instill and champion a professionalism framework and fiduciary mindset. Codes of ethics are less likely to shift culture, but rather they are seen as a compliance effort. There is a subtle but important difference between ethics and professionalism. Ethics is more akin to a competency that can be learned—the application of rules and principles that go beyond legal prescriptions—whereas professionalism depends on frameworks and acquired wisdom to help direct actions appropriately even in situations that are new and complex.

One such framework available to the industry is the CFA Institute Asset Manager Code, which cannot only define a firm's expectations for employees and customers, but also demonstrate the importance the firm places on putting investors' interests first.

According to studies conducted by CFA Institute and Edelman, trustworthiness, ethics, communication, and transparency are the top attributes that investors value, and they lead to the building of trust and long-term relationships with investment managers. The qualities valued and expected by clients relate to integrity, not just performance, and should be the qualities prioritized in an ethical code and in firm culture. In fact, institutional investors ranked the most important attribute of a firm as acting "in an ethical manner in all our interactions."¹⁵

Work in Collaboration across the Ecosystem

The investment industry touches many parts of society through its work for pension schemes, endowments, sovereign wealth funds, insurance companies, foundations, charities, and individuals. This report is skewed toward the role and influence of the investing institutions, both asset managers and asset owners. Because of this connection to society, the burden of regaining trust does not fall on the shoulders of these organizations alone, but on every organization and institution that has a stake in a more influential ecosystem that produces significant societal wealth and well-being.

As mentioned in the Purposeful Capitalism scenario, there are particular leadership opportunities for asset owners to exercise the greatest positive effects. A key notion is the ability of these owners, often in cooperation with others in the ecosystem, to encourage specific environmental, social, and governance (ESG) goals within the companies they own. Their influence extends to the workings of capital markets themselves, and they can have a positive impact advocating for improved regulatory effectiveness.

A prominent investment industry can help investment organizations and their employees become highly self-disciplined and competent, which requires support from regulators. The development of more effective regulation is certainly one of the preconditions for a more successful industry. The ambition should be for regulators to listen carefully to the industry and to practitioners in finance, but still be able to filter out the messages that carry undue bias to industry self-interest.¹⁶

Some of these elements are consistent with ambitions set by non-governmental initiatives. Such groups as the PRI, with its focus on responsible investing, and Focusing Capital on the Long Term, which brings together influential asset managers and asset owners in an attempt to shift the mindset of the industry, can be effective agents in helping build a self-disciplined and competent industry.

So, the question is, What are the tangible steps that could be taken by investment organizations that could create a move toward a professional industry?

CFA Institute believes that rules and regulations, although necessary, are not sufficient by themselves. High ethical principles and professional standards are essential to positive outcomes. Industry associations, such as CFA Institute, have an ability to help firms improve their fiduciary condition by setting professional codes and standards.

THE CFA INSTITUTE COMMITMENT TO BUILDING PROFESSIONALISM

In this final section, we look at ways that CFA Institute seeks to come alongside the industry to help shape a profession, beginning with existing activities that can be incrementally leveraged to greater effect (business as usual), and then offering some new ideas to make an impact (business beyond usual).

The CFA Designation and Program

CFA Institute has a unique role to play in increasing the competence and integrity of investment professionals given that the CFA designation is currently considered the gold standard in the industry.

According to CFA Institute CEO Paul Smith, CFA, "Investment managers should pursue the best qualifications if society is to trust our competence to serve their investing needs. We all have a personal responsibility to spread the word about the need for well-trained people throughout the investment management value chain."¹⁷

With the privilege of the CFA charter's influence comes responsibility. Maintaining the relevance of the charter in fast-moving conditions requires awareness of the need to quickly understand new practices, to be ready for change in all its manifestations, to understand the complexities of the financial system, to differentiate enduring changes from fads, and to be able to use supporting evidence from multiple sources.

CFA Institute believes that the CFA Program is an essential part of a successful investment profession. But there are other contributions that it can make that align with the CFA Institute mission to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.

Standards

The ethical and professional responsibilities that investment professionals owe to their clients are made clear in the CFA Institute Code of Ethics and Standards of Professional Conduct.

All candidates in the CFA Program study the Codes and Standards at each of the three stages of the examination process, and every member annually attests to abide by and adhere to them. Self-regulation is assured through a peer-review disciplinary process and the work of a Disciplinary Review Committee that directs investigations into disciplinary cases, determines violations, imposes sanctions, and discloses violations.

Advocacy

Both directly and through its numerous member societies, CFA Institute carries out advocacy efforts to increase professionalism within the investment management industry. It acts as a resource to regulators and other standard setters worldwide to aid in the design and implementation of professional guidelines. It conducts hundreds of outreach meetings annually, resulting in strong recognition and awareness of the policy positions of CFA Institute among the world's top regulators, who often reference and cite the work of CFA Institute in their rule-making process.

CFA Institute also offers its members and other industry professionals extensive tools to support their commitment to ethical and professional practice, notably a substantial continuing education program.

Research and Thought Leadership

CFA Institute conducts research and publishes thought leadership, such as this report, to bring industry issues and potential solutions to light. Our intention is to update this report periodically to continue the dialogue with stakeholders and to underscore new thinking and trends that may impact the profession.

Financial Literacy

As an educational organization, CFA Institute should also act as a resource to help the industry develop the next generation of savers and end investors. CFA Institute believes that financial markets are more effective when participants are knowledgeable. In attempting to build investment knowledge, it is important to encourage financial literacy programs that teach people strategies for the accumulation and utilization of capital.

Because financial literacy programs can be most effective when implemented locally, CFA Institute provides educational content and financial resources in supporting many of its local member societies that are actively engaged in offering financial literacy programs directly or through other financial literacy partners.

It is important, however, to remember that financial literacy programs can go only so far in solving problems that are the result of a myriad of issues, including the complex challenges inherent in engaging the unmotivated. CFA Institute conducts research into behavioral finance methods to design practical tools and innovative products to help savers and end investors navigate the financial decisions they must make to achieve better outcomes.

IDEAS TO MOVE THE NEEDLE TO A BETTER INDUSTRY

The research that underpins this report tells us that change is coming. We have anticipated how that change might play out in planning scenarios, and what state the industry could end up in depending on how well it adapts to change and to what degree it earns (or does not earn) widespread public trust.

We believe the following "to-do" list and a road map derived from it can be the first steps in the journey toward a future where a healthy investment management profession benefits societal wealth and well-being.

Professional Transformation: Identify what is needed to go from industry to profession

As described earlier, an "industry" is defined by the circumstances of a provider producing something of value to a consumer in a transaction. A "profession" is different; it carries a seal of approval and authority by society, which is granted and maintained by containing requirements for entry, standards of fair practice, disciplinary procedures, and continuing education for its professionals in conditions of an ongoing relationship. In doing this, the profession combines value and trust. The trust in this arrangement is of considerable value, not least because it creates the conditions for growth in wealth and well-being. The open questions are: How can the investment industry evolve so that it shares identifiable and key characteristics in the manner of medicine, law, and accounting? What is the current gap? What benefits could arise from filling this gap? For the industry? For clients? For society? CFA Institute intends to lead a consultative discussion on this.

Fiduciary Implementation: Master the meaning of "fiduciary" in a way that can be effectively implemented even with inherent conflicts

Fiduciary responsibility in most jurisdictions is defined by the principles of loyalty, prudence, and care. This means putting the interests of beneficiaries first when determining investment strategy, avoiding conflicts of interest, and investing to the standard of care of a prudent expert. This is not a black and white issue, and thus is difficult in a legal framing that seeks to create unambiguous standards. So, all investment organizations face the practical issue of balancing these requirements within the context of their own organizational sustainability. CFA Institute intends to conduct further research and engage in industry consultation on how organizations should be dealing with fiduciary responsibilities and other issues where legal

and regulatory frameworks are at potential conflict with the ambiguities and uncertainties endemic to the investment field.

Stronger Standards: Specify and influence culture and practice with regard to values and costs

CFA Institute successfully introduced standards for presentation of performance records in the form of the GIPS® standards. There may be other areas of practice that could benefit from such an approach. We cite standards for the structure and size of fees and costs as one possible idea. We also believe that the testing of new types of investment products could be the subject of standards in ways that draw on practices in other industries and professions (e.g., the pharmaceutical industry). We also think that good culture itself could be given some support through a standards or guidance framework; at least we believe that such an ambition should be discussed. Such a discussion would overlap with how well standards have evolved in relation to ESG and sustainability.

Work toward better diversity

CFA Institute is an advocate for diversity across many dimensions. Diversity is desirable for a combination of cultural and financial values. Research suggests that diverse teams are better at certain types of decisions, particularly the complex ones that are ever-present in investing. This research sees surface-level diversity issues, such as gender and a number of others, as having a first-level impact, but recognizes cognitive diversity as more deeply impactful. CFA Institute is considering what mix of research, advocacy, and/or standard-setting should be adopted.

Leverage the ecosystem

The CFA Institute membership currently acts as a valuable resource for polling on a wide spectrum of issues, drawing from the views of the organization's more than 140,000 members. We are struck by the potential of networks empowered by new technologies to focus resources and attention in particular areas. Our membership can speak more powerfully for society's benefit through such a mechanism, particularly if it speaks with one bold voice.

SUMMARY AND WAY FORWARD

In closing, we give a view that the investment industry has not been as positive of a force for society as it could or should be. Left to business-as-usual thinking and practice, we see some increasing challenges for our industry. Under alternative pathways, with business-beyond-usual interventions and influences, we believe we can successfully overcome these challenges and emerge stronger. We can shape an industry that clearly recognizes and acts on its societal purpose and generates trust and value in enduring ways.

This focus on purpose and societal benefit can produce parallel gains for the organizations that commit to this pathway. As John Kay reminds us, "paradoxical as it sounds, goals are more likely to be achieved when pursued indirectly."¹⁸

We have put forward a number of steps and ideas by which the investment industry can realize its fullest potential, and we now encourage our members and leaders of the industry to endeavor to make this a reality.

CFA Institute is committed to further consultation with leading industry figures on the following:

- Creating a road map for moving our industry to higher standards of professionalism, along with its implications for fiduciary responsibility and for attaining the status of a profession
- Working together on the most pressing industry issues, particularly business models that better capture purpose, trust and value, cultural values that are inclusive, and technological competencies that streamline our industry
- Maintaining the CFA Program's edge in fast-moving industry conditions

"Money might make money. But money does not create value. People create value with their ideas and hard work." –Horst Köhler

ENDNOTES

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¹⁰ CaseyQuirk, "Survival of the Fittest: Defining Future Leaders in Asset Management," Deloitte (7 December 2016).

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¹⁴ Ibid.

¹⁵ CFA Institute, *From Trust to Loyalty: A Global Survey of What Investors Want* (February 2016).

¹⁶ For more on this subject, see Elin Cherry and Robert W. Dannhauser, *Corrupt or Collaborative? An Assessment of Regulatory Capture* (CFA Institute, July 2016).

¹⁷ Will Goodhart and David Clarke, "The Value of the Investment Profession: A Report on Stakeholders' Views," CFA Society UK (April 2016).

¹⁸ John Kay, *Obliquity: Why Our Goals Are Best Achieved Indirectly* (London: Penguin Press, 2011).

About the Report

In 2016, CFA Institute commissioned the Institutional Investor Thought Leadership Studio to survey members of the investment management profession for an overview of the current and future state of the profession. A questionnaire was distributed to two lists, one drawn from Institutional Investor's database, the other from CFA Institute. There were 1,145 responses (644 from CFA Institute) collected from 8–22 December 2016, with a margin of error of 2.9%. In addition, Institutional Investor conducted interviews with 19 executives in the investment management profession to obtain context and further details about the collected data.

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CFA Institute

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials.

The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow.

CFA Institute has more than 146,000 members in 160 countries and territories, including 140,000 CFA charterholders and 147 member societies.

The CFA Institute Future of Finance initiative is a long-term, global effort to shape a trustworthy, forward-thinking investment profession that better serves society.

For more information, visit www.cfainstitute.org/futurefinance or contact us at FutureFinance@cfainstitute.org to offer your ideas about how to shape the industry for the future. We encourage you to cite this report using the link www.cfainstitute.org/futurestate

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