JUSTIN A URQUHART STEWART OF SEVEN INVESTMENT MANAGEMENT ON HOW THE FINANCIAL SERVICES INDUSTRY MUST BOUNCE BACK FROM PAST DISASTERS AND REGAIN THE CONFIDENCE OF INVESTORS.

A PHOENIX FROM THE ASHES?

What a fiasco! For a nation that has prided itself on its level of financial sophistication, we seem to have ended up in a pretty sorry state. A swift review of the key institutions involved shows a story of corruption, incompetence and failure as the most common themes. From banks such as Barings going bust, the shame of the old Lloyds Corporation, the mis-selling of pensions, precipice bonds and endowment policies, even our historical auction houses – all seem to have been tainted to some extent. It's not surprising therefore that investors and the general public have lost faith in anything to do with the financial services industry.

We seem to have done little to really help people to understand the financial world, and this situation has only been made more acute as the politicians have thrown more financial responsibility back down to the individual family. While this may have been a laudable aim, it has left the way open for too many innocents to play with the fireworks box, and unscrupulous salesmen belonging to some of our largest and most respected financial institutions, to commit outrageous financial crimes.

The fines levied on companies such as Equitable Life, Lloyds and other insurance companies seem to be just the tip of the iceberg. Below them lurk levels of financial incompetence that would seem unbelievable in anything but a ludicrous novel. Unfortunately, even with the privatisation and demutualisation programme of shares, we did little in reality to teach people how to invest, but rather told them how to punt as if it were a horse race.

WHAT A TALE OF WOE – WHAT A SCENE OF FINANCIAL DETRITUS. But from this vision of disasters we might now just have the chance of seeing a phoenix arise from these ashes.

From the various reports written on the industry, some clear tenets of financial structure and behaviour are arising. These must become not just a wish list of standards, but frankly a framework around which all financial products and services should be designed – from corporate pensions to protection policies, from ISAs to insurance bonds, all must build with these tenets or be rejected.

SO WHAT ARE THESE KEY ISSUES? They are really no more than common sense, which for some reason seems to have become a rarer commodity over the years. First, how about charging? The financial services industry has developed a sales commission driven culture with all the dependency of any drug habit. This, by its nature must drive sales by transactions and away from their suitability and success. Investment charges should be based on performance, not transactions.

Second, transparency. This is such a crucial issue for investors, and yet it is often seen as being too complicated. For investors to be able to see their investments, their value and what they consist of at any time, along with any charging and costs all clearly visible, would seem to be perfectly straightforward. The pension market has been particularly poor here, and the question of whose money is it anyway has even come up!

Then add a need for flexibility so people aren't penalised or locked into unsuitable services, and can change and evolve with their circumstances and not fossilise into a 'long-term portfolio' of out-of-date, valueless artefacts. Then there is the requirement for true independence of product, advice and investment management so that clients can be assured that they are not just sold the house fund rather than the best of breed.

In the investment world though, there seems to have been a major failure that should have been avoided. Seemingly, the stockbrokers, investment managers and pension managers forgot some of the key investment rules. We must remember that over the past three years, of the four main asset classes of property – equities, fixed interest and cash (of which the smallest is equities) – only one has gone down and three have risen: so how come our pension and investment funds have fallen by so much? The answer lies in our equity fixation and the inability of professional advisers and investment managers to operate a simple asset allocation process. Asset allocation is the discipline of regular and effective management of the different asset classes, which has been shown time and again to be the key differentiator in medium- to long-term investing.

Unfortunately, the short-term speculative stock-picking mentality of the racetrack has been confused with the discipline of investment management, and the result is there for all of us to see. And the excuse given? There was a stock market crash! Well it was one of the slowest crashes ever recorded, as it took over three years – but obviously not as slow as quite a few investment and pension managers!

From the ashes a phoenix is rising as a new generation of pension and personal investment managers come through. They will be armed with the new tenets of service and standards designed not only to avoid the follies of the past, but to try and fulfil the investor's needs more effectively.

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Justin will be speaking at The Treasurers' Conference, organised by the ACT, at Celtic Manor, 22 to 24 March 2004. www.treasurersconference.com

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