

CFA INSTITUTE **INSTITUTE TRUST** **& EDELMAN STUDY** 2013



CFA Institute



Edelman

THE VALUE OF TRUST

Strong performance alone is no longer enough for investment management professionals to earn investors' trust. Behavior – and the ability to demonstrate aligned interest – is also of foremost importance.

GLOBAL PERSPECTIVE

Investors worldwide say that trusting an investment manager to act in their best interest is the single most important factor in making a hiring decision. Achieving high returns was cited only half as often, and fee amounts or structure only one-fifth.

Trust is the backbone of client relationships in the investment management business, yet it is undeniably fragile. To better understand why, CFA Institute and Edelman commissioned Edelman Berland to develop the CFA Institute/Edelman Investor Trust Study.

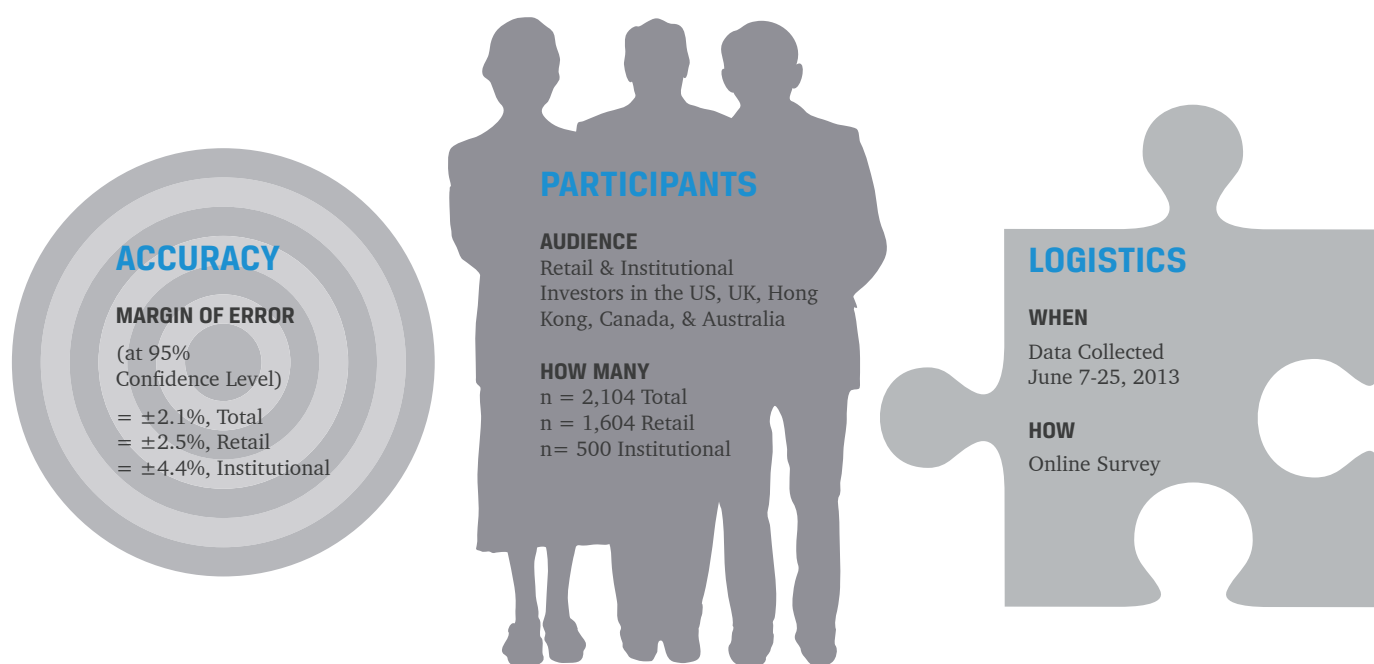
THE STUDY

The respondent sample includes the opinions of institutional and retail investors in the United States, United Kingdom, Hong Kong, Canada, and Australia on the state of trust in the investment management community.

RESEARCH OBJECTIVES

To better understand the dimensions that shape investor perceptions of trust in investment managers, as well as the actions that help to build trust.

METHODOLOGY



TRUST IN THE INVESTMENT COMMUNITY IS ON THE BRINK...

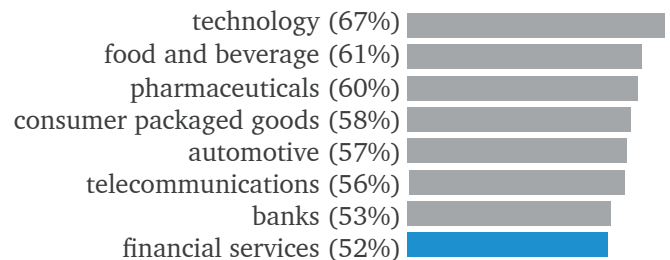
Though it exists, investors' trust in the investment management industry is fragile; only half (53 percent) of investors trust investment management firms to do what is right. Retail investors are less trusting of the industry than their institutional counterparts (51 percent vs. 61 percent, respectively). From a global perspective, investors in Hong Kong are far more trusting of the industry than those in the United States and United Kingdom; 68 percent of Hong Kong investors trust investment firms, compared to 44 percent of US investors and 39 percent of UK investors.

This limited amount of trust reflects a lack of confidence in the broader financial services industry. Hit by the shock of the 2008 financial crisis and ongoing scandals around money laundering, rogue trading, rate manipulation, and insider trading, the industry lost the faith of its key constituents – the clients, investing public, and other participants that help it function on a day-to-day basis.

And, financial services is the industry least trusted by the general population, according to the 2013 Edelman Trust Barometer, an annual exploration of trust in institutions, industries and leaders worldwide.

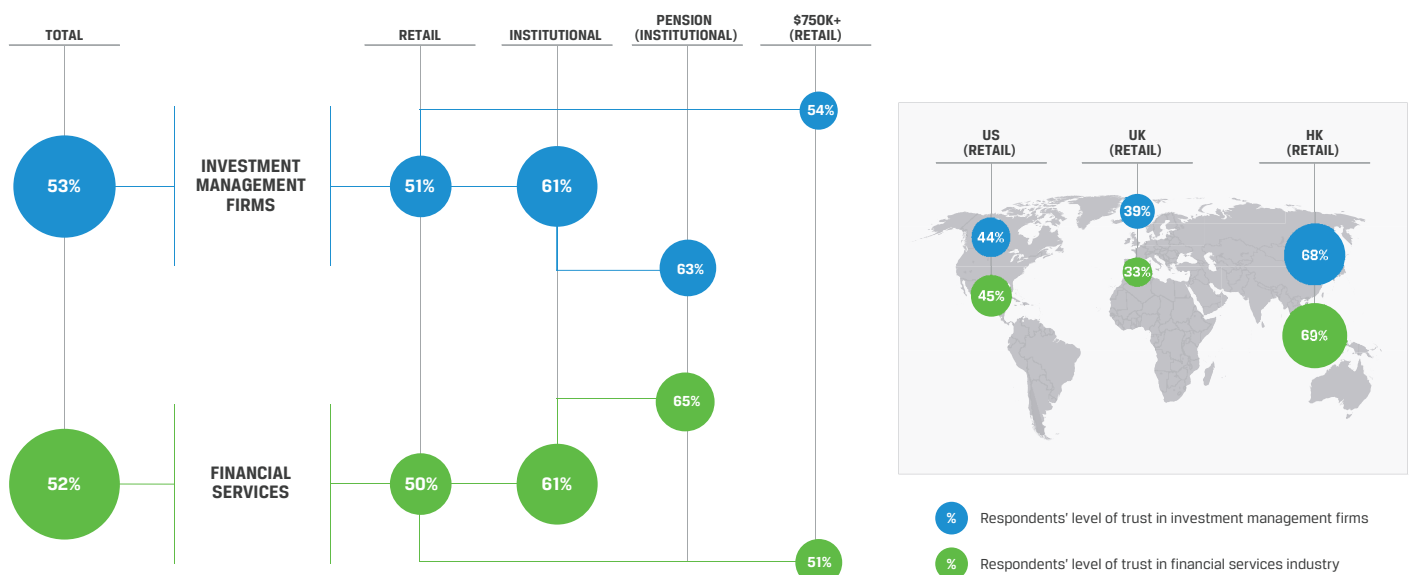
This is troubling, and should be of great concern to the investment profession. Edelman Trust Barometer research shows that informed publics are more trusting than the general public. Under this premise, investors who are informed about and currently engage with the investment management industry should have higher levels of trust. But in reality, investors trust other industries more than the industry in which they are entrusting their assets.

FIGURE 1: Even among investors, financial services is the least trusted industry



Question: Investors were asked whether they trust the above industries to do what is right.

FIGURE 2: Just over half of investors trust the investment management and financial services industries



Question: Investors were asked to indicate whether they trust the investment management and financial services industries to do what is right.

BUT TRUST CAN BE REBUILT

Interestingly, despite investors' lack of trust in the investment industry, they remain confident in the capital markets. Nearly three in four investors say they are optimistic about their fair opportunity for profit or loss in capital markets. And this is true worldwide: 74 percent of investors in Hong Kong, 70 percent of investors in the United States, and 69 percent of those in the United Kingdom express that belief.

On the surface, these numbers are high. But intensity is low – just 19 percent of investors “strongly agree” they have a fair opportunity to profit by investing in capital markets. This is a warning sign. The amount of distrust in the investment management and, more broadly, the financial services industries could be infecting the capital markets. And if this continues, it could damage the markets' role as an essential component of economic vitality.

“Trust is the building block that enables capital markets to serve society's needs.”

John Rogers, CEO, CFA Institute.

To maintain and build the ethical standing and purpose of the industry and capital markets, every participant in the investment industry must focus on enhancing trust.

CAN GOVERNMENT DELIVER?

Looking to the future, investors expect government regulators to play a significant role in building trust in the capital markets. Fifty-two percent of total investors pointed to national and global regulators as having the greatest opportunity to affect change and enhance trust – far more than individual investment management professionals (28 percent) or investment management firms (13 percent).

This is as understandable as it is controversial. Many investment firms lament that over-regulation will destroy competitive markets. Both during and after the financial crisis, people turned to governments globally for solutions, including bail-outs for the short-term and increased regulation for the long-term. Legislative and regulatory bodies proposed significant reforms on a worldwide basis including Dodd-Frank, Basel III, and Solvency II to help avoid potential future catastrophes.

But it is yet to be determined if and how regulators will be successful in implementing these reforms. Instead of providing solutions, governments entered into several of their own crises – especially in the US and EU. And, as a result, trust in government plummeted. Today, only 14 percent of global respondents trust governments to make ethical decisions, according to the 2013 Edelman Trust Barometer.

FIGURE 3: Investors were asked to indicate which attribute is most important when making a decision to hire an investment manager



Question: Investors were asked to indicate which attribute in the above is most important when making a decision to hire an asset or investment manager.

“When people lost trust in business during the financial crisis, they turned to government. And when they lost trust in government, they turned to individuals. This carries over into the investment management industry. As this study shows, it’s up to individual professionals to behave in ways that bolster trust and affect reputational change.”

Ben Boyd,
Global Chair, Edelman’s Corporate Practice

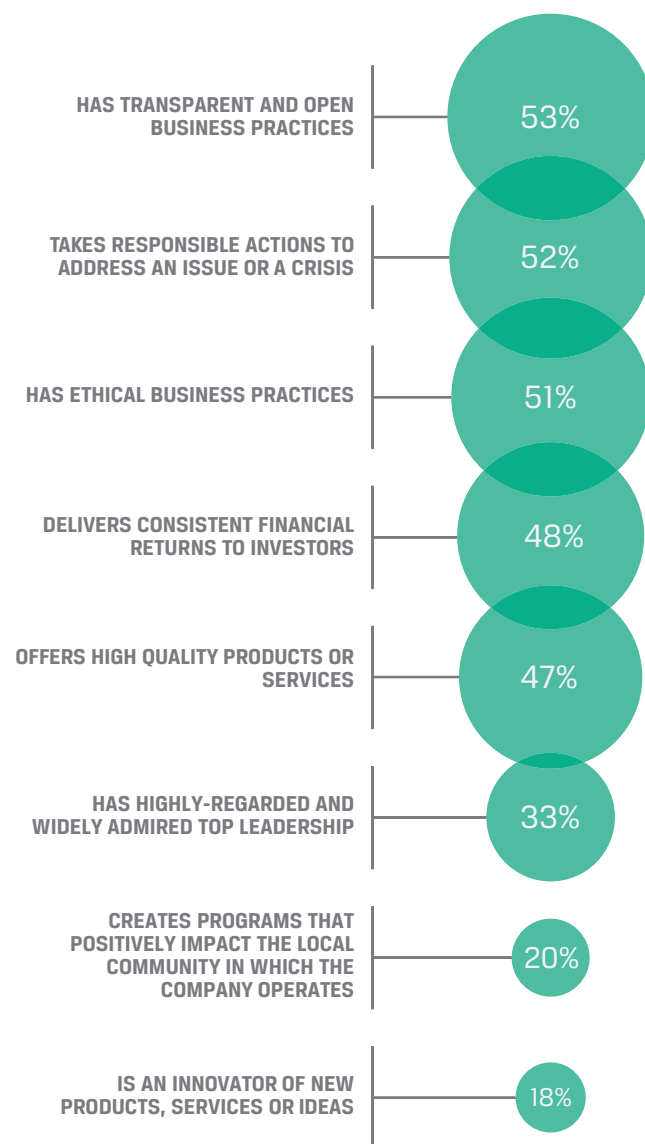
It is clear that investors expect governments to improve oversight and enforcement within the capital markets and thereby trust in those markets. However, it is also up to investment professionals and their firms to take action.

INDIVIDUAL INVESTMENT PROFESSIONALS CAN – AND SHOULD – DELIVER

Investors say that the investment management professionals they deal with have been the most effective in enhancing their trust through this point in time. When asked who was most effective in building trust in the capital markets over the past year, more than half of investors cited their investment managers – ahead of their investment firms, national regulators, and global regulators.

But how do these individual investment professionals build trust? According to investors, it is by moving beyond just performance and demonstrating trusted behaviors. “Returns are what investors pay their managers to achieve; but investors make the decision to hire and continue to work with those who demonstrate a commitment to professional standards of ethical conduct that are in the investor’s best interests,” said John Rogers, CFA Institute.

FIGURE 4: The top attributes that build trust in an investment manager relate to integrity – not performance



Question: Investors were asked: how important is each of the above attributes to building your trust in an investment manager?

DOING WHAT'S RIGHT MATTERS

As previously stated, investors worldwide say that trusting an investment manager to act in their best interest is the single most important factor in making a hiring decision. Achieving high returns was cited only half as much, and fee amounts or structure only one-fifth.

Performance-related attributes – such as delivering consistent financial returns and offering high quality products and services – are now only table-stakes. They alone do not build trust. As shown in figure 4 on page 5, investors say that the most important attributes in building trust are behavior-related, with the top three being:

- 1) transparent and open business practices,
- 2) responsible actions to address an issue or crisis,
- 3) ethical business practices.

By focusing only on performance-centric standards, investment professionals are missing opportunities to maintain and build trust. It is the more engaging, external-facing behaviors and policies that will differentiate trusted advisors from the rest.

So what should investment management professionals do to move beyond performance, demonstrate their aligned interest, and ultimately build trust?

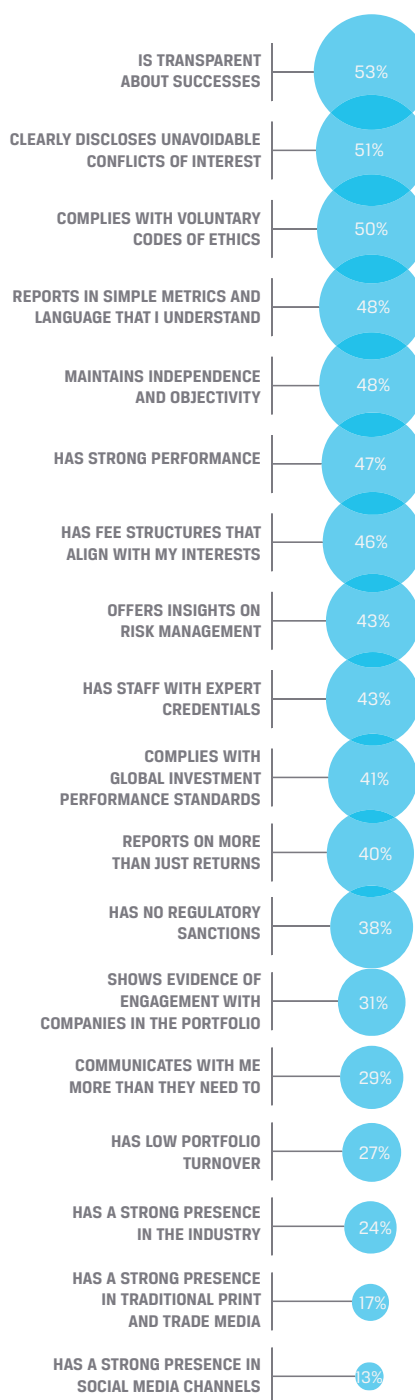
TAKING ACTION: A PATH FORWARD

Performance alone is no longer enough when it comes to earning trust. This places an additional burden on professionals and firms. According to the CFA Institute/Edelman Investor Trust Study, there are three best practices to which all investment management professionals should adhere.

BE TRANSPARENT

Investors say that being transparent is the most important action that investment managers can take to build trust. This means articulating triumphs and

FIGURE 5: The top actions that build trust in an investment manager also relate to behavior over performance



Question: Investors were asked to indicate the most important action in building trust in an investment manager.

failures, clearly disclosing unavoidable conflicts of interest, and bringing potential issues to the forefront early and often.

Investment management professionals should

- Provide clear insight into investment processes, risks and risk management, and limitations of the investment process
- Affirm the primacy of client interests and resolve conflicts of interest in favor of the client, with forthright disclosure of conflicts that cannot be mitigated
- Align fee structures so that compensation reflects the client's success in achieving risk and return objectives
- Provide full disclosure of fees (including the amount, the calculation methodology, and the impact on the portfolio from payment of the fees)

DEMONSTRATE INTEGRITY

In this environment, it is important for investment management individuals to maintain performance while championing engagement, integrity, and purpose. Investors cite compliance with a voluntary code of ethics (50 percent) and maintaining independence and objectivity (48 percent) as actions that matter most.

Professionals should also consider building trust by adopting the following actions

- Adhere to the CFA Institute Asset Manager Code of Professional Conduct, which provides an opportunity for investment managers to commit to a high global standard of practice on a voluntary basis – going beyond local regulatory requirements to affirm client interests
- Comply with GIPS™ Standards to provide investment performance reporting for prospective clients that is consistent with global best practices
- Disclose regulatory infractions promptly and completely

COMMUNICATE EARLY AND OFTEN: AMBIGUITY IS THE ENEMY OF TRUST

We live in a time where skepticism is rampant. Today, 60 percent of people need to hear something three to five times in order to believe it, according to the 2013 Edelman Trust Barometer. Investment professionals should therefore communicate early and often – throughout the process, not only at moments of return – to have stakeholders believe and trust.

Investment professionals should also

- Take a client-centered approach to disclosure and reporting when possible
- Consider performance reporting not just on a time-weighted basis that reflects the investment manager's performance, but also on a dollar-weighted basis, as this will offer insight on the client's actual performance given client-directed cash flows
- Provide a fair representation of the investments made, results achieved, expenses incurred, and risks taken

An increased focus on behavior creates extra burden, but much is at stake. Through trust-building actions, client relationships will be strengthened and the integrity of the industry and capital markets will be preserved.

ABOUT CFA INSTITUTE/ EDELMAN INVESTMENT TRUST STUDY

The CFA Institute/Edelman Investor Trust Study is a survey of trust in the investment community. It was produced by research firm Edelman Berland and consisted of 20-minute online interviews conducted June 7 – June 25, 2013. The CFA/Edelman Investment Trust Study online survey sampled 1,604 retail and 500 institutional investors in the United States, United Kingdom, Hong Kong, Canada and Australia. For more information visit www.cfainstitute.org/investortrust.

ABOUT US

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 113,000 members in 140 countries and territories, including 102,000 CFA charterholders, and 137 member societies.

For more information, visit www.cfainstitute.org.



EDELMAN

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