IDEAS FOR LEADERS | JUNE 2016

banking insight

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HARVESTING THE
WISDOM OF THE CROWD

BLOCKCHAIN ASCENDING

Banking for Sustainability:
The Policy, Regulatory and Financial Case for Action

BANKING ON FULL RESERVES

THE STATE OF BASEL III

Although regulators are turning the heat up on compliance with Basel III, ASEAN banks are staying ahead of the regulatory curve.

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Editor's Note

REBUILDING TRUST THROUGH REFORM

THERE'S NO REST for the weary in the global financial sector, as the relentless pace of reform marches on.

Regulatory reform continues in full swing; this issue takes a sweeping look at Basel III, which marks the most concerted global effort by regulators, policymakers and financial players to reduce systemic risk in their bid to avert a repeat of 2008's financial crisis. Although the timeline for full compliance is by 2019, the majority of jurisdictions are currently well into the implementation phase, with the Basel Committee on Banking Supervision (BCBS) coordinating member states at the global level and monitoring non-member states at regular intervals. Attesting to the state of regulatory flux, Basel IV is already waiting in the wings even though Basel III is still underway. We offer some insights into Basel IV as well to keep readers abreast of what's key in the fourth round.

Ever evolving, fintech continues to disrupt banking and will fundamentally change the way financial institutions conduct their businesses. One of the newest trends which banks are fervently investigating is blockchain, the architecture underpinning cryptocurrency Bitcoin which has been hailed as a game-changer and revolution. At its simplest, the blockchain can be described as the register of all bitcoin transactions, one which is completely decentralised, public, transparent and verifiable. Indeed, author and journalist John Lanchester in the *London Review of Books*, said this in an essay on blockchain: "A decentralised, anonymous, self-verifying and completely reliable register of this sort is the biggest potential change to the money system since the Medici. It's banking without banks, and money without money." Like the internet in the early days, the blockchain story and its potential uses are still unfolding. But we've attempted to give readers an introduction and update on what's happening in the blockchain space, especially with regards to ASEAN.

Speaking of changes that date back to the earliest days of finance, might there be prospective reforms in the fundamental system of banking as we know it? Check out our update on the campaign to replace fractional reserve banking with full reserve banking, which has gained interest and supporters in Switzerland, Finland and Iceland. We consider viewpoints emerging from the Bank of England to Frosti Sigurjónsson, Icelandic lawmaker and writer of the 'Monetary Reform: A Better Monetary System for Iceland' report to assess if full reserve banking can really be a panacea to address the fundamental failings of the current financial system: "the ability of banks to create credit, money and purchasing power, and the instability which inevitably follows", as Sigurjónsson put it.

While identifying key new developments is a paramount objective every issue, we also want to offer pragmatic strategies and insights into managing change. Among a slew of diverse subjects, this issue explores how chief risk officers as the fulcrums of their organisation can enhance risk culture from top to bottom, and how banks might want to strengthen their information gathering and data analytics competencies to make better decisions and improve their competitiveness.

Nevertheless, while we might be preoccupied by trying to best manage change and the parallel opportunities and risks, we mustn't lose sight of the real reason and goals behind these shiny new reforms – which is to achieve better business and better governance. In everything that we do and in all the reforms that we implement, we have to place the public interest at the core of our strategies and initiatives. Only then can we reinvent ourselves positively to achieve sustainability and legitimacy, and regain public confidence and trust in a world that seems intent on bypassing old-school banks, that demands "banking without banks." ✱

Hope you have a fruitful read.

The Editor

+ Fintech continues to disrupt banking as we used to know it. One of the newest trends which banks are fervently investigating is blockchain, the architecture underpinning cryptocurrency Bitcoin which has been hailed as a game-changer and revolution.

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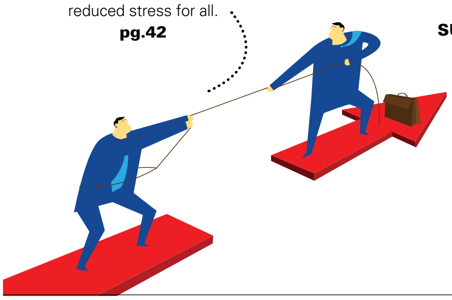

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THE PANAMA PAPERS

The Panama Papers, an unprecedented investigation by the International Consortium of Investigative Journalists (ICIJ) together with other media partners, is the largest leak in offshore history. ICIJ's data and research unit indexed, organised and analysed the 2.6 terabytes of data that make up the leak. The leak includes 11.5 million records, dating back nearly 40 years, and contains details on more than 214,000 offshore entities connected to people in more than 200 countries and territories.
Interestingly, the leak also shows how major banks have driven the creation of hard-to-trace companies in offshore havens, said the ICIJ. More than 500 banks, their subsidiaries and their branches – including HSBC, UBS and Société Générale – created more than 15,000 offshore companies for their customers through Mossack Fonseca, the law firm at the heart of the leak. ✱

BLOCKCHAIN: THE NEXT EVOLUTION

PwC's report, "**Blurred Lines: How Fintech is shaping Financial Services**" says blockchain, a distributed ledger technology, represents the next evolutionary jump in business process optimisation technology, which could result in a radically different competitive future in the FS industry. Blockchain could disrupt and redistribute current profit pools towards the owners of new, highly efficient blockchain platforms. Huge gains in transparency and costs savings are possible.
However, the survey of 544 CEOs, Heads of Innovation, CIOs and top management involved in digital and technological transformation across the FS industry in 46 countries, found that while the majority (56%) recognise blockchain's importance, 57% say they are unsure or unlikely to respond to this trend.
Apathy could cost them. PwC's Global Blockchain team has identified over 700 companies entering this space, 150 of whom it says are "ones to watch" and 25 of which it expects will likely emerge as leaders. ✱

"**FINTECH** is changing the FS industry from the outside. PwC estimates within the next 3-5 years, cumulative investment in Fintech globally could well exceed USD150 billion" - Steve Davies, EMEA Fintech Leader at PwC commenting on PwC survey, 'Blurred Lines: How Fintech is Shaping Financial Services'.

83%

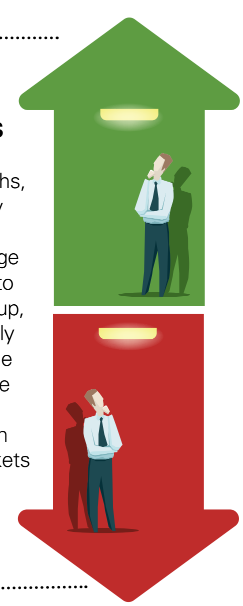
the percentage of respondents from traditional FS firms who believe **PART OF THEIR BUSINESS IS AT RISK** of being lost to standalone Fintech companies - PwC report 'Blurred Lines: How Fintech is Shaping Financial Services'.

INADEQUATE LIVING WILLS

The New York Times in April 2016 reported that the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) rated the "living wills" of five of the eight largest banks in the US as not being credible. The living wills are a requirement of the 2010 Dodd-Frank financial overhaul, intended to assuage the risks to the broader economy of large financial institutions which are "too big to fail".
The Fed and the FDIC., which jointly oversee the largest banks, agreed that the plans put forward by five of the big banks, JPMorgan, Bank of America, Wells Fargo, State Street and Bank of New York Mellon, were "not credible or would not facilitate an orderly resolution under the US Bankruptcy Code," reported the NYT. ✱

STOCKS SHOCK

THE DOW INDUSTRIALS and the S&P 500 may be heading toward record highs, but Americans – especially middle-class adults and those below 35 years of age - appear hesitant to buy into the rally. According to Gallup, only 52% say they currently have money invested in the stock market, matching the lowest ownership rate in the poll's 19-year history. In 2007, just before the markets were crushed in the Global Financial Crisis, ownership hit a high of 65%. ✱



STRs UP IN HK The *HK Sunday Morning Post* revealed that the number of reports of suspicious financial activity made to the Hong Kong authorities by law firms in the city jumped from 222 in 2014 to 894 in 2015. And overall, the number of suspicious transaction reports made to the government's Joint Financial Intelligence Unit climbed to an all-time high of 43,000. ✱

GOLDMAN SACHS OFFERS SAVINGS ACCOUNTS

According to the *Financial Times,* investment bank Goldman Sachs Inc. has begun offering online savings accounts for as little as a USD1 deposit through its online platform *GSBank.com.* This is intended to help diversify its funding base and satisfy liquidity requirements, following its acquisition of about USD16 billion of US deposits from General Electric. The new funds are expected to help support Mosaic, the bank's online lending arm. ✱

"Being part of our policy team at the Bank will provide continuity and the much needed certainty in this prevailing period of great uncertainty." – Outgoing Bank Negara Malaysia Governor Tan Sri Dr. Zeti Akhtar Aziz on the appointment of **DATUK MUHAMMAD IBRAHIM** as her successor.

3.2%
the IMF's (International Monetary Fund) global growth forecast for this year, down by 0.2 percentage points from its projection issued in January 2016.

PRESSURE ON UK BANKS

KPMG'S ANNUAL BANK BENCHMARK report finds that pressure on the UK's biggest banks is at an all-time high. Key findings include:

Overall profit before tax decreased by 40% to £12.4 billion in 2015

Total bank levy increased from £1.8 billion to £2.2 billion representing a 21% increase

Between 2011 and 2015 redress costs totalled £55 billion accounting for 72% of banks' profit – of which £31 billion relates to PPI (Payment Protection Insurance) mis-selling. ✱

Promoting the AEC - Bank Negara Malaysia recently signed two Heads of Agreement with the Bank of Thailand and the Bangko Sentral ng Pilipinas, outlining areas on market access and operational flexibilities that may be accorded to Qualified ASEAN Banks in the respective jurisdictions under the ASEAN Banking Integration Framework.

PREPARE FOR DIMINISHING RETURNS
A new McKinsey Global Institute (MGI) report, ***'Diminishing Returns: Why Investors may Need to Lower Their Expectations'***, has warned that the golden era of exceptional market returns is ending. Returns on equities and fixed-income investments in the US and Western Europe over the next two decades could be considerably lower than they have been in the past 30 years. The report, written in collaboration with McKinsey's Strategy and Corporate Finance Practice, estimates that for equities in the two regions, average annual returns could be anywhere from approximately 150 to 400 basis points lower, or 1.5 to 4.0 percentage points. For fixed-income, the gap could be even larger, with average annual returns between 300 to 500 basis points lower (3 to 5 percentage points), and in some cases even lower than that. ✱

BY ANGELA YAP

THE STATE OF BASEL III

ALTHOUGH REGULATORS ARE TURNING THE HEAT UP ON COMPLIANCE WITH BASEL III, **ASEAN BANKS ARE STAYING AHEAD OF THE REGULATORY CURVE.** BUT ONLY TIME WILL TELL IF THESE STRINGENT EFFORTS ARE ENOUGH TO AVERT THE NEXT FINANCIAL CRISIS.

In yet another overhaul of regulations, Basel III marks the most concerted global effort by regulators, lawmakers and financial players to reduce systemic risk in their bid to avert a repeat of 2008's financial crisis.

Although the timeline for full compliance is by 2019, the majority of jurisdictions are currently well into the implementation phase, with the Basel Committee on Banking Supervision (BCBS) coordinating member states at the global level and monitoring non-member states at regular intervals.

+ the downside of raising the capital adequacy bar is reduced supply of available credit which in turn raises the cost of lending.

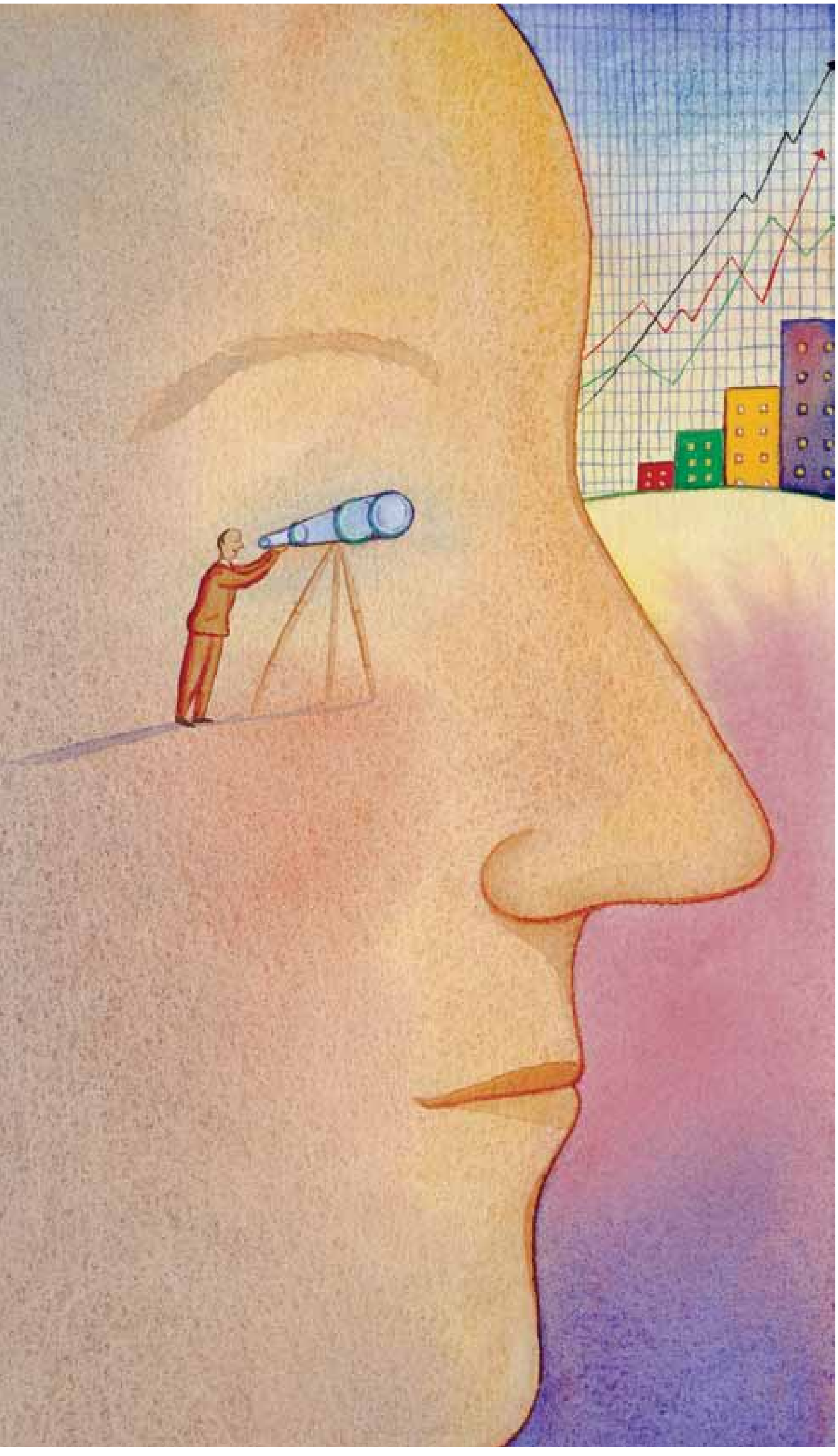
REPORT CARD

Most countries issued regulatory guidelines for banks by end-2013. Across the board, although the pace of reform varies there is a trend of early compliance especially in capital adequacy requirements, with more tempered success in leverage and liquidity measures.

Data and progress reports by BCBS support a number of key conclusions:

- **Capital adequacy requirements have been largely met ahead of schedule.** Previous concerns have melted away as banks exhibit eagerness to shore up capital. Across the board, there is early compliance ahead of 2019's fully phased-in minimum capital requirements of 4.5% CET1 (Common Equity Tier 1) as well as the total common equity standard of 7% (comprising common equity of 2.5% RWA [risk weighted assets]). According to BCBS' November 2015 report on Implementation of Basel Standards, there was zero capital shortfall in all Basel member states' internationally active banks. However, the downside of raising the capital adequacy bar is reduced supply of available credit which in turn raises the cost of lending. This concern continues to niggle the market, with ever-watchful eyes on return on equity and investment.

- **Room for improvement on banks meeting the leverage ratio.** Designed as a supplementary measure to Basel II, the requirement for banks to hold capital equal



to 3% of assets was mooted to cool excessive lending. Some countries such as the UK have proposed that the percentage be increased during boom times. BCBS recently simulated scenarios to assess the preparedness of member states to meet the leverage ratio based on the fully phased-in Basel III Tier 1 leverage ratio. Out of 221 banks, 10 banks didn't make the cut with an aggregate shortfall of 3.7 billion. Furthermore, three out of these 10 banks fell short of meeting the Tier 1 target capital ratio of 8.5%.

▪ **Capital buffers have finally been set and if banks fall within the buffer range, constraints will be imposed on distributions of capital without affecting operations.** These buffers seek to mitigate stress in the market and banks are required to hold:

- A capital conservation buffer - set at a minimum 2.5% of RWA.
- A countercyclical buffer - calibrated between 0%-2.5% of RWA as recommended by BCBS.

The countercyclical buffer will ultimately be determined by domestic regulators who will monitor credit growth and establish triggers to spot build-up of excessive system-wide risks. Already, EU members such as Sweden have set higher than required countercyclical buffers at 1.5% effective 1 January 2016 although the adoption has been much less rigorous in Asia.

▪ **In a bid to end "Too Big To Fail", the Financial Stability Board (FSB) issued its final systemic buffer applicable to global systematically important banks.** A total loss absorbing capacity (TLAC) of at least 16% of group's RWA is required starting from 1 January 2019 and 18% by 1 January 2022. The FSB-led impact assessment estimated that the benefits of TLAC such as reduced probability and cost of crises (15-20 bps) outstripped costs such as increased borrower's rates (2.2-3.3 bps) and annual output costs (2.0-2.8 bps of GDP).

▪ **Compliance to liquidity ratios continues its uptrend.** This indicates sufficient high quality liquid assets to withstand market shocks and decreased reliance on short-term wholesale funding and in effect greater funding stability. BCBS reported that weighted averages for both the liquidity coverage ratio (LCR) and net stable funding ratio were above

Beyond the Bare Minimum

SOCIETE GENERALE IS MAKING THE MOST OF ITS MOVE TO ASSESS COUNTERPARTY RISK AHEAD OF BASEL III.

Going beyond bare minimum compliance, Societe Generale has implemented an enterprise-wide IT solution that automates the calculation of credit valuation adjustment (CVA) and other risk variables to churn millions of financial simulations which would directly feed into traders' desktops. The result: At the press of a button, they now have access to crucial real-time information on counterparty credit risk, alternative trades of varying risks or better yields.

BIG WINS

> Streamlined approach to valuing CVA.

> Efficient capital allocations as traders actively manage their positions – identifying lower-risk trades, and proactively offer better pricing to lower-risk counterparties.

> Foreseeable reduction of bank's risk profile.

DRAWBACKS

> Operational overhaul and cost of integrating solutions to back-, middle-, front-office and bank-wide processes.

Have the benefits of this enterprise-wide implementation justified its cost? Keyvan Silvain, Head of the CVA Desk in Paris, says: "… we have made a very good return on our investment. The capital optimisation is very significant, and we have reduced our capital for VaR (Value at Risk) and CVA considerably with our hedging positions."

the 100% mark. Although there are laggards, these are gradually decreasing in number and size. A key finding from the European Banking Authority's impact assessment found that the new liquidity standards did not reduce lending to the real economy (SMEs, trade finance) or adversely affect financial markets, putting to rest fears that LCR would hamper economic growth.

- **Post-crisis, some countries have used early compliance as a strategic tool to mitigate reputational risk and restore trust.** Setting ambitious targets above and beyond the minimum requirement has had a two-pronged effect:
  1. It signals to the market that fundamentals are sound and above industry average;
  2. This raises their standing in the eyes of peers and regulators.

A case in point is the Monetary Authority of Singapore (MAS) which is ahead of the curve by transposing Basel III to island-incorporated merchant banks and instructing non-bank financial institutions to adopt the risk-based capital framework, ahead of many other Basel peers.

- **Strengthening risk capture is still a work-in-progress.** This is one of the more progressive Basel III features which casts a wider net to cover a spectrum of other critical risks in the trading book, securitisation and counterparty credit assessment. The implementation is less straightforward than other capital adequacy initiatives as the proposed framework imposes a significant operational burden and opens up gray areas which are still in the process of refinement via consultations between BCBS, regulators and banks. For instance, there are now stricter boundaries on what instruments can or cannot be switched between trading book and banking book to curb potential arbitrage but the downside is that operationalising the framework will be complex and eat into banks' bottom lines. Market players have reverted with simpler and less costly alternatives that would sufficiently capture risk over various asset classes and liquidity horizons.

- **Increased regulations have put pressure on margins, leading to banks redesigning their portfolio.** To illustrate, The region is ahead of the curve in a number of aspects. According to Moody's Investors Service, the majority of ASEAN banks are well-capitalised, on target to meet capital adequacy requirements and are expected to maintain higher quantity and quality of capital compared to its international peers.

PricewaterhouseCoopers' 2015 'Indonesian Banking Survey' found that while banks in the archipelago acknowledged the need for capturing credit, liquidity and operational risks in the system, margin pressures remained a top concern. Local, *Shariah* and state-owned Indonesian banks have met this challenge by switching their portfolios to focus on more broad-based fee income like insurance, remittances, and higher-yield products such as SME loans.

- **Interpretations differ between jurisdictions, leading to inconsistency and lack of comparability.** This applies to a wide range of Basel III rules from quantitative models and definitions to more qualitative aspects such as assessment frameworks and reporting. For instance, there is no global minimum standard for a countercyclical capital buffer assessment framework, and Hong Kong regulators allow banks to report biannual rather than quarterly figures. Basel member states and regional groupings such as the EU and ASEAN are currently working to streamline material inconsistencies.

ASEAN TRENDS

The region is ahead of the curve in a number of aspects. According to Moody's Investors Service, the majority of ASEAN banks are well-capitalised, on target to meet capital adequacy requirements and are expected to maintain higher quantity and quality of capital compared to its international peers. For instance, Malaysia and Singapore voluntarily apply more stringent definitions of CET1 where unrealised gains are not fully accounted for. Philippines has also applied an above-average leverage ratio of 5% and banks

should comply by 1 January 2017, a full year ahead of the recommended Basel deadline. By 2019, CET1 will be raised from 4.5% to 6.5% with Singapore and Philippines at the higher end, and Malaysia, Indonesia, and Thailand at the lower end of the compliance spectrum.

ASEAN has also seen an increase in issuance of Basel III-compliant debt papers in order to build up their balance sheet and enhance liquidity positions. Moody's reported improved uptake of debt papers despite investors taking on losses if the point of non-viability rate or other triggers kick in. To gauge sentiments, in 2014, Krung Thai Bank issued Thailand's first-ever Basel III instrument – a USD700 million 10-and-a-half-year bond – three weeks after a coup by the nation's army. The issuance retains its position as the highest yielding Thai-denominated bond.

One notable drawback is that despite meeting minimum requirement targets, comparability of performance and ratios amongst ASEAN countries is difficult. Indeed, harmonisation of regulations across different jurisdictions is a daunting task but necessary in order to mitigate the risk of arbitrage. This challenge

+ harmonisation of regulations across different jurisdictions is a daunting task but necessary in order to mitigate the risk of arbitrage. This challenge requires more than just the will to change.

Aside from crucial technical and operational aspects which need to be ironed out, banks must find their balance between growth and curbing risky behaviour. There is no mother-of-all-solutions; we have seen swathes of change from Basel's infancy to its latest form as regulators seek to impose financial stability.

requires more than just the will to change. In economies such as the New ASEAN-5 – Brunei, Cambodia, Laos, Myanmar, Vietnam – development is a strong motivator but it has multiple structural advancements to make before it catches up with others.

Case in point: Myanmar. Banks have yet to implement Basel I but the recent lifting of international sanctions has added incentive to overhaul its outmoded financial system. With a 53 million population, financial reforms include debates on granting independence to the Central Bank of Myanmar and enhancements to its recently-passed Banks and Financial Institutions Law (pending the Presidential signature), which as far as possible will bring it in line with Basel III. Already, smaller banks are jittery. But like how the ADB predicts Myanmar could be one of Asia's fast-growing economies expanding at 7%-8% per annum, it would not be too far a stretch to say that successful regional economic integration may just be ASEAN's crowning glory.

Casting the net wider, early day forecasts of an East-West disparity in Basel III's approach are gaining traction. Many in the East view the accord as a 'one size fits all' solution that fails to address the distinctive risks of its emerging economies. As a result, calls are emerging for an 'Asian voice' in the international reform of finance. At an October 2015 Borrowers & Investors Forum, Standard & Poor's Head of Financial Institutions Ratings, Ritesh Maheshwari succinctly expressed this sentiment: "The key agenda for Asia Pacific banks is to manage credit growth, rather than cushion against losses." The range of issues raised include bail-in features, simpler risk-weighted assets rules to bring down the region's cost of capital, and implementation of TLAC.

'JACK BE NIMBLE'

While regulators are trying their best to rein in risk, doomsday prophecies continuously abound. *Bloomberg's* report on 28 March 2016 titled 'The Next Perfect Storm' opened with these ominous words: "Those looking for when the next financial crisis might be should set a reminder for 1 January 2018."

What this means is that the effectiveness of Basel III will only be known when the next wave hits our shores. Aside from crucial technical and operational aspects which need to be ironed out, banks must find their balance between growth and curbing risky behaviour. There is no mother-of-all-solutions; we have seen swathes of change from Basel's infancy to its latest form as regulators seek to impose financial stability. Banking will continue its evolutionary path and the future prosperity of individual players will depend very much on how well and quickly the sector adapts to change.

GET READY FOR 'BASEL IV'

LOOMING ON THE HORIZON IS **A NEW SET OF REQUIREMENTS UNOFFICIALLY DUBBED 'BASEL IV'.** YOU WILL, HOWEVER, BE HARD PRESSED TO FIND AN OFFICIAL REFERENCE TO BASEL IV FROM THE BASEL COMMITTEE AS THE PROPOSED CHANGES ARE MORE LIKE A DISPARATE SET OF AMENDMENTS COVERING PREVIOUS ACCORDS RATHER THAN A NEW STANDARD FOR BANKING.

Nomenclature aside, the objective of Basel IV is to enhance the comparability of risks across all banks in different jurisdictions. It does so by incentivising financial institutions to adopt a newer version of the Standardised Approach (SA), currently used and easily adopted by smaller banks, over the alternative Internal Model (IM) approach.

Big banks in general opt to employ the IM approach to capture more granular risks. The IM approach leads to more sophisticated risk modelling and could lead to lower RWAs, the primary advantage for banks adopting IM over SA.

Basel IV seeks to turn the tides. The Revised SA is expected to strengthen and reflect greater sensitivity for a comprehensive range of risk elements – credit, counterparty, securitisation, market, operational, CVA, and step-in – and achieve harmonisation of reporting and regulations across jurisdictions.

By 'beefing up' existing standardised models, the objectives of Basel IV are summarised as:

- **Balancing risk sensitivity vs. complexity.** Recent studies on Basel have shown that depending on the risk model employed, banks with portfolios bearing similar levels of risk showed an excessive level of variability in calculated RWA. The IM approach allows for greater risk precision but its most glaring drawback is that it hampers overall market discipline – there is no baseline for comparison with hundreds of different IMs being used throughout the industry. The move towards adopting the Revised SA aims to achieve the robustness of Basel II and III yet reflect the simplicity of Basel I, enabling both international and local banks to be assessed on the same fundamentals.

- **Emphasis on feasibility.** To enhance reporting comparability, the Revised SA will introduce new dynamic drivers based on availability, intuitiveness and ability to correlate/ explain trends across jurisdictions. For instance, it reintroduces external ratings as a component of credit risk albeit in a non-mechanistic way i.e. external ratings will no longer be central to RWA calculations and will instead be used for more general economic assessments such as customer selection and pricing. This about turn after BCBS' proposed ban on use of external ratings has been lauded by the British Bankers'

These proposed changes, comprising RWA calculations and Pillar III disclosures, are not expected to affect Capital-to-RWA ratios but will significantly increase capital requirements. Several revisions have been proposed by BCBS while other revisions are still in the consultation phase, and already, fail-safe mechanisms have been introduced in this new standardised approach.

Association as "a step in the right direction on credit risk".

- **Limiting national discretion.** Jurisdictions will experience a rollback on national discretions in order to harmonise reporting and regulatory standards including capital requirements. A more punitive approach is also expected in the form of higher risk-weights imposed on non-compliant banks for omissions such as missing information on counterparties and other risks.

- **Introducing obligatory capital floors.** In order to bridge the disparity between Revised SA and IM, floors are likely to be imposed on both approaches. For example, Revised SA may impose that the Probability at Default (PD), a key output of the IM approach, cannot fall below a specific threshold, say 10%. This means that under the IM approach, even if a portfolio has a PD of 4%, it must use the 10% minimum imposed under the Revised SA when calculating RWA, to enable comparability of output derived under both approaches.

These proposed changes, comprising RWA calculations and Pillar III disclosures, are not expected to affect Capital-to-RWA ratios but will significantly increase capital requirements. Several revisions have been proposed by BCBS while other revisions are still in the consultation phase, and already, fail-safe mechanisms have been introduced in this new standardised approach. Example: although external credit ratings are allowed for general assessment, banks will be required to conduct their own due diligence to assess if capital requirements should be higher.

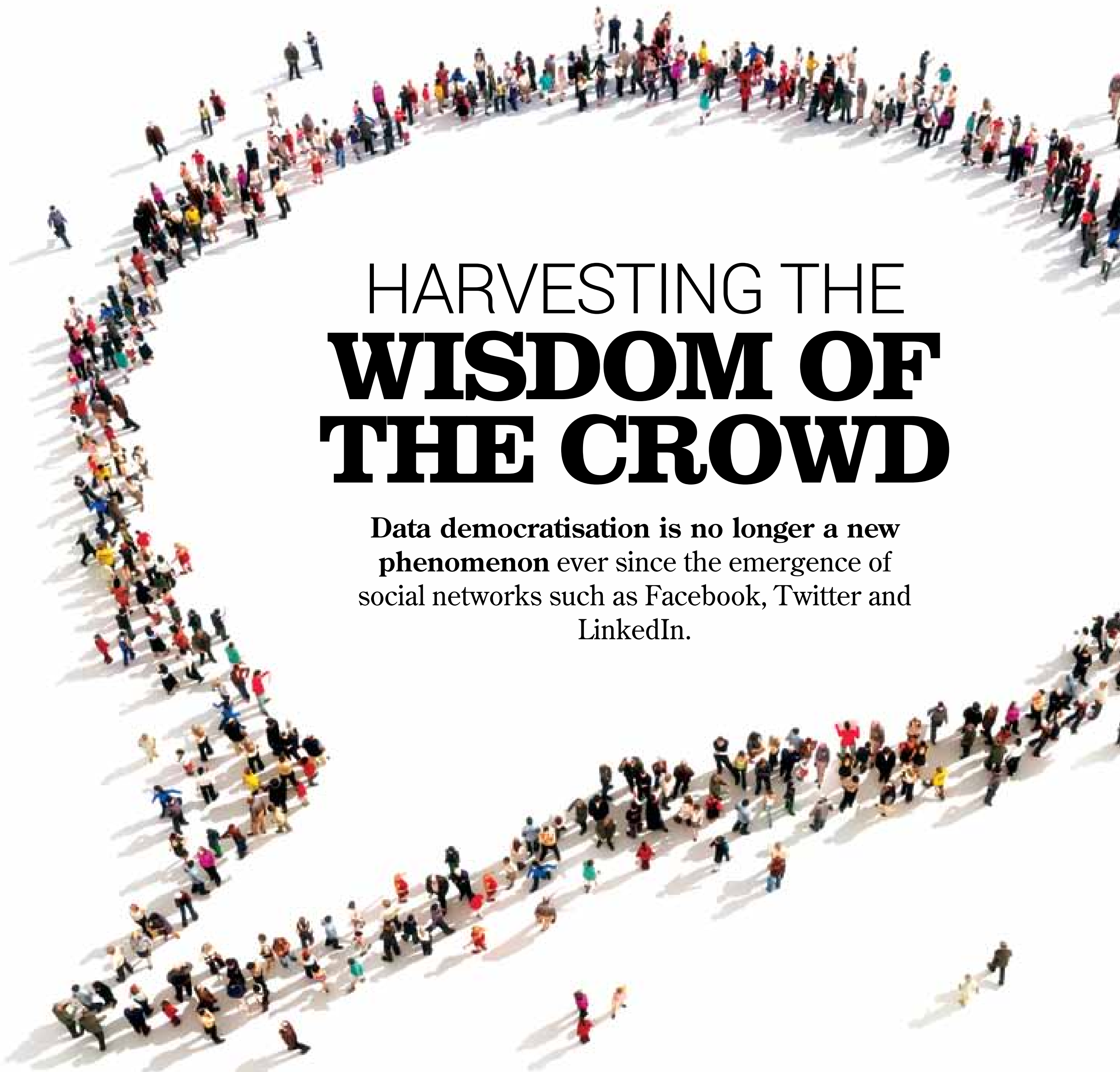
Discussion are just beginning on the widely touted Basel IV but already, diverse views are emerging.

Bundesbank's Andreas Dombret, the board member overseeing bank supervision, expressed support for simplified rules which would aid smaller banks on calculating market risks but emphasised, "We are working on the finalisation of Basel III, and on nothing else." On the end of the spectrum, *Euromoney* recently characterised Basel IV as yet another series of 'blunt standardised measures'.

Irrespective, the industry should brace itself for another round of reforms post-Basel III. ✱

■ Angela Yap is a multi-award-winning social entrepreneur and founder of Akasaa Pte Ltd. She is a writer and author of several books on business and human rights issues, backed by her experience in corporate banking, strategy with a Big Four firm, the United Nations Development Programme, and Amnesty International Malaysia.

 BY DANNIE NGUYEN



HARVESTING THE WISDOM OF THE CROWD

Data democratisation is no longer a new phenomenon ever since the emergence of social networks such as Facebook, Twitter and LinkedIn.

Ever on the lookout for new opportunities, the financial trading segment was the first to capitalise on the power of the community's shared knowledge with the creation of popular networks such as eToro, TradeHero, etc. Three years ago, the innovative fintech enterprise Sentifi was founded to enable the broader financial industry to harvest the wisdom of the crowd or collective wisdom on a global scale. Sentifi Chief Executive Anders Bally speaks with *Banking Insight* about crowd intelligence, the values of crowd wisdom, and the financial industry of tomorrow.

Sentifi does not average the information from the crowd. Sentifi expands the horizon of available information by identifying and giving millions of crowd-experts on specific topics a platform to be heard.

Q How can banks and financial institutions leverage from the wisdom of the crowd or collective intelligence? What are the benefits and challenges of utilising collective intelligence?

They will be better informed because they are getting holistic views about listed stocks or financial assets from the knowledge shared by every influential stakeholder, from employees and suppliers of those listed companies to regulators, activists, investors and more. They will also be able to gain insights earlier, and consequently, they may be able to make better forecasts about what is going to happen in the financial markets.

Q In Sentifi's experience, is crowd wisdom superior to expert wisdom? Wouldn't collective intelligence result in average information and average decision-making?

Sentifi does not average the information from the crowd. Sentifi expands the horizon of available information by identifying and giving millions of crowd-experts on specific topics a platform to be heard. These crowd-experts can be from anywhere in the world. Thereby, Sentifi contributes to the democratisation of intelligence used for financial market relevant analysis. For example, let's take a look at the Volkswagen scandal: It was an environmental activist who first talked about the so-called Dieselgate. Sentifi Engine is listening to people like the said activist. We listen to a large number of crowd-experts who are relevant stakeholders. And we make this information transparent to the crowd.

^ **DR. ANDERS BALLY** serves as the Founder and the Chief Executive Officer at Sentifi Group AG. He is a serial entrepreneur with more than 24 years' operational and strategic experience in building successful international businesses in the financial and software industry. He holds a PhD from the University of Fribourg (CH).

Q Have markets, investors and investment decisions really become more efficient and effective with the use of aggregate intelligence? Has this been quantified? Does consensus come at the detriment of accuracy and precision?

Big data is better than small data. Crowd intelligence does not mean to increase the visibility of consensus. It actually challenges the general agreement that usually is led on by the mainstream media. Crowd intelligence is about bringing visibility to the otherwise overshadowed but candid insightful voices.

But that's not all. Our Engine measures financial relevance, the impact and longevity of every message as well as ranks their sources. If one has always shared insightful, accurate and precise information about financially relevant topics, he or she will get a high score from us. And only with a high score is he or she able to influence our analysis.

Q Doesn't the use of collective intelligence to anticipate trends contribute to short-termism? Isn't this also at odds with the philosophy of long-term investors such as Warren Buffett and Benjamin Graham, and would lead to increased market volatility?

Our system does not make nor recommend financial decisions. We only provide investors with timely insightful information, so they can make sound, and better decisions. Our Engine can detect and recognise short-term developments as much as long-term trends. Both are discussed in the financial crowd. In your example: Warren Buffett is one of the best crowd members, and consequently he is also one of the best members of Sentifi.

Q Who are the investors/organisations making use of crowd intelligence and why? What products and services have been designed combining collective intelligence and fintech, especially in the banking sector by your clients such as Deutsche Bank and Black Rock?

In the past, these clients signed up to display our widgets of crowd intelligence on their homepages. They need to have good content for their own clients and employees. Today, asset and portfolio managers are asking to use our services, called myMarkets, to monitor market conversations about their personalised portfolio of financial assets. We are also developing myCompany, a solution for listed companies to manage their exposure in global financial markets. Users of this product can monitor and react in a timely manner to relevant conversations about their companies and key executives from influential

WITH 2.7 MILLION VOICES PROVIDING INSIGHT, ISN'T THAT A LOT OF NOISE? HOW DO YOU SEPARATE WORTHWHILE IDEAS FROM THE NOISE? WHO PROVIDES THE ANALYSIS AND VALUE-ADD?

Our core competence is the ability to structure unstructured data, clean out the noise and extract insights that are relevant to the global financial markets with our machine. We have built a self-learned engine with proprietary algorithms to identify, classify, evaluate and rank voices from all over the world based on their experience, professional roles and quality of their shared content. In the next two years, we aim to bring together an ecosystem of 100 million sources. Our model is scalable. It is a kind of autopilot for the financial market. And you know the autopilot makes much fewer mistakes than the human pilot.

stakeholders, including traders, regulators and activists. We are the next-generation *Reuters* based on the wisdom of the financial crowd!

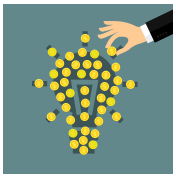
By democratising information, do you find that this supports ethical and sustainable investment? Do you think democratising information and collective intelligence might also promote transparency and good governance and the unshielding of beneficial ownership/ultimate ownership e.g. as in the Panama Papers scandal? How could fintech collective intelligence and information crowdsourcing help regulation and enforcement?

The Internet democratises information - yes, but likely on a very low level. Everybody is a receiver on the Internet and everybody is also, at the same time, a sender. That produces transparency and, as you say, maybe democracy. But it also produces a lot of noise. A big data fintech company such as us is only helpful, if we can really show the wisdom of the crowd and not the foolishness of the crowd.

What directions can collective intelligence be taken in? What other innovations can result from collective intel in fintech?

There is no other business that is more data driven than the financial industry. So Big Data and financial solutions are the married couple of the future. Knowing your customer, knowing the markets, finding relations between seemingly unrelated developments is something that we can expect from the big-data machine on one hand. On the other hand, it is the clash of cultures that every fintech provokes: Don't even think that you'll live tomorrow in the same world as today. ✱

■ *Dannie Nguyen is the Head of Crowd-Expert Ranking at Sentifi AG, a Swiss company curating crowd intelligence about global financial markets using machines. She has experience in designing, building and commercialising data-driven technology products and community-driven businesses for both enterprise and consumer markets. She founded PinDone Inc., a peer-to-peer marketplace for services and was a founding member of Accenture's Smart Building Solutions serving clients globally.*



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TPPA: REWRITING THE RULES FOR PACIFIC RIM FINANCE

What does the grand Trans-Pacific Partnership Agreement **hold in store for the financial sector?**

Attesting to increasing globalisation, trade relations are still going strong, establishing further cooperation and interconnectedness between countries. The Trans-Pacific Partnership Agreement (TPPA) seeks to continue this trend.

Linking key Pacific Rim countries, the Trans-Pacific Partnership comprises twelve nations that together make up 40% of global economic output: the United States, Canada, Chile, Peru, Mexico, Australia, New Zealand, Japan, Singapore, Brunei, Vietnam, and Malaysia. The US-spearheaded initiative will see the partnership implemented after collective ratification, with the expected year of completion being 2018.

While ostensibly a trade pact, the TPPA's scope and impacts will not be limited to the economic sphere. Geopolitically, the TPPA is perceived as a US strategy to contain China's influence, especially in the South China Sea where tensions have been flaring over control of the USD5 trillion trade route. US President Barack Obama bluntly stated that the TPPA "allows America – and not countries like China – to write the rules of the road in the 21st century, which is especially important in a region as dynamic as the Asia-Pacific."

If it comes to fruition, the TPPA aims to further liberalise and open up its members' markets for trade and services. Other gains, according to the Office of the United States Trade Representative (USTR), will be economic growth, poverty reduction, job creation and retention, better living standards, and enhanced competitiveness, productivity, and innovation. The pact will also seek to influence labour and environmental laws, and advocate good

governance and transparency.

However, the TPPA's true novelty and precedent-setting nature lies not in eliminating conventional trade barriers but in eradicating non-tariff barriers (NTBs) such as quotas, sanctions, red tape and protectionism. Post-World War II, trade liberalisation has become tougher as low-hanging fruit was plucked, leaving more sensitive issues such as sovereignty and deregulation on the table.

The TPPA is attempting to overcome these contentious areas, even if it does bypass key segments of the international economic circuit, such as China and the EU. This will also mean that the TPPA will circumvent the WTO (World Trade Organisation), since the latter's role in negotiating trade deals has been stymied due to the still unfinished Doha Development Round, as Edward Alden noted in the World Politics Review. Thus, the TPPA can be considered as a tool to reinvigorate stagnating trading systems, and ultimately, as what the International Monetary Fund (IMF) Managing Director Christine Lagarde labelled a right step in avoiding "a new mediocre in the global economy".

THE TPPA AND THE FINANCE SECTOR

Game-changers for the financial sector relate to the TPPA's chapters on financial services, investment, the Investor-State

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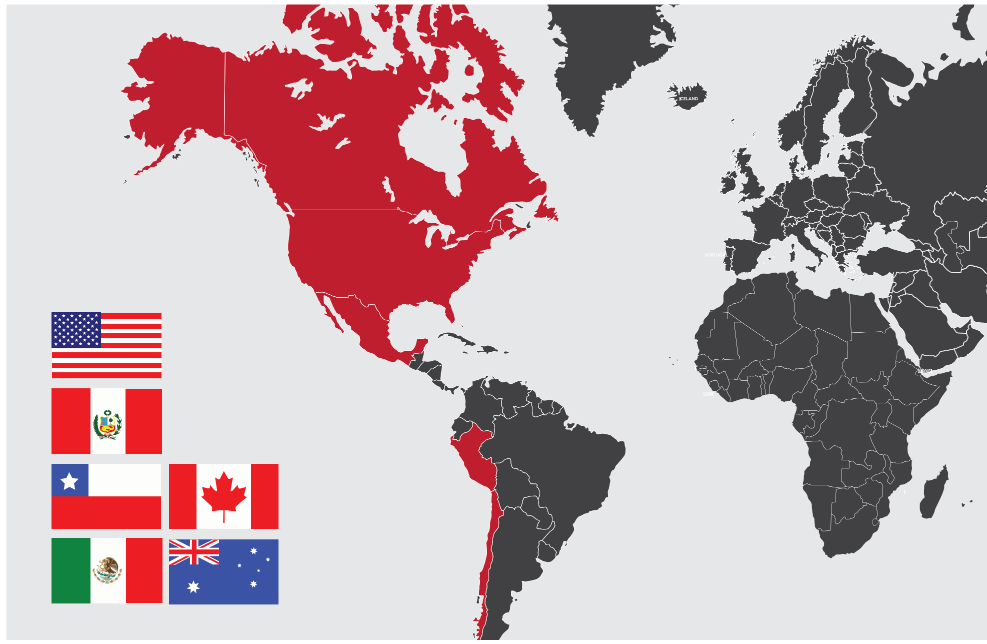
Dispute Settlement (ISDS), and gains from the elimination of relevant NTBs. Barriers to services are essentially non-tariff in nature, according to the Federation of American Scientists' TPPA brief for the US Congress, and encompass issues such as bank licensing laws, investment restrictions, and regulation.

Essentially, the TPPA will "reduce regulatory barriers for foreign service providers (FSPs)" to access other markets and possibly construct "a broader regional market for financial services", claims global law firm Herbert Smith Freehills. The TPPA also commits to openness and non-discrimination, writes Anna Gelpern for the Peterson Institute of International Economics study titled 'Assessing the Trans-Pacific Partnership (Volume 1): Market Access and Sectoral Issues', while simultaneously pledging stricter and more concrete measures on "greater access to payment and clearing systems and cross-border portfolio management, along with constraints on state provision of financial services". Herbert Smith Freehills also notes that the TPPA will continue efforts to streamline regulation in line with Basel III, G20, and Financial Stability Board (FSB) standards. But these initiatives will have to take into account how diverse the TPPA's members are in terms of existing regulation and development.

A key concern with TPPA's laws is that they don't dovetail with local frameworks and national contexts, and could potentially override sovereignty and autonomy, which triggered strident protests. Albeit clauses to ensure that government intervention to safeguard national interests have been written into the TPPA text, how this will pan out remains to be seen, given that the TPPA operates on a negative list basis for financial services and investment commitments - meaning all countries party to the TPPA are bound to carry out these commitments unless they explicitly state otherwise and draw up exclusions. Furthermore, any new changes by national governments must be congruous and consistent with the stipulations within the TPPA's chapters. Blanket rulings and enforcement carry other consequences as well: for example, the TPPA requires members to allow all financial products and services if it is already permitted in other member countries. Since the TPPA aims to open up markets, it will further liberalise transnational financial services, which will allow for the sale of certain financial services from and to TPPA countries without the vendor having to establish new overseas operations in the destination country. The only caveat, according to the USTR, is that these provisions are subject to authorisation and registration in the client country to ensure appropriate oversight and regulation in line with domestic interests. The USTR further states that under the 'national treatment' and 'most favoured nation' principles, a TPPA-party supplier can offer a new financial service in a market if domestic companies are allowed to offer that same service, further levelling the playing field between domestic and foreign companies. However, certain restrictions remain intact, such as imposing conditions on bank branch openings to protect local players.



+ Under TPPA, the national treatment principle translates into lower levels of protectionism for domestic financial enterprises. Hence domestic services must build up competency and capacity in order to compete on a more level playing field, except where there are exemptions.

INSPIRING CONFIDENCE, DEVELOPING MARKETS

Under TPPA, the national treatment principle translates into lower levels of protectionism for domestic financial enterprises. Hence domestic services must build up competency and capacity in order to compete on a more level playing field, except where there are exemptions. For instance, the regulatory exemptions written into the TPPA text may potentially result in continued preferential treatment

TPPA markets should also become more attractive to foreign investment by reinforcing the ISDS mechanism, which aims to inspire market confidence by providing a channel for investors to resolve grievances against the state - and at the last resort, to bring their cases to an independent and international panel for arbitration.

for local banks, notes Herbert Smith Freehills, as countries still have the right to exercise "nationally-based prudential and monetary policies".

TPPA markets should also become more attractive to foreign investment by reinforcing the ISDS mechanism, which aims to inspire market confidence by providing a channel for investors to resolve grievances against the state - and at the last resort, to bring their cases to an independent and international panel for arbitration. However, concerns were raised that foreign companies could abuse the ISDS to challenge any legislation that threatens to impede trade and services, even at the expense of national security or interests, and consequently sue the relevant governments. Prior examples of FSPs utilising the ISDS tend to revolve around claiming injustice over promised national treatment, while it could be used also to challenge expropriation, where the state seizes property for public benefit. But as a safeguard, the TPPA specifically guarantees a minimum standard of treatment (MST) for investors, as well as protection from expropriation.

Other noteworthy points include the exemption from the new cross-border data initiative. While companies in other industries are not required to establish localised data centres, financial service companies do not have the same privilege. Owen Davis at the *International Business Times* notes that banks must keep foreign client information within borders if requested by the host government. Clancy Yates at the *Sydney Morning Herald* adds, however, that financial companies can transfer and process information within TPPA member countries, subject to confidentiality and privacy.

LOOKING TO THE FUTURE

Overall, banks affected by the TPPA stand to gain. Vietnam National University's Director of the Faculty of Economics and Business, Dr. Nguyen Hong Son anticipates that banks in TPPA markets will gain from the transfer of modern banking management technology and new banking models. Other economists, including Dr. Dao Le Kieu Oanh from the Banking University of Ho Chi Minh City, forecast enhanced liquidity and business prospects due to increased FDI, easier access to international funding at lower costs, and increased provisions of import-export loans and services once trade increases. Gelpern noted that the TPPA will also facilitate cross-border investment advice and management services, as well as access to public clearing and payment clearing systems for FSPs.

At the same time, FSPs must be cognizant of the TPPA's various exemptions, specifically for countries like Malaysia that Gelpern says have opted for "extensive reservations to the financial services chapter". The exceptions extend beyond provisions to safeguard the Islamic finance market, of which Malaysia is a global hub, but also includes the right to withhold licenses to FSPs in the public interest. Malaysia's Institute of Strategic and International Studies (ISIS) noted some exclusions pertaining to the finance sector in its TPPA cost-benefit analysis: Malaysia will not provide national treatment to any FSP that does not open physical operations on its soil, and Bank Negara Malaysia and the Securities Commission Malaysia will have the right to monitor and control all financial institutions in Malaysia. PricewaterhouseCooper's TPPA cost-benefit analysis adds that existing and future development institutions may accord preferences to Malaysians when supplying their services; state-owned enterprises like Petronas will also continue enjoying non-commercial assistance, e.g. preferential access to credit, so long as this does not adversely affect the interests of other TPPA members.

If successful, the TPPA will pave the way for other significant multilateral trade pacts such as the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and US as well as the Trade in Services Act (TISA), a trade pact negotiated between 23 members of the WTO constituting 70% of world trade in services. Nevertheless, regardless of whatever unfolds come 2018, it cannot be denied that the potential ratification of TPPA will be a tremendous catalyst to change for FSPs in the affected markets.

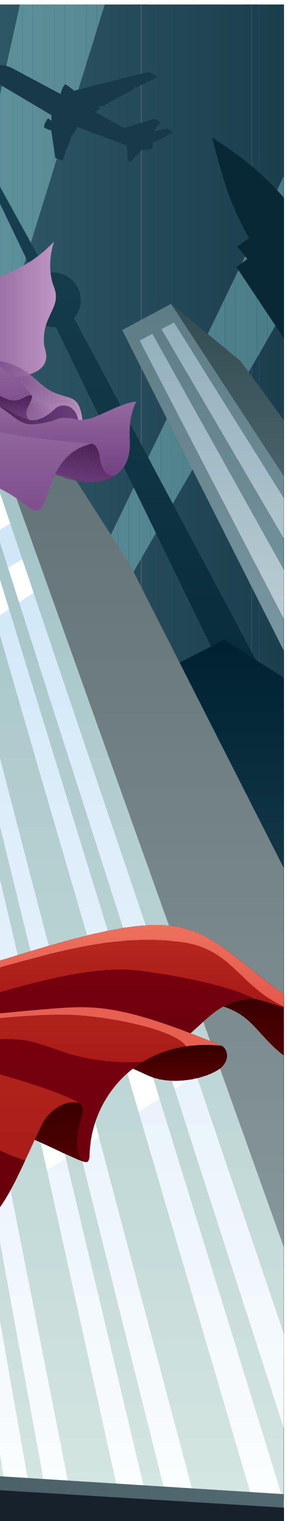
Catalysts for Change

WHAT BEARING WILL THE TRANS-PACIFIC PARTNERSHIP AGREEMENT (TPPA) HAVE ON THE ASEAN ECONOMIC COMMUNITY (AEC)?

The ASEAN Economic Community (AEC) and the Trans-Pacific Partnership Agreement (TPPA) are two trade pacts slated to transform the terrain of multilateral trade. But are they complementary or competing?

At their roots, the TPPA and the AEC have similar methodologies even if their goals differ. The TPPA aims to rewrite the regulatory rules of trade and services, while the AEC aims to augment the collective growth of the Southeast Asian region and uplift the social and economic wellbeing of the ASEAN people. Nevertheless, both seek to liberalise trade and eliminate barriers and expand domestic markets through strengthening cross-border trade and services flows. In this sense, the TPPA and AEC complement each other - as Singapore Prime Minister Lee Hsien Loong attested to even back in 2013.

However, it should be noted the two are only complementary if a country is party to both. Malaysia, Singapore, Brunei and Vietnam have all become signatories to the TPPA, touted to be the largest trade pact in recent years. The other ASEAN countries - namely, Thailand, Indonesia, the Philippines, Cambodia, Laos, and Myanmar - have not. Could this create divisive conditions?



What happens, for instance, if the TPPA and AEC have conflicting rules and regulations on trade and services? ASEAN has always subscribed to the principles of non-interference and sovereignty protection. Though the AEC seeks to dilute non-tariff barriers (NTBs), it may not wish to do so to the same degree as the TPPA, especially if deregulation erodes state powers over domestic markets. For instance, certain ASEAN members declined to join the TPPA due to differences over Intellectual Property Rights (IPR) and state-owned enterprises. Thus, might regulatory divergence affect the internal economic integration ASEAN is currently striving towards? In addition, might it widen the gap between members in IPR regulation, asked Chen Jingyang at the Asia Foundation in an article entitled 'TPPA and RCEP: Boon or Bane for ASEAN?'.

Another possibility, as Shohib Masykur writes for the Jakarta Post, is that trade flows may be diverted to TPPA ASEAN members from non-TPPA ASEAN members. TPPA-party countries like the US, Australia and Japan - all of whom are Top 10 trading partners with all ASEAN countries - may channel more trade and investment to TPPA ASEAN members due to the benefits offered by the trade pact. Non-TPPA ASEAN members may not only find their balance of trade with these countries being jeopardised, but may also find the economic disparities between them and the more advanced ASEAN countries increasing. This potential consequence, notes Masykur, will be due to the TPPA ASEAN members having more incentive to improve economic indicators, facilitating a more conducive international business environment, and enhancing economic management capacities to achieve the TPPA's high standards. Thus, instead of a seamless AEC, the region could emerge "as a chain of disparate markets, divided between fast-growing modern economies (ASEAN-6) and inward-looking poor countries (Cambodia, Laos, Myanmar and Vietnam or CLMV)," Elodie Sellier wrote in *The Diplomat*.

As such, it could be argued that the trade pact divide arguably affects ASEAN's goals. Masykur notes that a reason behind the AEC's establishment was to avoid members prioritising national economic agendas over the region's collective interest. The TPPA's endangerment of regional integration has thus sparked criticism from non-TPPA ASEAN members like the Philippines, whose Finance Minister Cesar Purisima has said: "If there's a lag between the joining of the others in a high-quality agreement such as TPP, there can be resentment, especially as we continue to integrate."

It remains to be seen how this situation will play out, and both trade pacts have a long way to go to reach fruition. Nevertheless, there is little doubt that once realised, both the TPPA and the AEC will be major catalysts in shaping a dynamic and open new ASEAN that will be a beacon in global growth.

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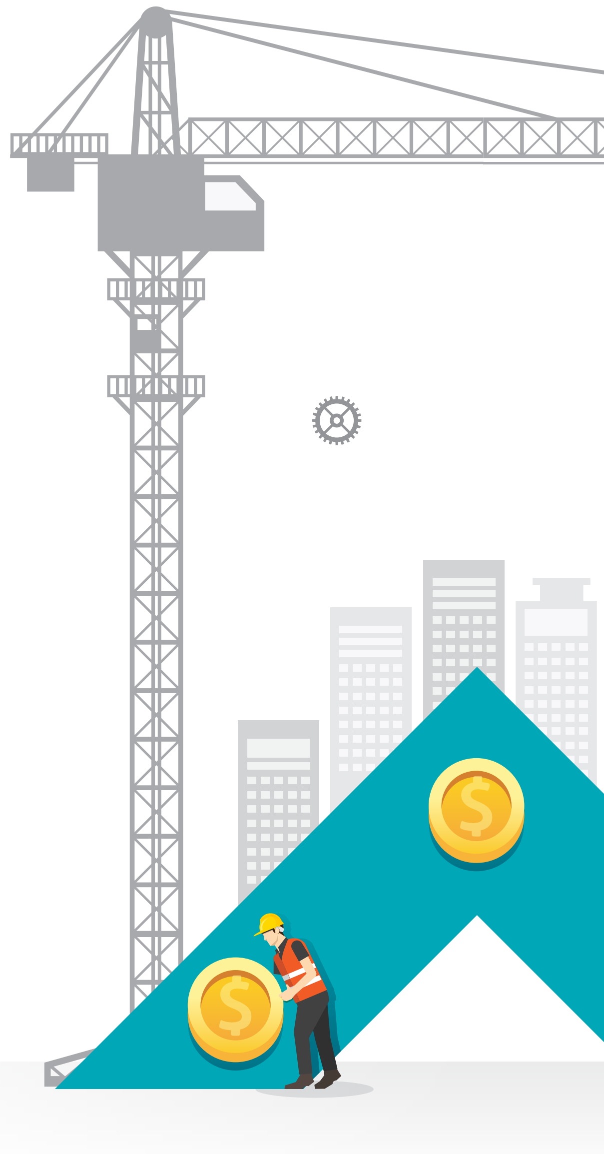
A WEALTH OF OPPORTUNITIES

ASEAN'S JOURNEY TOWARDS ECONOMIC INTEGRATION IS STILL UNDERWAY, BUT THE FINANCIAL SECTOR STANDS TO BE A BIG WINNER ONCE THE ASEAN ECONOMIC COMMUNITY (AEC) ACHIEVES ITS VISION.



The ASEAN Economic Community (AEC) launched on 31 December 2015 seeks to establish a single market and production base to boost ASEAN's economic competitiveness, forming a community of 622 million people and the world's seventh largest economy, as well as Asia's third largest market that collectively makes up USD2.6 trillion in GDP, according to ASEAN's Integration Report 2015. By 2030, McKinsey predicts that ASEAN will become the fourth-largest economic community in the world.

Already, the AEC has plucked its low-hanging fruit. According to an Asian Development Bank (ADB) report entitled 'Realising an ASEAN Economic Community: Progress and Remaining Challenges', "more than 70% of intra-ASEAN trade incurs no tariff and less than 5% is subject to tariffs above 10%." According to the Managing Director of the Monetary Authority of Singapore Ravi Menon, "more than 90% of key deliverables targeted for completion in 2015 have been implemented" with agreements to improve investor protection, liberalise sectors for investments, and provide greater transparency on investment rules also being enshrined in the AEC Blueprint.

Understandably, the AEC is a nascent journey. Though the project was officially implemented in December 2015, its realisation is a work in progress and there are still many key issues to address. These include the absence of a supranational authority - e.g. regional institutions akin to the EU Parliament and EU Court, language - and the lack of a collective ASEAN identity, wrote Patrick Low of Hong Kong University's Asia Global Institute in the *South China Morning Post.* Perhaps the biggest challenge will be to address the development divide, disparity and diversity (political, economic, and sociocultural) between the established ASEAN-6 and newer ASEAN-4 states (Cambodia, Laos, Vietnam and Myanmar) that could impede the vision of the AEC as a global business locus.

+ AEC'S FINANCIAL MILESTONES

Overcome these barriers, and the AEC could ignite explosive growth in major sectors such as finance. Finance is recognised as one of the most important sectors supporting ASEAN's

Overcome these barriers, and the AEC could ignite explosive growth in major sectors such as finance. Finance is recognised as one of the most important sectors supporting ASEAN's economic and social development, and the AEC has stated its commitment to liberalise "financial services, capital account regimes, and inter-linked capital markets" in its Integration Report 2015.

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The ASEAN Bank Integration Framework (ABIF) aims to enforce "principles of equal access, equal treatment and equal environment to the banking industry" by 2020, as stated in the Integration Report 2015. As a start, the mechanism of the ASEAN Capital Markets Forum, which seeks to integrate equity markets regionally, has three signatories so far, i.e. Thailand, Malaysia, and Singapore.

Nonetheless, this divergence has a silver lining. Alice Huang from the Federal Reserve Bank of San Francisco writes that integration at different speeds allows different countries, especially those with less developed banking sectors, to "improve efficiency and shore up capital, so that domestic banks are better able to compete with other regional players". These sentiments were echoed by the International Monetary Fund (IMF), while the ADB's Head of the Office of Regional Economic Integration Iwan Azis has said that providing a level playing field is most important to ensure that there are no winners and losers, but collective champions.

Without doubt, financial services look set to gain in several ways through the AEC should liberalisation take off. Firstly, Huang notes that improved market access and global competitiveness will be complemented by the ABIF policies, which will allow for bank growth to increase through regional mergers and acquisitions. Secondly, Accenture Consulting's review of the AEC notes that the integration agenda will open up new opportunities for retail and wholesale banking, and the ongoing digitisation and improved connectivity will open new doors for mass-market wealth and asset management services. Thirdly, the AEC aims for financial inclusion, as noted in its AEC Blueprint 2025. This will allow service providers to deliver to under-served segments like the Micro, Small and Medium Enterprises (MSMEs) by diminishing the digital gap and establishing credit bureaus for MSMEs; for example, the AEC will also improve access to and reduce costs of services like mobile technology and micro-insurance by enhancing distribution channels. Fourthly, financial service providers (FSPs) can look forward to capital account liberalisation, enhanced payment and settlement systems, and opportunities to fill financial development gaps due to the AEC's goal of capacity building.

To achieve these gains, ASEAN unity will be imperative. ASEAN members must work collectively to overcome disparity, in order to ensure inclusion for all and deliver on the tremendous latent potential of the AEC. ✱

■ *Amalina Anuar is a KL-based writer interested in political economy, international relations, and comparative integration between Europe and Asia.*

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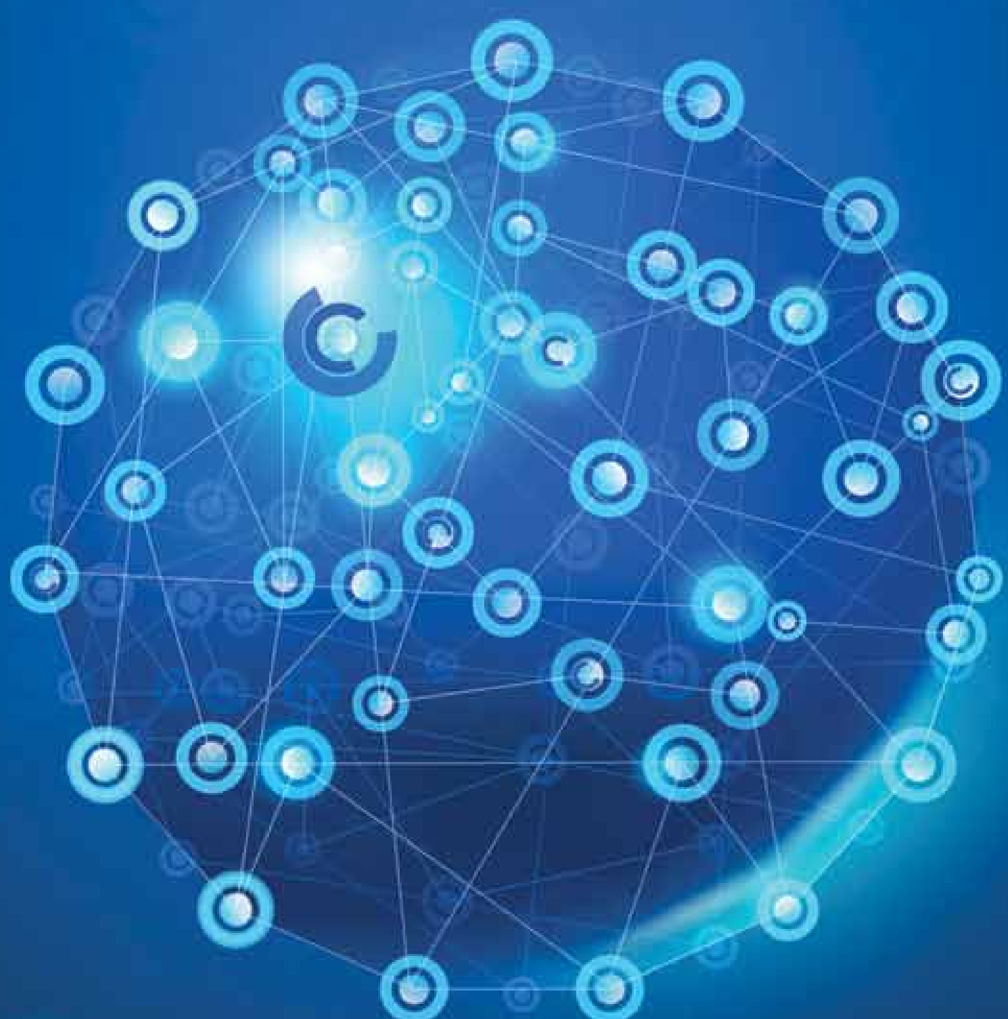
BLOCKCHAIN ASCENDING

Blockchain is being touted as a revolutionary technology that could disrupt finance as we know it. What does this mean for banks?



To put it simply, the blockchain is a decentralised, unalterable, secure and transparent public ledger distributed across millions of computers. This ledger or record keeps track of all Bitcoin digital currency transactions without granting any single person or entity control over the record. These qualities grant it integrity, make it impervious to fraud, and make the blockchain a "machine for creating trust," as the *Economist* put it.

Is a banking revolution powered by blockchain in the offing?

The idea of the blockchain - which is the technological infrastructure that underpins the controversial Bitcoin crypto-currency - is gaining sizeable attention and traction, particularly in the finance sector.

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It is also precisely these qualities that are drawing banks and financial institutions to experiment with the blockchain to deliver innovative new services. Last year, Anju Patwardhan, the Group Chief Innovation Officer for Standard Chartered Bank wrote a public LinkedIn post stating that "blockchain has the potential to become a technology model for a low-cost and transparent transaction infrastructure".

Banks appear to be working together and individually to develop best practice in the nascent blockchain space. According to a *Reuters* report in December 2015, 30 institutions including JP Morgan, BNP Paribas, and Citigroup were joining New York-based financial tech firm R3 CEV to research ways the technology can be used in financial markets. Meanwhile, JP Morgan partnered with start-up Digital Asset Holdings in February 2016, according to the *Financial Times,* with the goal of investigating how to use blockchain to make the process of trading loans more efficient and cost-effective.

Exchanges have jumped on the bandwagon too. Late last year, Nasdaq made its first trade utilising the blockchain. Using its Linq blockchain ledger in order to issue securities to a private investor, it was the first time the need for the middle man such as a clearing house was removed from the transaction. Many in banking, including the Chief Executive of Nasdaq, Bob Greifeld, considered it a "seminal moment," adding that "the implications for settlement and outdated administrative functions are profound."

Regulators were wary of the issues around regulating alternative unregulated currencies such as Bitcoin, in particular their affiliations with the dark web and fuelling illegal activities have also cautiously indicated that blockchain could be useful. The Bank of England labelled it a "key technological innovation" and the Monetary Authority of Singapore stated in a keynote address at the Global Technology Law Conference 2015 that the technology could be "applied in any area which involves contracts or transactions that currently rely on trusted third parties for verification."

Potential cost savings are another factor bolstering blockchain's appeal. A report on Fintech co-authored by Santander estimated that applying blockchain technology has the potential to reduce "infrastructure costs attributable to cross-border payments, securities trading and regulatory compliance by between USD15-20 billion per annum by 2022."

BLOCKCHAIN SANS BITCOIN

Blockchain first came to prominence as the technological platform supporting the alternative cryptocurrency Bitcoin. Blockchain's properties of being decentralised and tamper-proof are

+ Blockchain's properties of being decentralised and tamper-proof are precisely what make the technology and its applications so promising for banks and regulators seeking to improve the integrity of financial systems and curb fraud.

So how do blockchains work? Unlike regular currency, Bitcoin currency is not printed, it's discovered. Once a payee initiates a transaction using Bitcoin wallet software, the transaction is broadcast onto a global bitcoin network. It is then collected into a "block" with several hundred other transactions, which must then be vetted and authorised by "miners" who are responsible for maintaining the general ledger and earn Bitcoin currency for their work.

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Financial institutions are betting on the idea that the concept of a blockchain can be applied anywhere and that the system of miners that validates Bitcoin's blockchain can be replaced by any number of other mechanisms. But what are these alternative mechanisms? And can blockchain be applied in the global banking system without Bitcoin and its miners?

Apparently so, according to several heavyweights which have created workable models utilising blockchain. Citigroup has created its own digital currency based on the blockchain, with Ken Moore, Head of Citi Innovation Labs, telling the *International Business Times* that, "We have up and running three separate systems within Citi now that actually deploy blockchain distributed ledger technologies."

The startup SmartContract is using blockchain technology to create self-executing, computable contracts which, according to the company, "are made tamper-proof through storage and/or execution on decentralised infrastructure." This setup is similar to what many banks say they could use to efficiently validate and authenticate transactions and agreements without Bitcoin currency serving as an incentive to so-called miners.

The Economist, which has written many articles in support of the blockchain technology, seems to think it's entirely possible to apply to the banking sector without using Bitcoin currency as an incentive. Imagining one hypothetical setup, the magazine wrote "a group of vetted participants within an industry might instead agree to join a private blockchain, say, that needs less security" and that "blockchains can also implement business rules, such as transactions that take place only if two or more parties endorse them, or if another transaction has been completed first."

This kind of vision resembles what the Linux Foundation's Open Ledger Project is working to develop, which they hope will be "an enterprise grade, open source distributed ledger framework and free developers to focus on building robust, industry-specific applications, platforms

and hardware systems to support business transactions."

BLOCKCHAIN IN ASEAN

Given the lack of legacy infrastructure in many ASEAN markets, the blockchain's applications offer significant potential in this region. Firstly, there is the prospect of strengthening ties in the region by linking the ASEAN stock exchanges and reducing friction of transactions being carried out across borders, which is one of the goals of the ASEAN Economic Community (AEC). This could happen in the form of using blockchain to create more efficient mechanisms to

In the ASEAN region, start-ups and initiatives in this space are already proliferating, whether with or without Bitcoin. CoinPip is a Singapore-based money transfer service that uses the blockchain to help enterprises send money to vendors, contractors, and remote employees across international borders within the region. Charging just a 2% flat fee, CoinPip uses Bitcoin and blockchain to eliminate forex charges, banking fees, and minimum payment amounts, providing more options for businesses who want to grow across regional borders.

facilitate foreign exchange or, even more significantly, by contributing to the creation of an alternative currency founded on the same principles of blockchain, but distinct from Bitcoin.

Discussing an alternative currency in the 'Handbook of Digital Currency', author David Lee Kuo Chuen, who is the Director of the Sim Kee Boon Institute for Financial Economics at the Singapore Management University and who holds a PhD from the London School of Economics, wrote, "A Pan Asian Coin could be the bridge to the integration of capital, debt, and derivative markets besides stimulation of economic trades. Such a concept or initiative, with support from regulators or financial markets, can lead to a reduction in business costs and the formation of a common market in finance in economics."

In the ASEAN region, start-ups and initiatives in this space are already proliferating, whether with or without Bitcoin. CoinPip is a Singapore-based money transfer service that uses the blockchain to help enterprises send money to vendors, contractors, and remote employees across international borders within the region. Charging just a 2% flat fee, CoinPip uses Bitcoin and blockchain to eliminate forex charges, banking fees, and minimum payment amounts, providing more options for businesses who want to grow across regional borders. Though it uses Bitcoin currency and is focused mostly on B2B at the moment, their model could one day tap into a huge consumer remittance market - which in 2016 is expected to grow to USD130 billion in East Asia and the Pacific according to the World Bank - that the blockchain could potentially be used to facilitate.

In addition, Citigroup is said to be courting blockchain developers in the Asia Pacific region; the potential to use a blockchain-based currency as a mechanism for financial inclusion in the region is rumoured to be their motivating factor. Just as many unbanked individuals in sub-saharan Africa have leapfrogged the need for a conventional bank account using apps like M-Pesa and a mobile phone, so too could ASEAN's unbanked population - but this time the blockchain could potentially serve as the mechanism by which they receive funds and sidestep brick and mortar banks.

Also in the Asia Pacific region, in 2015 iWWorldExchange announced the launch of a new blockchain technology exchange based in Hong Kong, which would improve access to finance for small and medium-sized companies. Operating like any other exchange, the main difference is that all assets are denominated in Bitcoins. iWWorldExchange targets firms that want to go public and raise capital but seek a more affordable alternative to traditional exchanges. The blockchain-based exchange is considered ideal for both entrepreneurs and cryptocurrency traders.

Blockchain might also play a part in future geopolitical strategy to strengthen trade and markets. In March, as part of the "American Innovation Roadshow" launched in conjunction with ASEAN nations, the US State Department publicly advocated the adoption of blockchain technology in the region as a mechanism for "reducing corruption and improving efficiency." Both Vietnam and Indonesia responded affirmatively, citing in their prepared remarks the blockchain's potential to "naturally encourage fiscal and business transparency."

However, it pays to be prudent. Despite the initial enthusiasm, it cannot be denied that the blockchain is an inchoate technology and its applications and potential still largely in flux. Getting buy-in across the financial sector from both players and regulators will be critical to ensuring the technology's long-term sustainability and impact. At this stage, it still remains to be seen if the blockchain can live up to its embryonic potential as a game-changer in fintech. ✱

■ *Flora Whittaker is a freelance journalist based in London.*

BY JAMES CHONG & YEOH XIN YI

Preparing for the Unknown: BEST PRACTICES IN RISK MANAGEMENT

Chief Risk Officers in the 21st-century financial institution need to **address eight key areas of risk** to build a robust enterprise-wide risk culture.

The 21st-century financial institution faces a myriad of challenges, particularly with the rise of regulatory reforms across the globe, while technological advances and current economic conditions have seen corporations responding to change in varying degrees.

In the financial industry, banks are coping with technological changes which have impacted the business; on one hand, these bring new opportunities and on the other, increase the risk of running the business. Underlying all these is the fundamental issue of risk behaviour, which has come under focus since the recent financial crisis. Further, industry prosecution has revealed activities of misconduct and unethical behaviour as some root causes to reputational and financial threats.

Asian financial institutions are not exempted from these trends, and also are privy to the changing environment and its consequences.

In coping and adapting to these developments, Chief Risk Officers (CROs) of the 21st century financial institutions now find themselves with a somewhat different suite of priorities to address compared to their traditional role. The following are eight key areas which risk officers should be focusing their attention on in the coming years:

08

Key Areas

- Risk Culture
- Stress Testing
- Recovery & Resolution Planning
- Technology Risk Management
- Financial Crime
- Data Security
- Achieving Compliance Programme Effectiveness
- Improving Risk Data Aggregation and Reporting

01

RISK CULTURE

Regardless of the growing number of regulations imposed by regulators, the essence of risk management lies in the actual practice. How well do employees across the organisation behave and understand risk? Top management, including CROs, continue to face challenges in embedding an effective risk culture throughout the organisation. Since risk culture has cascaded across the organisation, the trade-off between profit-making and risk appetite is likely to hit CROs the hardest. CROs have to strike a fine line between risk exposure and business benefits while protecting stakeholders' value. The increasing focus on efficiency is moving towards risk efficiency, if it hasn't already. What are the returns on risks taken by the bank? What are these risks that the bank is taking? How does the organisation decompose these risks and ensure the culture is ready to manage them? The view of risk is not confined only to portfolios of business products, but also includes an enterprise-wide risk view, where every person in the bank is likely to be a risk owner and needs to acknowledge this. A strong risk culture ensures that risk taking is acknowledged right at the outset, from the point a product is developed to when a client is being brought onboard, and continues to be monitored, all while risk continues to be managed. Banks are still working on cultivating a risk culture-based environment, and more focus is expected in this area.

02

STRESS TESTING

With the continuous evolution of new regulatory requirements, increased volatility in the financial and commodity markets, and continuous innovation of financial products, the landscape for financial institutions is increasingly unpredictable. To perform an effective and integrated stress test, financial institutions are required to pull together knowledge, competencies and infrastructure across the organisation. Organisation structure, weak internal controls as well as imperfect documentation are observed challenges which lead to enormous resources spent and incoherent stress testing results. Some financial institutions continue to face challenges in developing an integrated stress test programme, which includes interaction of various risks and macro-prudential factors. Inadequate stress testing inputs will only result in poor stress testing results which would be deemed unfit for analysis and management decision-making. Reliable stress testing processes and analysis can support management's understanding of key risk drivers, scenarios, and consequently drive business decisions.

03

RECOVERY & RESOLUTION PLANNING

Banks and regulators alike have come to view Recovery Planning as a vital element in enabling a bank to restore itself to a financially sound position in the face of different internal, external and potentially systemic shocks.

Within the industry, thinking around this issue has moved rapidly beyond the existential concerns surrounding the fate of troubled institutions. Recovery Planning is now well understood as a way to protect shareholder value, by enhancing and integrating existing risk management frameworks including capital planning, liquidity management, stress testing, and contingency planning.

At the same time, the regulatory impetus remains strong. Political and societal expectations upon financial institutions have changed irreversibly. This has thrown up uncomfortable questions about how a bank would respond, and how certain shocks would impact upon, or implicate, different business units, particularly within a group structure.

For institutions globally and in the Asia Pacific region, these challenges are particularly relevant. Many banks are still at a relatively early stage in the journey to develop a Recovery Plan for the region, or their particular jurisdiction.

04

TECHNOLOGY RISK MANAGEMENT

The increased use of technology in the banking environment has caused financial institutions to establish a strong information technology risk management function (ITRM) to manage technology risk. ITRM functions manage and monitor technology risks so that companies can anticipate and avoid problems rather than react to them. CROs are advised to establish a strong technology risk management function to proactively manage technology risks, rather than reacting to audits, new regulations, new business strategies, and other disruptions.

05

FINANCIAL CRIME

Financial institutions should continue to monitor the activities of employees, vendors and third parties to detect and, wherever possible, prevent financial crime that can result in financial losses and damaged reputations. CROs should be especially wary of frauds that indicate collusive behaviour. The latter is on the rise due to the emphasis companies have placed on improving their financial controls environment to comply with regulations. These controls make it more difficult for individuals to perpetrate frauds, but co-conspirators can enable fraudulent schemes to bypass certain control structures.

A 'Global Anti-Money Laundering (AML) Survey' published by KPMG in 2014 found that the top three AML spending by financial institutions globally and in the Asia Pacific are directed towards enhancing transaction monitoring systems, recruitment and customer due diligence, with the latter being the top focus area of regulators globally and in Asia Pacific.

Financial crime risk management could be placed under the purview of the CRO and Chief of Compliance, covering the areas of AML and sanctions controls, Anti-Bribery and Corruption controls, market conduct controls, monitoring and awareness, reporting and governance.

06

DATA SECURITY

Diminishing security perimeters have been discussed for some time, but it is now fully acknowledged that corporate security perimeters no longer exist. Data and critical processes cross many organisational boundaries, including customer self-service, strategic sourcing, supply chain integration, business partnerships, and technology enhancement. Being able to understand risk, not just at the technology infrastructure or data levels, but also at the business process level, is critical. Since the banking environment has gone more digital than ever before, CROs need to monitor those connections if they are to better understand how trusted third parties are using and protecting the information. It is also important for CROs to provide their trusted business partners with greater insight into their own control and security environments.

07

ACHIEVING COMPLIANCE PROGRAMME EFFECTIVENESS

A growing number of regulations affect every facet of a financial institution's operations and are implemented and enforced by an array of agencies worldwide. In this environment, financial institutions need to anticipate regulations and plan for their implementation under the leadership of the CRO and the Chief Compliance Officer. Financial institutions could maintain an inventory of relevant regulations; employ a methodology to help prioritise regulatory obligations and manage regulatory change; evaluate compliance programme effectiveness with regard to monitoring, testing and reporting; and ensure that they have an enterprise-wide view of regulatory risk and are able to collaborate internally to present a comprehensive report to the Board.

08

IMPROVING RISK DATA AGGREGATION AND REPORTING

As regulatory requirements become more stringent, and the demand for risk data aggregation and improved data quality increases, it is essential that CROs concentrate on improving risk reporting. Such improvement involves enhanced report content and the automation of real-time information collection. The ability to identify risk exposure across entire organisations and geographies and the capacity to understand its concentration risk and counterparty risk from a business perspective is imperative.

The risk management universe is broadening, with the key role of risk managers residing in a stronger purview over the risk-taking capacity, risk appetite and driver of efficiency being a key focus of the financial institution. While most of the focus areas highlighted above are common topics on most regulators' agenda, these risks have also become prominent as a result of the evolution of banking, the risk behaviour arising from decades of banking operations, and banking behaviour which may or may not be suitable in current times. It is therefore a necessity for a risk professional to evolve with the times, continuing to be relevant to the changing environment. ✱

■ *James Chong is Executive Director and Head of Financial Risk Management, KPMG Malaysia and Yeoh Xin Yi is Director, Financial Risk Management, KPMG Malaysia.*

BY ANGELA YAP

KNOW YOUR CLIENT

REVISED RULES, NEW TECHNOLOGIES, AND NOW, PRESSURE TO UNSHIELD BENEFICIAL OWNERSHIP THROUGH CENTRAL REGISTRIES, ARE ALL PART OF A GLOBAL PUSH FOR TRANSPARENCY AND GOVERNANCE. IN LIGHT OF THESE, HOW WILL BANKS AND FINANCIAL INSTITUTIONS REWRITE THE KYC (KNOW YOUR CLIENT) PLAYBOOK?

Uncovering the trail of money laundering and terrorist financing is crucial in protecting the integrity of the international financial system.

Case in point: The Panama Papers, an unprecedented leak of 11.5 million documents pointing to influential businesspeople, heirs, and political leaders who masked their identities behind offshore companies, 'dummy' owners and nominees. With the sheer magnitude of personalities and structures involved, the industry is undergoing a period of introspection – identifying gaps in determining the true owners of a company and whether standards are robust enough to prevent banks from becoming vehicles of financial crime.

Why is it important we get this right? Corporate vehicles – companies, trusts, foundations, partnerships – are the engines of commerce. The United Nations Office on Drugs and Crime estimates that USD2 trillion (5% of global GDP) is laundered annually. The impact of money laundered under the guise of corporate vehicles is that fewer jobs are created, prices are artificially inflated and economic activity is dampened.

In order to curb money laundering, it is mission critical that banks correctly identify beneficial owners – the real McCoys who exert control in a company.

A KYC PRIMER

The concept of 'beneficial ownership' recognises the reality of business, that the person in whose name an account is opened may not be the individual with ultimate control over such funds. In legal entities such as trusts, foundations, personal investment companies, most countries require that the trustees or individuals who are able to exert significant control over its activities be made known.

It needs to be stressed that 'control' goes beyond mere signatories or legal titles. The ultimate beneficial owner may exert power through ownership or other means such as entitlements. By uncovering the individuals who exert ultimate control, we are able to deduce the source of wealth and whether such monies were obtained through proper and legal means.

+ Generally, an individual is considered to be the beneficial owner if he or she

Controls more than 25% of the company's shares or voting rights (though some countries have imposed more stringent quantitative thresholds).

Exerts influence over the company or its management such as the ability to appoint or remove directors.

Why is this important? The ability to synergise beneficial ownership information with other data sources allows us to detect unusual or suspicious activity including discrepancies between disclosed information, actual sources of funding and how sums were utilised. Through this process, banks are able to gauge if the client is a money laundering risk.

Knowing the identity of beneficial owners lays the foundation to a strong anti-money laundering and counter financing of terrorism (AML/CFT) programme.

+ Know Your Client (KYC) is the formal process of enquiring, establishing and verifying the client's business and individuals who manage it. The process is conducted as part of onboarding the client.

One of the more challenging aspects of this for the private banker is to identify persons who may warrant further due diligence into their source of wealth or business activity. For instance, relationships with politically exposed persons will automatically trigger the enhanced due diligence process where the banker must procure documentary evidence on the client's source of wealth and income.

Most governments have expressed the level of transparency that it expects when disclosing beneficial ownership. Financial institutions (FIs) must formally declare that they have conducted sufficient checks and know their customers well enough to mitigate exposure and reputational risks.

Know Your Client (KYC) is the formal process of enquiring, establishing and verifying the client's business and individuals who manage it. The process is conducted as part of onboarding the client. Once the business relationship is formally established, periodic risk-based monitoring must be maintained to ensure client information is kept current.

KYC procedures involve the timely submission of statutory and transaction documents by the client which the bank will then use to corroborate against other existing data sources such as credit history, watch lists, news reports and financial data.

One of the more challenging aspects of this for the private banker is to identify persons who may warrant further due diligence into their source of wealth or business activity. For instance, relationships with politically exposed persons will automatically trigger the enhanced due diligence process where the banker must procure documentary evidence on the client's source of wealth and income. If any unusual or suspicious activity is detected, AML/CFT protocols must be launched and investigations will follow. This process is sensitive and requires the utmost discretion. When the alarm bell is raised on possible ML/TF activity, banks' standard operating procedures necessitate a 'lock down' to avoid raising any suspicion to the companies or beneficial owners that an investigation is underway.

CENTRAL REGISTRIES

A much-awaited move is the formation of central registries containing information on beneficial owners. It is a concrete step to prevent financial crimes by making information on ownership and power of control more transparent and easily available.

This involves the aggregation and sharing of information on owners, their related companies and other legal entities such as private investment companies, trusts and foundations. The responsibility rests also on trustees to provide timely information to obliged entities.

Despite its clear advantages for transparency, controversy has erupted on who would have access to central registries. Advocates believe that aside from regulators and FIs that pass a 'legitimate interest' test, members of the public who can prove legitimate interest should also be granted access. Countries such as the UK and Norway have already pledged to make their central registries publicly available.

Advocates believe that aside from regulators and FIs that pass a 'legitimate interest' test, members of the public who can prove legitimate interest should also be granted access.

However, others oppose the creation of central registries, defending the owner's right to privacy as the database will include personal details such as residence addresses and dates of birth. Offshore banks have reiterated that existing due diligence protocols are sufficient to prevent financial crime.

The UK itself reflects this dissonance. Although Britain is in the process of establishing its central registers, its Overseas Territories – Anguilla, British Virgin Islands, Cayman Islands, Monserrat, and Turks and Caicos – are pushing back. Their success is attributed to the cloak of anonymity which they provide and the Overseas Territories would be at a severe disadvantage if it followed in Britain's footsteps to centralise and make private data publicly available. The territories also argue that its competitive edge would be diminished if it alone is made to establish central registers while other global offshore centres opt out.

Nevertheless, a growing number of jurisdictions have started the ball rolling in setting up central registries by enacting new legislation or proposing amendments to existing laws. The final structure however will vary across jurisdictions. For instance, when implemented, the UK will be the first country in the world to make the registry fully searchable and publicly available online, whilst the US will leave it in the hands of respective states to decide whether to make registers public or private.

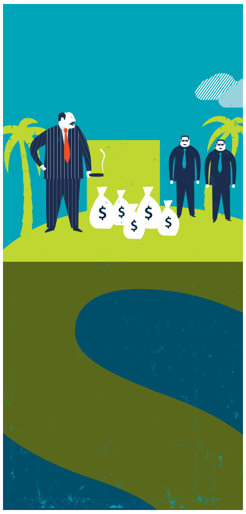
LEVERAGING ON TECHNOLOGY

As regulatory requirements and standards for KYC continue to evolve,

Upping the Ante

PROMINENT REGULATIONS HAVE LED THE WAY FOR INCREASED FINANCIAL TRANSPARENCY AND RISK GOVERNANCE IN KYC.

The EU's Fourth Anti-Money Laundering (AML) Directive was approved on 20 May 2015 by the European Parliament and member states with a two-year window for national implementation of these AML provisions. This latest Directive has upped the ante and the UK will be one of the first countries in the Union to implement these measures:



+ INCREASED BURDEN OF PROOF Obliged entities must now identify and prove lower risk of money laundering before seeking to apply simplified customer due diligence (CDD) procedures. Exemption from full CDD is no longer automatic for clients such as local authorities or public-listed firms. Obliged entities must also provide written assessments and keep records evidencing appropriate client AML/CFT risk identification.

+ QUANTITATIVE THRESHOLD
The EU bar, set at a 25% equity stake or more, seems to have set the tone for the Financial Crimes Network (FinCEN), a department under the US Treasury. It also set the bar for beneficial ownership at 25% or more equity interest vide its Notice on Proposed Rulemaking on 30 July 2015. But this is not a hard and fast rule as there are other more stringent benchmarks such as the US Federal Law on Foreign Account Tax Compliance's 10% stock by vote or value in US-owned foreign entities. Furthermore, the 10%-rule does not apply on investments by a US citizen where any shareholding is reportable.

+ WIDER DEFINITIONS
The definition of politically exposed persons (PEP) now includes prominent office-bearers such as politicians, judicial appointees, and influential persons in the armed forces, family and spouses or equivalent. Twelve months is the minimum period whereby a person is classified as a PEP risk but the onus is also on obliged entities to apply appropriate risk mitigants until the former PEP is no longer deemed a risk.

Another guiding principle is the G8 Action Plan issued in 2013 where member states pledged to bolster transparency of ownership for legal entities and cut out red tape for foreign counterparty access to this information.

Mirroring this, the White House launched its Action Plan, which included the establishment of national central registers on beneficial ownership. One of the Plan's more arresting features is the promise of autonomy to each of its 50 states, allowing them to decide how far beneficial ownership data would be made publicly available. It is expected that onshore corporate tax havens such as Delaware and Nevada would, as far as possible, prevent public access to beneficial ownership information.

THE PANAMA PAPERS

THE TROVE OF 11.5 MILLION LEAKED DOCUMENTS KNOWN AS THE PANAMA PAPERS CONTINUES TO CREATE RIPPLES.

Since its release on 4 April, leaked data on 214,000 shell companies under the care of the Panamanian law firm of Mossack Fonseca has led to the resignation of at least one politician, Iceland's former Prime Minister, and implicated a host of others including Russia's President Vladimir Putin, families of China's supreme ruling party and members of international football body FIFA. Among the alleged infractions committed by the law firm are instances where it offered high-net worth clients fake ownership records which would allow them to withdraw money from their accounts without being traced, as well as the services of 'dummy owners', one of whom was a 90-year-old British man, to act as the beneficial owner.

This news reignited measures to strengthen transparency and beneficial ownership information disclosure. Within days of the leak, the US Treasury Department moved to issue a rule, which was first proposed in 2012, requiring banks to identify a shell company's true account holders. A host of other nations – Australia, Austria, France, the Netherlands, Sweden – have announced investigations into possible corruption from the leaked papers.

In an interview with *Reuters,* one of the original architects of the long-delayed US rule, Chip Poncy said that the leaks may give banks insight into the beneficial owners that they should be obtaining when running background checks on their current clients.

However, a lesser-known fact of the data leak is that many of the personalities with offshore accounts – Stanley Kubrick, Simon Cowell, Jackie Chan, Pedro Almodovar, and the Duchess of York – show no signs of intentionally hiding assets offshore for any unlawful purpose. It is a point that needs to be emphasised given the reactionary response to the Panama Papers.

Since the 1970s, individuals and corporations have moved cash offshore for legitimate reasons:

+ **ASSET PROTECTION** – the No. 1 reason which protects you against frivolous lawsuits whilst tax obligations remain unchanged. For persons living under predatory regimes, this protects you against forced asset seizures.

+ **RETAINING INTELLECTUAL PROPERTY AND TRADE SECRETS** – prevents competitors from being tipped off on any investments in future product lines or technologies.

+ **COST SAVINGS** – big brands avoid paying more than necessary for services such as hotels, caterings or products as suppliers tend to charge a premium depending on the client.

+ **PERSONAL SECURITY** – for persons in high-risk jobs such as translators or rapporteurs for diplomats or the military in conflict zones, this source of income should be kept untraceable for security reasons.

+ **MINIMISE PROBATE** – offshore accounts allow properties to be divided according to your wishes instead of local inheritance laws which, depending on the local law, may not fit your definition of fair distribution.

Despite the negative press, this briefly reminds us that not everyone has a nefarious reason for maintaining an offshore account. At the time of this feature, protests are gathering traction in Europe and the top brass at leading global banks implicated in the Panama Papers have stepped down with more resignations to come. How will the industry quell the fury that has erupted? More interestingly, will offshore services be able to regain the confidence of clients whose personal data was breached by a source within?

banks are increasingly turning to technology for faster, leaner and more scalable solutions to meet compliance obligations. Big banks are going beyond KYC reporting, applying a more tactical approach to enhance data precision and minimise turnaround time.

+ The hallmarks of a strategic KYC compliance programme are:

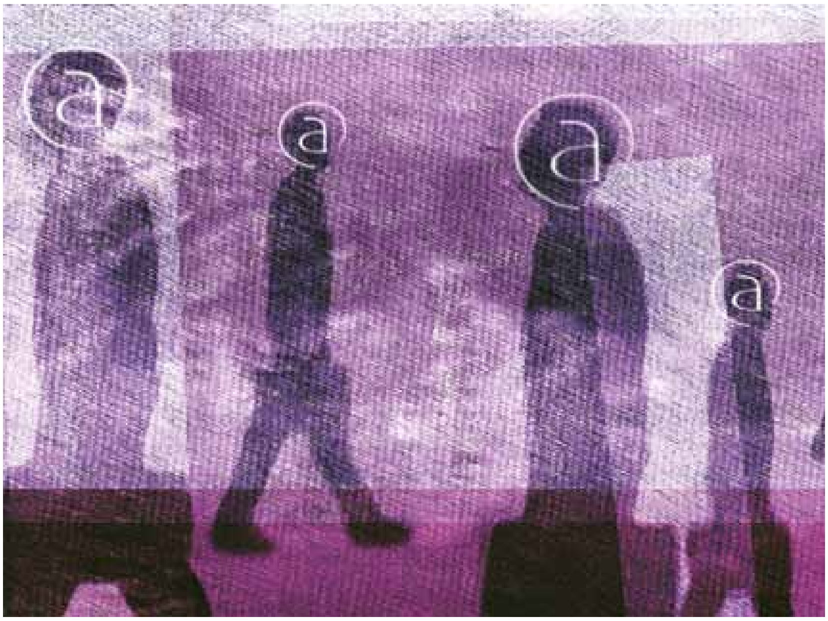
A single customer view that encompasses the client, his associates and transactions. This is crucial for both relationship and risk management.

Ability to adapt to the various national regulations, an especially critical task for FIs with a global footprint.

A scalable and flexible system which allows for reuse of existing data to meet other regulatory requirements.

While it may have no direct bearing on financial performance, the hidden costs of an outdated, manual KYC process add up in other ways – wasted time, delayed turnaround, training and retraining, low productivity or, in a worst case scenario, defaults. Hiring more people to do more compliance work may seem like an option but the industry's overall turnover rates are already high and educated, skilled talents is fast becoming a scarce resource. Add to the fray the probability of human error – misstrokes, data loss or tampering. The incentive to automate rises exponentially in risk-critical environments.

Specialist technology firms have emerged offering collaborative solutions to help the industry achieve its compliance objectives. They monitor and integrate external data sources – current legislation, jurisdiction change, news events, company announcements – into an existing environment, shaving valuable time off the investigation process by seamlessly connecting front-, middle-, back-office and alerting banks to potential high-risk clients.



In an interview with *Banking Insight,* Kelvin Dickenson, Vice-President of Compliance Solutions for Alacra Inc, a New York-based provider of KYC solutions, says, "Just doing KYC upfront doesn't meet the requirements anymore."

"We want to take the goodness and richness of data collected, put it into the back-office and demonstrate that this is how we know our customer, this is all the information we gathered during KYC and we can now properly manage this relationship."

Economies of scale have also lowered the costs for banks to adopt new technologies. Dickenson confirms that banks are moving away from large initial investments and installed software to lower cost of ownership via Software-as-a Service (SaaS) licensing.

The tipping point however may be the coupling of technology with enhanced databases such as central registries and increased disclosure standards. This confluence points to a new wave that will drive the investigation process.

He says, "Central registries are going to be a critical new data source that will help companies leverage technologies like Alacra to drive investigations forward much more completely and efficiently."

Where central registries fall short of giving FIs anything beyond basic corporate disclosures, a comprehensive KYC system allows for more meaningful research, counter-checks against multiple other sources on affiliations, financial transactions, political connections and more. The red flag can be raised with greater speed and accuracy.

CHARTING THE FUTURE

Managing these trends on the KYC frontier – enhanced disclosure, central registers, system integration – require more than just innovation and technology. It demands that banks cultivate a culture of flexibility and agility when faced with external shocks and stresses like the Panama Papers. Instead of expecting just one 'big bang' date for compliance, FIs should be vigilant and continue to stay on top of regulatory developments, with systems and people ready for future enhancements to AML/CFT procedures. ✱

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BY RAJEEV PESHAWARIA

TRUST: THE CURRENCY OF LEADERSHIP

IN A UTOPIAN ENVIRONMENT, HIGH TRUST BETWEEN LEADERS AND SUBORDINATES WOULD TRANSLATE INTO HIGH-OCTANE PERFORMANCE AND REDUCED STRESS FOR ALL. BUT HOW CAN WE BUILD THIS ELUSIVE QUALITY OF TRUST TO ACHIEVE POWERFUL COLLABORATIVE PERFORMANCE?

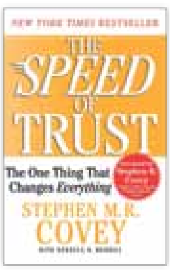
+ We spend the vast majority of our waking hours at work, yet not one of the participants included a boss or co-worker among the most trusted people in their lives.

The other day, a colleague invited me to teach a session in a leadership development programme he was running for 30 senior executives from one of our client organisations. He launched the session with a provocative question: Who are the three people you trust the most in your life currently, and why?

Almost all 30 executives named their mothers as one of their three choices, with fathers running a close second. The third choice varied among best friend, brother, sister, spouse, or a religious figure. Think about this for a moment. We spend the vast majority of our waking hours at work, yet not one of the participants included a boss or co-worker among the most trusted people in their lives.

When my colleague handed the floor to me, I jettisoned my lesson plan. Instead, I dug deeper into the trust question. My question became: "Who are the three people currently in your life upon whom your happiness and well-being most depends?" You guessed it: every single one of them listed their boss as one of them. Imagine! The one person most people's well-being depends upon the most does not make it to their most trusted list.

"Would you figure in your subordinates' top three most trusted list?" I asked. Pin drop silence. Next, I asked if they should be in the list, and they agreed that they should indeed. "Why?" I asked. The group intuitively concluded that high trust between them and their subordinates would equate to higher team and individual performance, and lower stress for all parties.



+ In his book The Speed of Trust, Stephen M.R. Covey points out that high trust equals high speed and low cost, whereas low trust means low speed and high cost.

There were lots of opinions about why bosses don't appear in the trust list – we had a very robust and animated discussion on it. Comments ranged from "My boss has no idea how hard I work to get things done here" to "All he cares about is results against stated goals so he can keep his superiors happy… when was the last time he got his own hands dirty?" After about twenty minutes, I finally got to the point I wanted to make all along. Suppose the class were filled with their subordinates, and suppose we asked them the same questions?

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Granted, there are plenty of bosses that indeed should not be trusted. These are self-centred people who abuse their authority for personal gain. I have no advice for such bosses other than that they should take a hard look in the mirror. But if you are the type of boss that genuinely cares for his people, and believes in the power of collaborative performance, read on.

The logic is simple. If people trust you, they will give 110% to their work. I remember a few years ago while I was working at a global bank, I ran into trouble with a couple of powerful people who (due to their own insecurities) did not want my function to succeed. It got to a point that the huge amount of time I had to spend on watching out for land mines began to impact my work, and the work of my team as a whole. Sounds familiar? Luckily, I had a boss I could trust. I opened up to her, and she assured me that she would watch my back and take care of the issues. Based on her assurance, I went back to work with full energy, and my team and I ended up creating amazing results for the bank. Years later, when one of my subordinates was struggling to convince his peers about approaching a project in line with his suggestions, I was able to pay that trust forward. My subordinate was worried that his peers would complain to me about him being obstinate, and not a team player. He could not tolerate the thought of me (his boss) thinking of him as un-collaborative. At the same time, he was convinced that if his suggestions were implemented, our company would easily move ahead of competition. Sensing his struggle, I called him to my office for a chat, and told him that I trusted him completely. "Be your normal collaborative self, listen to what your peers have to say, and if you are still convinced, remain firm on your suggestions. If they still think of you as stubborn, don't worry, we will correct that perception later," I told him. He did exactly that and the project was a huge success, and was implemented in record time. Later, his peers understood too.

In his book *The Speed of Trust,* Stephen M.R. Covey points out that high trust equals high speed and low cost, whereas low trust means low speed and high cost. He cites the case of aviation security in the US. Prior to 9/11 one could reach the airport just half an hour before flight time and easily make it on board. Why? Because people had a high degree of trust in aviation security. Now it takes anywhere from 1.5 to 2 hours. While the extra security measures have made flying safer, Covey points out that the added cost of TSA security ultimately shows up on every airline ticket. In another example, Covey sites the added time and money costs of implementing the Sarbanes-Oxley Act which was designed to improve trust in public markets in the wake of the Enron and WordCom scandals. On the other hand, he gives the example of Warren Buffet deciding to acquire McLane Distribution – a $23 billion company – from Walmart in just one two-hour meeting because of high trust between Berkshire Hathaway and Walmart. Besides the speedy conclusion of the deal, both companies saved millions of dollars in legal and investment banker fees.

A team with high trust will similarly produce results faster and at lower cost. It is clear that trust is one of the keys to organisational or group performance. I therefore call it the currency of leadership. But can bosses ever make the Most

Trusted list? Does the authority that bosses have over their subordinates automatically make them untrustworthy in the eyes of subordinates? As one participant put it, "Besides being good to them, I also have to ensure discipline in my team, and I need to provide tough constructive feedback when needed. This automatically puts me at a disadvantage when it comes to winning their trust….. no matter what you do, no matter how fair you are, the moment they take one tough stand, bosses are seen as self-centered, authoritative, and therefore untrustworthy….." After grappling with this issue for quite a while, I have to admit there is at least some truth in what this participant said. Let's take a very real scenario. One of your direct reports has been under-performing for a while now. You have invested in training, coaching and have given them a lot of direct feedback on how to improve, but have seen no improvement. You are now convinced that he is a misfit on your team, and needs to be let go. Even if you handle the conversation (of letting him go) in the nicest possible way, what are the chances that he will trust your judgement and respect the fact that you gave him every possible opportunity to succeed?

Even in situations that don't demand firing someone, the chances of earning the trust of a subordinate with less than stellar performance are low. As a manager, you will need to give tough feedback, and demand higher levels of performance. Very few people have high enough maturity and self-awareness to fairly judge their boss' behaviour towards them. Let's face it, it is much easier to blame the boss than to accept responsibility for your own performance.

+ So what are bosses to do here? Should bosses give up on trying to earn their subordinates' trust? Clearly, that would be a shame in light of our "high trust = high performance and low cost" argument above. One idea to maximise trust, and therefore performance, in your team might be the 20:60:20 strategy:

Ensure your highest performing and most dedicated (top 20%) subordinates trust you without a doubt

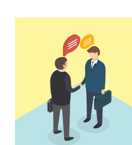
Maintain a reasonably high level of trust with your solid citizens (the middle 60%) – subordinates that are good but not great

Don't invest too much time trying to get your bottom 20% to trust you

If you are wondering why the 20:60:20 strategy and why not 100:0, you have a legitimate question. Here's my perspective: In most organisations, the 80:20 rule applies, meaning that 20% of the people produce 80% of the results. To this rule of thumb, add the fact that the top 20% need to be supported by the next 60% in order for the organisation to achieve its full potential, it is easy to see why it is a good idea to focus on the next 60% as well. As for the bottom 20%, well, no matter how much you try, not everyone will love you. Trying to win the trust of your least productive people is, unfortunately, not an efficient use of time and effort, particularly for today's time starved business leaders.

EARNING TRUST

Now, if you buy the above arguments (that trust is the currency of leadership and that leaders need to at least ensure they have the trust of the 20%+60%), then another key question emerges – how can leaders best earn the trust of their subordinates? While the answer differs according to context, I have generally observed that leadership trust is a combination of six factors: Commitment, Character, Competence, Consistency, Caring, and Centricity. Let me explain each of them briefly.



+ Very few people have high enough maturity and self-awareness to fairly judge their boss' behaviour towards them. Let's face it, it is much easier to blame the boss than to accept responsibility for your own performance.

❶ COMMITMENT

Commitment is the cause or purpose the leader pursues. It is the vision she has for a better future. If this vision provides hope and inspiration to people, they willingly give their trust (and followership) to her. On the other hand, if they don't connect with the leader's vision at an emotional level, or doubt the commitment of the leader towards the vision, they will find it difficult to trust the leader. Commitment towards a purpose is the primary driver of leadership trust. If one is to follow a leader with full commitment, there should be no doubt that the leader is also fully committed to the stated purpose. ***What is your leadership purpose? Are you fully dedicated to it?***

❷ CHARACTER

Next is Character, which is the set of values that the leader lives by. Not only is it important for followers to know that the leader is committed to a worthy purpose, they must also believe that the leader wants to pursue that purpose by playing according to the right set of values. Imagine two leaders are fighting for a just cause that you strongly believe in. One is pursuing success through violent means, while the other is using peaceful means. Which one will you trust more and follow? The answer will depend on your own set of values. My goal here is not to differentiate between right and wrong. Rather, it is to highlight the fact that character (deeply held values) plays a huge role in earning trust. ***What are your deeply held values that you will never compromise, no matter what?***

❸ COMPETENCE

In today's increasingly complex world, just having strong people skills is not enough. To earn trust, a leader must have core competence in her chosen field. The old school of management says that a general manager need not be a subject matter expert. In today's highly complex markets, it has become almost impossible for a rank outsider who does not have sufficient knowledge and expertise about the business to earn the respect of her subordinates. ***Do you have core competence in your chosen field? Does your level of expertise attract people to work on your team?***

❹ CONSISTENCY

Consistency is about delivering on your commitments without fail. If you do what you say, and deliver what you promise, people will trust you. If you don't, they won't. Simple. Let's face it, it is hard to trust someone who is inconsistent with their dependability. In today's increasingly competitive world of business there is very little room for error. One member's inconsistency can cost the entire team dearly. ***Do you keep your word and deliver what you promise almost all the time, regardless of circumstances?***

❺ CARING

There are two types of bosses in the world, ones that genuinely care for their people and others that don't. If I know that my boss will always take care of my best interests, I will be more willing to give her my very best efforts and energy. If, on the other hand, I have a boss that is likely to throw me under the bus to save her own skin, I will use a big part of my energy in taking care of myself. ***Do you truly care for your people, and do they know that you do? Do you feel their pain, and do you derive intrinsic pleasure from enabling their success?***

❻ CENTRICITY

Finally, the focus of the boss' actions and intentions determines her trustworthiness. Some bosses are self-centric and some are other-centric. Self-centric people care most about themselves, and strive hard to create a better future for themselves. In the words of Adam Grant, author of *Give and Take*, such people are Takers i.e. they take more from society than they give. Their worldview is one of self-preservation: "If I don't take care of myself and maximise my own gain, no one else will." Other-centric people are Givers i.e. they give more than they take from society. Their worldview is one of win-win: "If I take care of others, my interests will be taken care of automatically." It is well documented through research that Givers enjoy a much higher level of trust from their subordinates than Takers; and that in the long run, Givers are more successful. ***Are you self-centric or other-centric? Are you a Giver or a Taker?***

Earning the trust of one's subordinates is not just a soft, nice-to-have asset. It is hard currency that can make the difference between success and failure. There are hardly any professions today in which individuals can be successful without the help of team members. To ensure you have enough trust from your subordinates, consider the 20:60:20 strategy and make sure your top 20% performers fully trust you, and the next 60% adequately respect you. A good place to start might be to try and honestly answer each of the six-C questions. Just as you can assess your own trustworthiness by honestly reflecting on the six-C questions, you can also use them to assess the trustworthiness of others. ✱

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BY DR. ADAM NG

BANKING FOR SUSTAINABILITY

THE POLICY, REGULATORY AND FINANCIAL CASE FOR ACTION

"…business-as-usual cannot get us to sustainability or secure economic and social prosperity; these can be achieved only through radical change, starting now. To play its role, business will still need to do what business does best: innovate, adapt, collaborate and execute. These activities will change along with the partnerships that we form with other businesses, governments, academia and non-governmental organisations in order to get it right for all."

The co-chairs of the World Business Council for Sustainable Development (WBCSD)'s 'Vision 2050: The New Agenda for Business'

In today's increasingly challenging era, the financial sector has a significant role in catalysing the global transition to sustainable development and shared prosperity. Sustainability can be practiced from the inside (financial institutions' internal operation) to the outside (financial institutions' financing and investment). Yet, can banks do well while doing good? Does a bank that improves its economic, environmental, social and governance performance increase, decrease, or leave unchanged its financial performance? Is the banking sector up to the challenge as the steward of long-term capital, preserving and enhancing different types of capital in the value creation process?

Let's discuss three propositions. First, there is opportunity for banks, particularly Islamic banks, to finance and invest in corporations that adopt robust sustainability practices. Second, regulators and central banks can address environmental risks and fund sustainability. Third, the ecosystem needs a new sector of organisations at the intersection of the public, private, and social sectors - the emerging fourth sector – to offer sustainability advisory and technology services to banks and corporations striving to make an organic difference.

OPPORTUNITY FOR BANKS

The opportunity for banks emanates from the strong economic relevance of sustainability parameters for corporate management and for investors. A study conducted by University of Oxford and Arabesque Partners in 2014, **'From the Stockholder to the Stakeholder: How Sustainability can Drive Financial Performance'**, shows that solid environmental, social and governance (ESG) practices result in lower risk and better operational performance of firms. Stock price performance of firms is

The ecosystem needs a new sector of organisations at the intersection of the public, private, and social sectors - the emerging fourth sector – to offer sustainability advisory and technology services to banks and corporations striving to make an organic difference.

positively affected by good sustainability practices. Firms with good sustainability standards have significantly lower cost of capital and better access to capital. Indeed, according to the Cambridge Institute for Sustainability Leadership, "many companies are using sustainability as a strategic lens, translating it into product and service opportunities, productivity and innovation potential, bottom-line savings, reputational and market growth, and license to operate."

There are banks that aim to help people, businesses and the planet prosper in the "conventional" financial space. In 2014, Banco Santander reported that 55% of its employees are women and 10.49% of staff have been promoted, with 59,569 volunteers in social initiatives involving the community and over 10,000 ideas gathered on how to improve the bank. Overall satisfaction among customers was 85.3%. €314.1 million worth of loans were given to micro-businesses and €187 million was invested in the community, 78% of which was spent on higher education. As leaders in financing and promoting renewable energies, Santander tracked a 4.8% overall reduction in CO2 emissions and an 8.3% global reduction in paper consumption within its internal operations relative to the year before.

Triodos Bank is another case in point. Triodos invests only in businesses and real economic activities that create a positive impact on the planet. The bank doesn't invest in complex financial instruments and managed to withstand headwinds and even grow through the global financial crisis. In fact, its balance sheet structure resembles that of an Islamic bank. With a presence in five countries and expanding across the globe, Triodos inculcates investor and partner relationships with customers and gives full transparency to customers to ensure alignment of values between their depositors and borrowers. It encourages co-owning the bank, and there is even a save and donate product to infuse charity into its business model.

ISLAMIC FINANCE AND SUSTAINABILITY

In recent years, serious attempts have been taken to foster the link between the Islamic finance industry and socially responsible and sustainable financing and investment. Among the initiatives are:

- The USD500 million Immunisation Sukuk (2014),
- The Green Sukuk and Working Party's (Clean Energy Business Council (MENA), Climate Bonds Initiative and Gulf Bond and Sukuk Association) development of Islamic financial products to invest in climate change solutions (2013),
- The USD225 million Ihsan Sukuk to fund the improvement of education in Malaysian Government schools that was approved by the Securities Commission Malaysia SRI Sukuk Framework (2014),
- The launch of the first *Shariah*-compliant funds based on ESG principles: SEDCO Capital Global Funds (2013) and BIMB-Arabesque i Global Dividend Fund 1 (2015).
- The contribution of almost 20% (USD80.78 million) by the Islamic finance sector in Malaysia of financing for projects under Malaysia's Green Technology Financing Scheme over 2010-2015.

Yet, there is still a gap. Globally, Islamic finance is not considering the wider risks, such as social and environmental, but focusing mainly on credit and market risks. Islamic banks are lagging behind in global initiatives such as becoming signatories to the Equator Principles and Principles for Responsible Investment, Global Reporting Initiative and Carbon Disclosure Project, publishing sustainability reports, measuring their impact on carbon footprints and having impactful CSR initiatives (e.g. environment).

Islamic banks should therefore seize the opportunity to build dedicated capacity to serve the social and environmental priorities of their clients. First, in terms of internal capability, culture and performance, it is important to improve data analytics technology and skills in sustainability risk management, as well as to integrate sustainability to enhance banks' internal operational performance and reputation. Second, with regard to operational best practices, Islamic banks could contribute to and adopt local and global perspectives on best practices for sustainability risk management and reporting. Third, on financing and investing solutions, Islamic banks could strengthen originating, structuring, distribution and advisory capabilities to meet demand for high impact and innovative financing and investing solutions. They could also set up and manage *Shariah*-ESG compliant funds from global asset portfolios. Fourth, thought leadership could be developed through research and insights on key sustainability trends, strengthening banks'

leadership role in global initiatives, engaging with regulators on links between stability and sustainability, and becoming active owners and influencing the management of invested companies.

THE ROLE OF REGULATORS

While facilitating market development, regulators and central banks should also address environmental risks and fund sustainability because the environment and financial system are both public goods. According to Lloyd's, an acute disruption to global food production may result in the main European stock markets losing 10% of their value and US stock markets 5%. Recognising the significance, several national authorities in emerging markets (e.g. China, Peru, and Brazil) are already addressing the financial stability-environmental risk nexus in their regulatory frameworks.

The Cambridge Institute for Sustainability Leadership and the United Nations Environment Programme (UNEP) Finance Initiative report in 2014 claims that there is flexibility in Basel III for regulators and bank risk management to address financial stability risks related to environmental risks. The report shows that three approaches can be taken to reflect environmental risks in banking regulation and policy:

- understanding implications of social and environmental factors through better research;
- promoting integration of environmental and social factors in risk management at the transactional level and corporate governance through guidance and prudential regulation; and
- stimulating finance/investment into sectors and companies that are the root causes of environmental or social risks by adjusting incentives and requirements.

The report proposes that the Basel Committee should focus on the internal capital adequacy assessment process and supervisory review evaluation process (Pillar 2: Supervisory review process) as well as standardised or harmonised disclosure of information about exposure to, and management of, systemic environmental risks (Pillar 3: Market discipline). This is because regulatory capital and liquidity requirements (Pillar 1) have a marginal influence on the bank's decision to finance environmentally-friendly activities, and lowering capital and liquidity requirements may lead to arbitrage and poor incentives for banks. Regulators can also consider applying more favourable regulatory treatment to green asset-backed securities (e.g. rediscount these instruments under specific criteria).

Many companies are using sustainability as a strategic lens, translating it into product and service opportunities, productivity and innovation potential, bottom-line savings, reputational and market growth, and license to operate.

In this respect, central banks can fund sustainability in at least five ways as advocated by Tan Sri Andrew Sheng, a well-regarded former financial regulator in Asia and a member of the UNEP Advisory Council on Sustainable Finance:

- factor social objectives into central banks' investment decision-making;
- develop targeted monetary policy measures (e.g. People's Bank of China's consideration to accept high-quality "green" assets from banks as collateral for liquidity support);
- participate in the United Nations Principles on Responsible Investing and the Sustainable Banking Network (at present, only four OIC member countries' central banks from Bangladesh, Morocco, Nigeria, and Pakistan are part of the Network);
- provide seed funding to existing and future national and global sustainability initiatives;
- support the implementation of a financial transaction tax, which could fund a global environmental or sustainable development fund; and
- incentivise bankers, asset managers and the corporate sector to invest in, or finance, sustainability activities.

BUILDING CAPACITY IN THE EMERGING FOURTH SECTOR

The third proposition pertains to the availability of sophisticated sustainability advisory, research and technology services firms that can work with organisations to enhance the understanding of material sustainability issues for their business. This can be done through the quantification of sustainability indicators that impact organisational strategy, operations and financial performance based on established and advanced tools and methodologies. Ultimately, helping organisations to create value for all major stakeholders via impactful evidence-based strategies and initiatives will become the new driver for business in this increasingly challenging age of sustainability. ✱

■ *Dr. Adam Ng, Assistant Professor at INCEIF and Research Associate at the Oxford's Global Economic Governance Programme, specialises in industry and academic research on sustainability. This article is based on his presentation at the 22nd Annual World Islamic Banking Conference (2 December 2015, Manama).*

FINTECH LEGISLATION CRUCIAL TO INSTIL CONFIDENCE

REGULATIONS SHOULD NOT BE SEEN AS A HURDLE TO THE GROWTH AND PROGRESS OF FINANCIAL TECHNOLOGY (FINTECH) SERVICES AS THEY ARE MEANT TO PROTECT THE INTERESTS OF STAKEHOLDERS AND INSTIL CONFIDENCE IN THE NASCENT INDUSTRY.

Deloitte Touche Tohmatsu Ltd's global leader for financial services Chris Harvey says that while a regulatory framework can be a burden, laying the foundation from the getgo ensures that the services offered adhere to market principles.

"You basically design [the framework] from the start. I think one of the interesting things that is going on in other parts of the world is that regulators are working with fintech firms to make sure they are compliant when they launch in a market," he adds.

Harvey was speaking on the sidelines of the Global Banking Conference 2015 organised by the Asian Institute of Chartered Bankers. He is the author of Deloitte's recent report, titled 'Staying Ahead of the Pack: How Financial Services Firms are Planning to Win', in which he talks about the measures being taken by financial services firms to transform their business in response to the disruption caused by these fintech firms.

Regulations such as the implementation of the Basel III capital adequacy requirements have seen banks tighten lending.

The global financial services community has been through turbulent times in the aftermath of the 2008 global financial crisis, which saw regulators around the world imposing tighter capital requirements aimed at preventing another economic catastrophe. While the numerous measures have made it more difficult for financial institutions to do business, it has made room for innovative products with simpler structures in the marketplace, which was previously mired in complex offerings.

Regulations such as the implementation of the Basel III capital adequacy requirements have seen banks tighten lending. As a result, the fintech sector is booming as it engages in deals ranging from online investing portals to mobile payment systems, and transforms financing operations and processes to make them more lithe, efficient and transparent.

Seeing immense potential in the burgeoning sector and aiming to lessen the country's reliance on commodity export earnings, Malaysia is the first country in ASEAN to legislate the fintech industry. The Securities Commission Malaysia came up with a regulatory framework for equity crowdfunding in February, and is in the midst of formulating regulations to govern peer-to-peer lending platforms and automated investing, to name but a few.

While local regulators are keen to promote innovation in generating a vibrant and sustainable economy, they insist that parameters are necessary from the outset to instil credibility and trust. Stakeholders, however, have conflicting emotions about the move as they feel it could hamper innovation in the sector.

Harvey asserts that a comprehensive regulatory framework is essential to protect the interests of investors. Citing countries with a thriving fintech sector such as China, Harvey says regulators have actively engaged industry players to make certain that what comes out is right for the customer and marketplace. "Chinese regulators have been very forward thinking and have worked with a number of the fintech firms to launch new products and even new banks," he adds.

"Most of the regulations are actually pretty simple - not in terms of execution, but in terms of what [the framework] sets out to do. And it sets out to do the right thing, which is to protect consumers and the financial system. I don't see it as necessarily inhibiting innovation. If it does, it is probably not the sort of innovation we want."

BANKING INDUSTRY PLAYS CATCH UP

Fintech firms in developed economies such as the US and the UK are flourishing as the sector has gained recognition as the future of financial services. According to a banking industry white paper by *MarketResearch.com* and *Banking Reports,* global investments in fintech are expected to reach USD19.7 billion (RM84 billion) this year, almost double the USD10 billion last year.

The white paper - 'Five Banking Innovations from Five Continents' - says 60% of all fintech investments originated outside the financial establishment while another 20% of investments went from banks to fintech companies. This is expected to rise to 40% by 2020.

The annual global investment in fintech firms is expected to reach USD46 billion by 2020. In 2014, the investments were led by the US (63%), followed by Europe (18%) and Asia (12%).

Harvey notes that fintech firms, or disruptors as they have menacingly come to be known, are here to stay. And he is averse to blaming innovative products as the root cause of the 2008 global financial crisis.

"I think if you look at the real seeds of the financial crisis, it was due to one of the more simple products that we have out there - mortgages," he says.

"It was actually created by the sale of subprime mortgages to individuals who really shouldn't have got them. And then the way those packages of debt were treated, the way they were derivatised and sold on the markets. The reality was that the crisis was not created by derivatives, but derivatives enabled it."

The great advantage of fintech firms is that they are free from the burden of legacy, complex systems and processes that other financial service providers are saddled with, says Harvey. "In many cases, they are unregulated so they don't have to comply with all the regulations, like the banks. What they are doing is attacking specific parts of the value chain.

"What they are not doing is taking on the full end-to-end - they don't have balance sheets, they don't have big technology stacks to look after. It is a lot easier for them, so they are seen as a big threat. You can see the deposit base of most banks being attacked by some of these new lending and deposit mechanisms that are coming in."

In September, Deloitte published its 'Staying Ahead of the Pack' report on a global survey that showed financial services firms are transforming their business operations in response to these rapidly mushrooming disruptive entrants, not just by revamping their customer-focused technology but by digitising their backend processes. The survey had polled 200 executives from banking, securities, insurance and investment management firms around the world, and found that these firms were discreetly transforming their businesses in anticipation of the disruption in the industry.

While avant-garde customer-focused technologies continue to be the priority, many of the financial services firms surveyed said they were overhauling their internal operations by their digitising processes. Nearly two-thirds of respondents said they anticipated new industry entrants and were pursuing innovation to keep up with the potential disruptors.

"You can see the payment value chain already being disrupted by e-wallet services such as Apply Pay, PayPal and Ali Pay," says Harvey. "The advice I normally give my bank clients is that they should be looking at where the most customer friction is - in other words, where it is really difficult to do business, and where that meets at the point of the greatest profit. These are the points that disruption is securing, which is why they occurred in payments, which is why they are occurring in lending and other parts of the banking value chain."

Harvey says financial services firms are responding by innovating themselves and working with innovative organisations to essentially transform their infrastructure and provide similar products to those offered by fintech players. "The Lending Club [in the US], for example, is a major peer-to-peer lending organisation. In fact, the back end of all that are the banks.

"[Financial services firms] are also acquiring. They are going out there and being very selective and targeted. They are acquiring the fintech capability and bringing it in-house and using it to transform their services." ✱

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BY DR. RAYMOND MADDEN

The 3Es of Employee

ENGAGEMENT, ENRICHMENT AND EMPOWERMENT

+ The 3Es are the main drivers of sustainable talent management – and it is through a combination of these drivers that an organisation and its employees can become highly productive and deliver better business results.

In today's competitive business environment, employee productivity has become an increasingly important factor in sustaining business growth. As it has a major impact on an organisation's overall success, it is a crucial metric in understanding how effectively organisations are managing their employees. So how do we enhance productivity? To achieve high levels of employee productivity, it is vital to create an environment and a culture that keeps employees motivated, in which they feel valued, and personal growth is encouraged and rewarded. In other words, it is about **Engaging, Enriching** and **Empowering** employees – what we, at AIF, term as "the 3Es of talent management". The 3Es are the main drivers of sustainable talent management – and it is through a combination of these drivers that an organisation and its employees can become highly productive and deliver better business results.

Organisations that recognise and proactively manage the 3Es are more likely to gain a competitive advantage through their people strategy. These are organisations that people aspire to work for, where they feel a sense of pride and connection with the purpose of the organisation and where they feel motivated to do their best work. Furthermore, organisations that incorporate best practices in employee engagement, enrichment and empowerment are most likely to become a magnet for the best talent, foster a high-performance culture and build a sustainable high-performing organisation.

AIF's 3Es research report presents the findings of a survey of engagement,

enrichment and empowerment among 3,209 professionals covering all four industry sectors – banking, Islamic finance, insurance and capital markets. The financial services industry is a major contributor to the national economy and has a significant impact on its future growth. Managing the productivity of financial services employees in volatile times will be vital in helping promote financial stability and growth in the economy. In a rapidly changing business environment, talent management becomes even more crucial and is a hot topic for discussion in the boardroom.

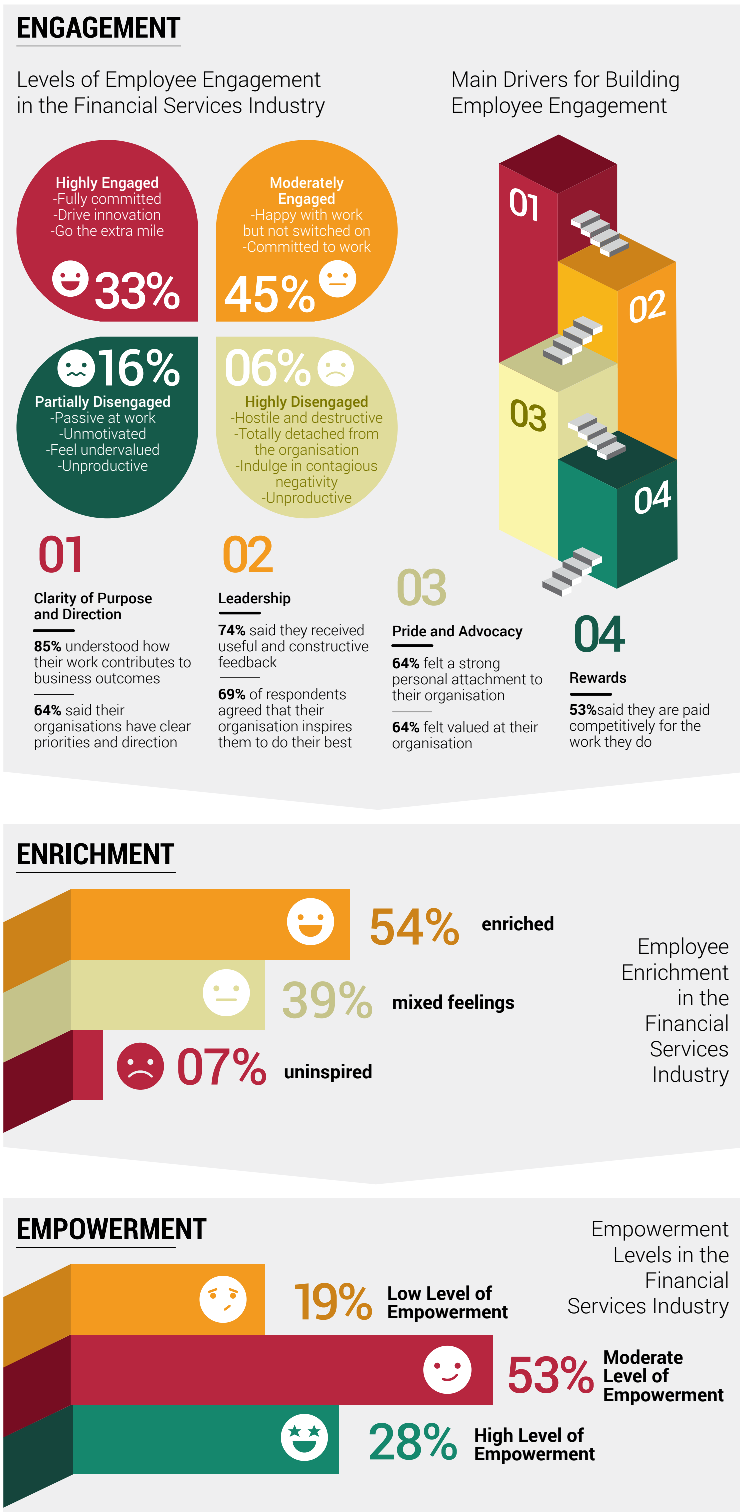
One of the key challenges with talent management is how to retain the best talent. Employee disengagement is one potential issue that contributes to retention problems. This issue is worrying for business leaders as it can have a material impact on business results. Employee engagement is, in fact, a vital driver in ensuring future business success.

EMPLOYEE ENGAGEMENT

Higher employee engagement results in greater employee motivation with engaged employees more often putting customers first, while also being less likely to leave their jobs. Higher engagement levels raise both levels of productivity and overall organisational performance. However, employee engagement has been in decline in recent years.

There is a strong correlation between high levels of engagement and productivity. When employees are engaged, they will often be more productive and engaged employees feel that their work gives them a sense of personal accomplishment. The survey findings within AIF's 3Es research suggest that only 33% of employees in the financial services industry felt highly

The 3Es of Talent Management



engaged, that is they were fully committed, drove innovation and tended to go the extra mile at work, while 45% felt moderately engaged and were generally committed to their work. Some 16% indicated they were passive at work, felt undervalued and were, as a result, unproductive and 6% felt highly disengaged and detached from their employer and their work.

Highly engaged employees say positive things about their organisation. AIF research revealed that 91% of highly engaged employees will recommend their organisation as a great place to work. They talk about the advantages of working at the organisation to their network of contacts including peers, competitors and customers. This will help the organisation attract good talent from competitors and also increase the level of trust in the organisation among customers. This will also improve the reputation of the organisation in the market and increase overall goodwill towards the business.

In addition, engaged employees intend to stay longer with their current organisation, with our research suggesting that 90% said that they will stay more than a year with their current organisation. This reduces the costs of recruitment and retraining which impacts the bottom line of the business and can significantly reduce operating costs.

In order to understand what drives engagement, the research sought to elicit from employees what keeps them engaged. The survey found the main drivers for building engagement include factors such as: employees having clarity of purpose and a sense of direction; pride and advocacy; the existence of leadership; and satisfactory rewards. We found that 85% felt they understood how their work contributes to business outcomes and that this contributed to their engagement levels. They felt that having clarity of purpose and direction at work was valuable with 64% stating that their organisations have clear priorities and direction. With regard to feelings of pride and a sense of advocacy at work, 64% of those surveyed said they felt a strong attachment to their organisation and felt valued by their employer. As regards to leadership at work, 74% said they received useful and constructive feedback, while 69% of respondents agreed that their organisation inspired them to do their best. In terms of rewards, 53% of respondents stated that their organisation paid them competitively.

As employee's roles have evolved over the years, HR professionals have had to respond to the challenge by enhancing the level of employee engagement. HR professionals in financial institutions are no longer carrying out the conventional tasks that they traditionally fulfilled; their role is now more diverse and is more about managing and developing talent and succession planning. They are now required to be more resourceful in planning future strategy at work as critical HR decisions will affect the overall business strategy.

EMPLOYEE ENRICHMENT

Enriching employee experiences and offering growth opportunities are essential for a company's future sustainability. Enrichment involves organisations giving employees the opportunity to fully use their abilities in performing their jobs and encouraging professional growth and career development. It involves giving employees the opportunity to use all their skills and also opportunities for personal growth including training and development.

Our 3Es research found that only half of the respondents, or 54% of employees in the financial services sector, felt enriched. When employees do not feel personal accountability or recognition for the tasks given to them, they feel disenfranchised and, as a result, employers should not expect their employees to feel a sense of self-worth towards their jobs. 39% of respondents possessed mixed feelings as to whether they felt enriched at work, while 7% felt particularly uninspired. Job enrichment and job enlargement are developmental strategies that help ensure employees are able to make the best use of their skills and technical know-how. These strategies should be part of the organisation's overall strategic plan to encourage career development and progression. Job rotation, organisational learning, and providing staff with opportunities involving more regional and international exposure are all effective ways of enriching jobs while allowing organisations to increase the overall skill level of their employees.

EMPLOYEE EMPOWERMENT

Employees are the most important asset of an organisation. Empowering them and creating motivated staff allows managers to act quickly and effectively in a changing and dynamic environment. Empowerment involves encouraging or authorising employees to make decisions independently within the context of their jobs. It comprises either formal or informal delegation, the sharing of authority and resources, and giving responsibilities to subordinates across all different levels in the organisation. The goal of employee empowerment is to nurture employees' sense of self-esteem by providing autonomy and opportunities for personal growth through allowing them to utilise their learning, knowledge, skills and positive attitude. We found that 28% of those surveyed expressed views that they felt highly empowered; 53% stated they felt moderately empowered; and 19% expressed low levels of empowerment. An example of employee empowerment working effectively can be found at Disney, where 'cast members' work to ensure every customer touch point is memorable. Disney empowers its staff through listening to them, thanking them for a job well done and recognising and implementing their suggestions. As a result, employees feel empowered and naturally want to continue to be effective and successful in their roles.

Employees also want to be kept updated and informed about what is going on in their organisation and want to experience a sense of involvement with their employer.

FINAL THOUGHTS

Engagement and an employee's intention to stay with their organisation are often influenced by relationships at work. Organisations should develop a sense of community and ensure favourable employer behaviours are evident by, for example, trusting employees through giving them autonomy to make their own decisions. By giving employees opportunities to express their opinions to management, organisations can open the door to enhanced engagement. Employees also want to be kept updated and informed about what is going on in their organisation and want to experience a sense of involvement with their employer. Employers can greatly increase engagement by communicating more and making sure their employees feel valued.

All managers want high performers in their team. These are employees who are fully engaged, enriched and empowered in their working lives. They are motivated, consistently demonstrate high performance and are highly productive. In order to develop high performers among employees, organisations must have effective talent management strategies that are part of their broader people strategies that focus on the 3Es. ✱

■ *Dr. Raymond Madden is Chief Executive Officer at the Asian Institute of Finance.*

MEET THE ETHICAL HACKER WHO HACKS OUT OF 'BOREDOM'

GADGETS AND INTERNET CONNECTION ARE UBIQUITOUS IN THE LIVES OF MOST PEOPLE. SO MUCH SO, THAT WE TEND TO TAKE CYBERSECURITY AND PRIVACY FOR GRANTED. **JAMIE WOODRUFF**, ONE OF THE WORLD'S BEST KNOWN ETHICAL HACKERS, KNOWS THIS FIRST-HAND.

Woodruff developed a passion for hacking at a very young age - 10 to be exact. And at 22, he is already a veteran in his field and is sought after by corporations and governments all over the world who want to protect themselves.

"I'm autistic," he tells #edGY. "So computers have always been my thing."

He is now a final year student pursuing a degree in Computer Information Systems at the Bangor University in the UK.

Woodruff travels the globe to attend summits, give talks, perform live hackings and work alongside companies, but nothing gives him a thrill like hacking into a system for the sheer fun of it.

He is also the Founder and Chief Technical Officer of Patch Penguin, a multinational cybersecurity company whose clientele includes large investment firms, private equity firms and financial institutions. Formed in 2015, the company is often sought for its expertise in penetrating testing, cybersecurity training, website vulnerability scans and source code reviews.

Hackers may have a bad reputation, but folks like Woodruff are known as "white hats", a term for an ethical hacker who is essentially a computer expert who, with the consent of the owner, attempts to penetrate a system to find security vulnerabilities that could be used maliciously by other hackers.

One of the most recent and high-profile cases of white hat hacking was that of adultery website Ashley Madison in July last year, when hackers exposed the data and information on thousands of the website's members in the name of morality.

Woodruff reveals that the corporations that seek him out almost always want the same thing - to know where the vulnerabilities in their systems lie and how they can be tracked.

"Financial institutions are most at risk because this is an ever-growing threat and they're more prone to attacks. The effect on them would be catastrophic," he says.

Earlier, Woodruff famously hacked into US reality TV star Kim Kardashian's website, where he discovered dozens of security holes that could potentially put the site's visitors at risk of malware and identity theft.

The hacking was not intentional.

"I'd heard about (husband) Kanye West getting a PhD and I thought that was bullshit, so I went to her website to read about it. And that's when I discovered the vulnerabilities."

Woodruff sent her team an email about it but when he received no response, he decided to go public. He said he chose to do so as he felt people should know about the security risks they face.

It is interesting to note that Woodruff has no inclination to save the world or end global crises with his skills. Instead, he nonchalantly admits that it is a passion that stems from boredom - which, he insists, is the reason anyone would have for hacking.

"People thrive on the 'LOLs'. They hack

+ Financial institutions are most at risk because this is an ever-growing threat and they're more prone to attacks. The effect on them would be catastrophic

because they've got nothing better to do. Hacking is about freedom with just the click of a button," he says, adding that every once in a while he likes to hack Google to see what he can find.

Woodruff explains that just by looking at a website, he can tell what its flaws are, which he can then use to his advantage. But as tempting as it is, he isn't allowed to expose someone or something with the information he's learnt.

"There's a code of conduct for that. I'd just be a vigilante then, if I made public any and everything I found. But it is very tempting, like heroin to an addict," he admits.

Woodruff concedes that danger always lurks with this kind of work, revealing that he personally knows of one or two black hat hackers who have either disappeared or were killed on the job.

"At the end of the day, it all boils down to what kind of 'hat' you wear. You can either use what you've learnt for personal gain, or you can use it to help people."

■ *Jamie Woodruff was a speaker at AICB's Global Banking Conference and was interviewed by the Edge publication. This article was originally published in The Edge's Personal Wealth and is reproduced here under permission. Writer Vichitra Nades. Photographer Haris Hassan.*

Lessons from White Hat Hacking

*Jamie Woodruff, white hat hacker extraordinaire, says that banks and financial institutions are most at risk from vindictive cyber attacks. He shares some fundamental tips for enhancing cybersecurity with **Banking Insight** via e-mail. Unsurprisingly, people are the weakest link in the chain.*

What are the main sources of cyber threats and vulnerabilities for banks today?

The biggest threat for banks is their employees. Employees are under-trained and not familiar with the protocols and frameworks that have been put in place to protect the bank, employees and end-users. Companies should invest more money into training employees and familiarising them with social engineering attacks.

What are the typical weaknesses of leading/common applications used by banks?

Outdated patches. A lot of companies, including those in the financial industry, run old legacy systems that need to be upgraded. However, they continue to use them because they work, not understanding the dangers they may pose.

Could you share some memorable incidents of penetration testing that you have done involving banks? What are the key lessons to be learnt from these incidents?

I have managed to highlight social engineering attack risks, by pretending to be a Domino's Pizza delivery boy to infiltrate the premises of a bank's headquarters. I walked straight past security and managed to lockpick my way into the server room. Lesson learnt: escort people around the premises, especially visitors.

What are your top tips for banks and financial institutions to improve their vulnerabilities and cybersecurity?

Again, make sure they have the correct patches and up-to-date systems installed and make sure their employees are proactively trained on a continuous basis.

Would you agree that vulnerabilities are due to human error e.g. human exploitation and manipulation? What are the common methods in which systems are hacked by exploiting human weakness?

Yes, I very much agree. A lot of developers within the banking industry are old and have been working with old programming languages and styles. New patches and code become redundant almost every day.

You say you are passionate about social engineering, which in the context of information security, refers to psychological manipulation of people into performing actions or divulging confidential information. How can banks use social engineering to improve their cyber and other defences?

They can introduce different social engineering attacks, and train their employees on what to look out for. Train staff actively in what to identify and how they can put steps in place to prevent these attacks and also how to report these attacks when they happen. ✱

BY V. MASLAMANI

Living Up to ISO 19600

How can Chief Compliance Officers implement compliance management systems which abide by Bank Negara Malaysia (BNM) standards and fulfil ISO 19600?

The banking sector around the globe has been profoundly affected by the pumped-up regulatory agenda since the last financial crisis in the West. Many new requirements and complex regulatory conditions have positioned compliance as one of the biggest challenges for banks wishing to stay clear of the huge fines and sanctions imposed by the regulators.

A GOOD CCO IS INTEGRAL

As such, the need for an independent compliance function is becoming a common phenomenon, with regulators pushing for a greater role to be played by the Chief Compliance Officer (CCO) especially in large and complex banking groups. In turn, the challenges and expectations placed upon the CCOs have grown tremendously, where they are held accountable to roll out measures to ensure their organisation's adherence to its compliance obligations i.e. meeting regulatory requirements, industry codes, ethical standards and internal policies.

Furthermore, in Malaysia, the Financial Services Act (FSA) 2013 and Islamic Financial Services Act (IFSA) 2013 provide for CCOs to be charged for compliance failures. Thus, it is not surprising that the CCO's position in some large organisations is being elevated to the C-suite in view of their growing responsibility and the strategic role expected of them.

Banking businesses today require extensive innovation to remain competitive and that requires an adaptable yet skilled CCO to manage regulatory demands while maintaining the reputation of his/her organisation in the marketplace. A good CCO is one that 'future-proofs' his or her organisation by keeping tabs on anticipated regulatory changes and who exerts good control over emerging compliance risks to avoid future compliance failures.

ISO 19600 – COMPLIANCE MANAGEMENT SYSTEM

In tandem with the growing importance of the compliance function, many regulators and industry bodies have

A good CCO is one that 'future-proofs' his or her organisation by keeping tabs on anticipated regulatory changes and who exerts good control over emerging compliance risks to avoid future compliance failures.

issued or re-issued various standards, guidelines and industry codes to strengthen compliance and ensure strict adherence to ethical standards. More and more regulators are issuing complex regulatory standards, some with extraterritorial reach. Thus, it was a great relief for like-minded compliance officers when the international compliance standard, ISO 19600 – Compliance Management System, was issued in December 2014. This guidance standard sets the benchmark for how organisations regardless of their size or industry should act to meet their evolving compliance obligations. It should be noted that for banks in Malaysia, until recently they lacked clear guidance (except for the compliance functions in the investment banks) on how the CCOs should formulate the compliance policy, manage the compliance function and plan their activities to meet the regulatory standards. To fill the vacuum, Bank Negara Malaysia (BNM) at the end of 2015 issued the Compliance Standards (CS) which will be effective from January 2017. Thanks to BNM, by design, the requirements of CS appear to be similar to the ISO 19600.

In an era where good corporate governance, ethical business conduct and social responsibility are cornerstones of the regulatory agenda, ISO 19600 provides the basis for benchmarking against international best practices. It provides guidance for developing, implementing, maintaining, evaluating and improving an adequate compliance risk management programme for an effective and responsive compliance management system.

HALLMARKS OF ISO 19600

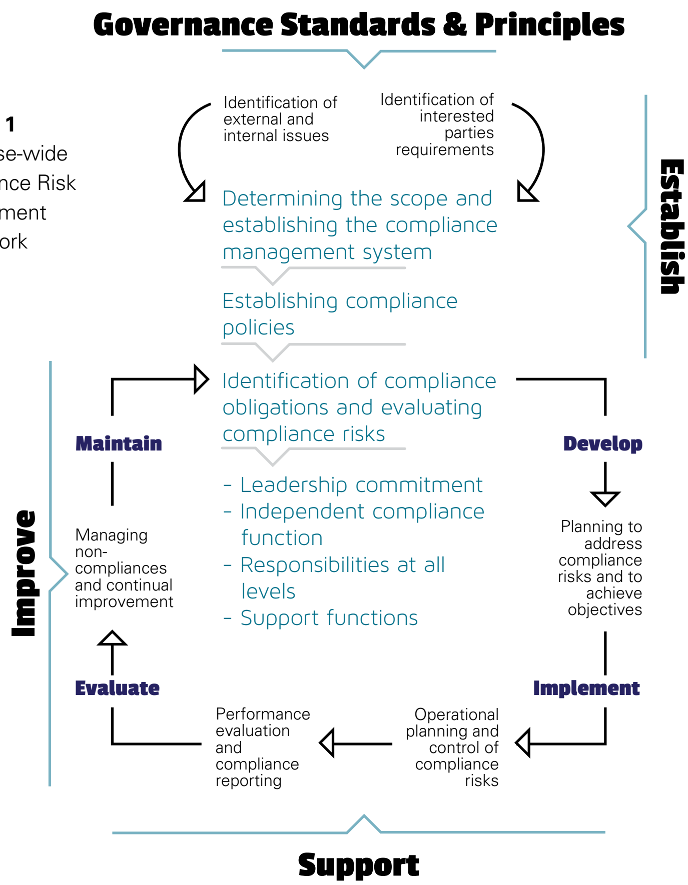
Following are some of the key details of the ISO 19600. First and foremost there are two key statements that should be mantras for any organisation:

1 Organisations desirous of long-term success must maintain a culture of integrity and compliance; and

2 Compliance's success is shaped by top leadership and leaders at every level by adopting an organisational approach in applying core values, accepted corporate governance requirements, ethical and industry/community standards in whatever the organisation does. In short, leadership must promote compliant behaviour.

+ This guidance standard sets the benchmark for how organisations regardless of their size or industry should act to meet their evolving compliance obligations.

FIGURE 1
Enterprise-wide Compliance Risk Management Framework



There are several key terms in ISO 19600: Compliance Policy, Compliance Risk, Compliance Obligations, Compliance Culture, Competence, Procedures, and Continuous Monitoring and Improvement, Non-Compliance and Audit. These terms should not be alien to any competent CCO, and thus will not be discussed in detail in this article. Instead, the focus will be on how to integrate and embed ISO 19600 into the enterprise-wide Compliance Risk Management Framework (CRMF).

+ The ISO 19600 – Compliance Management System, standardises approaches to build a consistent and effective compliance function.

THE ENTERPRISE-WIDE COMPLIANCE RISK MANAGEMENT FRAMEWORK

Figure 1 depicts how this can be done and is perfectly in line with the demands of BNM's CS. Firstly, the organisation's governance standards and principles become the overriding architecture determining the intent and contents of compliance framework.

The governance standards determine the level of compliance obligations. Compliance obligations can vary depending on the standard of governance adopted by each financial institution. Some may choose to comply with minimum mandatory requirements while those aspiring to achieve greater corporate governance may adopt voluntary commitments applied in the developed markets.

In ISO 19600, the centrepiece to the Compliance Management System (CMS) is an enterprise-wide compliance risk assessment that needs to be conducted to identify all the compliance obligations of an organisation. It goes without saying that 'we don't know what we don't know'. Without an adequate assessment, CCOs would be blindsided and would fail.

Conducting compliance risk assessment would require identification of the scope in **Figure 1**. This is akin to the creation of a compliance rule register based on the identification of internal and external requirements and stakeholders' demands. This would also serve as the repository for identification of the compliance obligations, be they external or internal requirements. This would be an arduous task since there aren't any definite sources or resources readily available in Malaysia. Much depends on the experience and capabilities of a CCO in leading his or her team in creating the repository for their organisation.

Based on the repository, a compliance risk assessment should be conducted to determine compliance obligations; thereafter compliance risks must be risk rated in accordance with the compliance risk appetite of the organisation. Conducting compliance risk assessment can be a daunting exercise as this has not been attempted by many local banks. However, this is one of the key demands of the BNM's CS and ISO 19600. In 2017, banks in Malaysia must demonstrate to regulators whether compliance risks have been adequately evaluated and mitigation measures have been built to manage the compliance risks. In cases where CCOs find it difficult to carry out this task, it is probably best to seek external help.

In developing the compliance risk management framework, it should be noted that it should detail clearly the oversight role of the Board of Directors, and the leadership role of the CEO and other senior management members in shaping the compliance culture in their organisation. It should document the role of control functions and their inter-dependencies to reduce overlaps. Not to be missed is a clear statement articulating that responsibility for compliance lies not only on the shoulders of the CCO and the compliance function but it is everyone's responsibility. This is where the savviness of the CCO will be put to the greatest test. He or she must be able to work with others to build processes across the organisation to meet the identification, reporting and evaluation process of the compliance controls. If there is a general lack of staff awareness on compliance and a weak compliance culture prevails, the CCO must convince senior management to commit budgets towards enhancement. Thus, as shown in **Figure 1**, the CRMF must have 'support' that should be built around it to make compliance successful. This support includes policies & procedures, learning modules, compliance repository, MIS & analytic capabilities, etc.

STEPS TO SUCCESS

The ISO 19600 – Compliance Management System, standardises approaches to build a consistent and effective compliance function. It allows the establishment of the context, development and implementation of compliance controls, continuous evaluation and improvement of compliance risks' management measures. In short, organisations intending to improve their compliance standards must take note and consider the following key requirements of the ISO 19600:

- To develop CMS within the context of the organisations' strategic direction, business goals and values weighed against regulatory demands;
- Determine stakeholders' demands and their compliance expectations;
- Evaluate mandatory compliance obligations and voluntary standards to be adopted in designing the compliance obligations;
- Conduct a compliance risk assessment and risk categorise the compliance obligations;
- Develop a compliance risk appetite. Thereafter, use a risk-based approach in determining the allocation of compliances' resources to compliance risks in various categories;
- Ensure CMS is integrated into the operational and business processes of the organisation; and
- Ensure the organisation's values and its leaders promote a compliant behaviour and culture.

While putting all these requirements of ISO 19600 in writing is easy, making it work will be the greatest challenge. This is where a CCO must possess enough seniority, expertise and the respect of others to convince the Board and the senior management on compliance. CCOs must be able to make business sense of compliance for compliance to be appreciated by the senior management and others. A CCO will be considered successful if he or she can use ISO 19600 as a guide to build the compliance risk management framework and goes all out to make it work.

It is recommended that Malaysian banks, especially those with a regional and international presence, adopt ISO 19600 to build their CMS and showcase their compliance as being in line with international best practices. The benefits of adopting ISO 19600 are manifold:

- It is an avenue to review existing compliance programmes
- Helps standardise and simplify the approach in developing CMS
- Provides for a risk-based approach in determining responses to compliance obligations
- Aims for the leadership to promote compliance culture and integrity
- Ensures readiness to meet BNM's Compliance Standard
- Enhances the ability to benchmark and showcase against international best practices.

CONCLUSION

To make it work, the Board and senior management must first be convinced that good compliance makes good business sense. Compliance should not be seen as a hindrance to business and innovation. An organisation must provide adequate support for the successful implementation of CMS. Adequate resources must be availed to the CCO for the establishment, development, implementation, evaluation, maintenance and continual improvement of CMS. While punitive action remains a sore point with some CCOs, there have been positive changes in Malaysia due to fines being imposed by BNM, where some banks are doubling their compliance resources.

CCOs in Malaysia must seize the opportunity presented to them by the current environment of greater regulatory pressures to enhance compliance. CCOs for their part must also raise their standards and work with the Board and senior management in shaping the compliance standards and compliance culture in their organisation. In addition, the CCOs must endeavour to raise their understanding of the organisation's business strategy, product knowledge, operational requirements and innovation in banking to assist their CEO and business heads to achieve organisational strategic goals while succesfully navigating the regulatory minefield. This will, in the long term, help to eradicate the common labelling of compliance as postman, policeman and agent or spy for the regulators.

Every CCO should work with others to ensure their organisation fulfills its social and regulatory responsibilities, effectively manages compliance risks and protects its reputation. They can use ISO 19600 – Compliance Management System to benchmark their current compliance risk management framework against international best practices. The CCOs should use it as a tool to prove that if compliance is applied risk-intelligently, it can be a sound decision for competitive advantage. CCOs must be able to demonstrate that anyone who perceives compliance as a regulatory burden is still in a state of denial! ✱

■ *V. Maslamani is an experienced compliance professional who has served in various capacities in the banking sector over the last 27 years.*

C-Suite Bankers' Next Game Plan: Data Analytics?

Data is now classified as the fourth pillar of business, alongside people, process and technology. **Malaysia-based banks need to be more competent and effective** in their deployment of data analytics to catch up with their global peers and to differentiate themselves in intense competition.

Data analytics has been making waves globally for approximately two decades, but Malaysian banks are still at a nascent stage when it comes to mining data for competitive advantage.

According to 'C-Suite's Next Game Plan: Data Analytics?', a major study conducted by AICB and EY, Malaysia-based banks' data analytics capabilities lag behind when benchmarked against their global peers. "Rated as an emerging market for data analytics, Malaysia is in the early maturity stage when it comes to people, process and technology. They will take about one to two years to fill the gap and to catch up when it comes to realising value from their data assets," surmised Chow Sang Hoe, Asean Advisory Leader, EY, at an exclusive briefing on Data Analytics organised in January 2016 by AICB and EY.

IDENTIFYING THE GAPS

Like their global peers, Malaysia-based banks demonstrated comprehensive internal and external data governance policies, and likewise cited data inventory policies, policies on the use of employees' devices, and policies relating to data management as gap areas requiring improvement.

Drilling deeper, the critical shortage of analytical abilities is a key factor that will hinder development. The survey found that nearly half (48%) of Malaysia-based banks perceived themselves to be "average" in optimising the extraction of useful insights from their data assets, meaning that analytics skills are deficient. Relative to global peers, Malaysia-based banks also received an average score in the quality of data-driven insights into risks, customers, markets, workforce issues and competitors. In addition, data analytics is more utilised in understanding current and historical data (hindsight and current insight), whereas predictive data analytics (foresight) is lesser used. "While data is growing exponentially, missing is the ability to generate insights, to ask questions, to translate information into action and to track the action," said Chow.

Another structural challenge is that in Malaysia, data analytics is regarded as being part of IT, and is typically housed under the IT function. This perception has to change. "Data management and data analytics are not technical issues, but the fourth pillar of business – where the pillars are people, process, technology and data. Data is not a by-product anymore," warned Chow.

In terms of technology, the survey also found that Malaysia-based banks are largely equipped with "statistical-reporting-GRC" data management tools and less equipped with advanced analytics-related tools.

While data is growing exponentially, missing is the ability to generate insights, to ask questions, to translate information into action and to track the action.

RELATIVE TO GLOBAL PEERS, MALAYSIA-BASED BANKS ARE PERCEIVED TO BE:

An emerging analytics market

Having scope for wider adoption of customer analytics and strategic collaborations

Lacking in investment focus on optimising data insights

AHEAD OF GOVERNANCE POLICIES

Higher focus on compliance (security, privacy and access) functions

ALIGN ON TALENT ACQUISITION

Intend to appoint a data analytics individual

Has hired or (to hire) a specific individual for data governance

AWAY OFF TALENT ACQUISITION

Data assets optimisation

Lagging behind global peers on extracting useful data insights

Lagging across key areas of data analytics
- Risk
- Customers
- Markets
- Workforce issues
- Competitors

Key obstacles preventing maximisation of data assets:
- People
- Data collation process
- Data quality

Leadership in data analytics

Lack of specific CDO/CAO for enterprise-wide data analytics management

Customer analytics**

Lagging in adopting customer analytics

Note: ** Malaysian results only. No comparable global survey.

BRIDGING THE GAPS

Banks identified their lack of analytical skills and capabilities, as well as data collection / collation difficulties as the main obstacles in preventing them from maximising the use of their data assets.

+ Leadership and competencies

Putting the appropriate specialists in place to handle data processes and assets would be a step in the right direction.

It is critical that organisations appoint a visible leader to champion data analytics. The survey found that 75% of global banks appoint a specific individual such as a Chief Data Officer (CDO) as their data custodian, whereas less than half (44%) of Malaysia-based banks do so. Malaysia-based banks leave it to their Chief Technology Officer (CTO) and Chief Information Officer (CIO) to be responsible for data processes across the enterprise, such as collection and warehousing, analytics and insights, data privacy, data security, data integration and management, and data governance.

However, given that skills shortages are a perpetual issue in talent-hungry Malaysia, where can banks source data analytics leaders and specialists? Freddy Loo, Executive Director, Ernst & Young Advisory Services Sdn. Bhd. quipped that hiring a CDO and other analytics experts was akin to hunting down an elusive unicorn. To address the shortage, Chow recommended that the AICB take a leadership role in building up the talent pool for data analytics specialists.

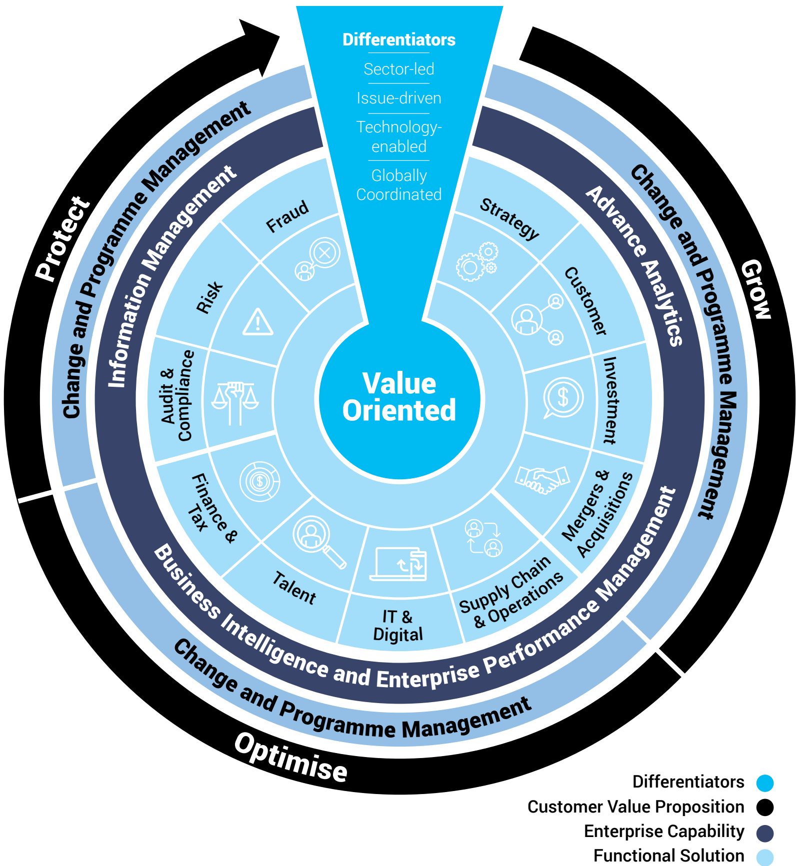
Banks should also consider outsourcing analytics to reputable and reliable third parties to build their capabilities. "Growing skills organically can be too slow. There is a lot of value in bringing in a solutions partner to close that gap," recommended Sungkyu Chang, Partner, Ernst & Young Advisory Services Sdn. Bhd. More than half (56%) of Malaysia-based banks are open to third-party engagement to enhance their data analytics capability.

While data analysts need a compendium of skills, Chow said that the most difficult criteria to match are the business and collaborative skills. "Apart from understanding the business, data specialists must have the personality to collaborate with others to overcome territorial attitudes and silos. Getting a CDO who is able to respectfully work with others to get the work done is critical to success."

+ Risk Management

Risk management and performance improvement are key areas where analytics can make a significant difference. The survey found that banks intend to prioritise analytics investments for the objectives of managing risk and strategic planning in the next two years.

Jason Yuen, Advisory Partner, Ernst & Young Advisory Services Sdn. Bhd., advised banks to leverage on analytics



to beef up cybersecurity defences in an era where banks are increasingly vulnerable to hacking and cybersecurity threats are increasing exponentially due to more pervasive technology. Urging banks to improve their monitoring capabilities to enable early detection of cyber threats internally and externally, Yuen said that "data analytics enables us to understand and identify abnormal behaviour and patterns."

+ Customer Analytics

Customer analytics is an emerging area of global best practice where Malaysia-based banks have scope for wider adoption to enhance performance and differentiate themselves. "Use analytics to drive differentiated behaviour and to wow the customer," enthused Sungkyu. There is room for improvement; two out of three Malaysia-based banks appear to have partially adopted a customer analytics approach while 37% have not adopted it at all. 63% rate customer analytics as useful for marketing, sales and product service development activities, but identified gaps in datasets, competency, investment focus and regulatory constraints as barriers to optimising customer analytics.

FOCUS ON YOUR BUSINESS AND YOUR CUSTOMER

For positive change, the most important paradigm shift that banks must make is to recognise that data management and analytics are not technical issues but business issues. "Data is the fourth pillar of business, with people, process and technologies comprising the other three pillars," Chow emphasised. "The biggest challenge in analytics is not technology but change management and process management. Technology alone will not solve the problems, because data will not be useful without insights."

In particular, Malaysia-based banks face risks around customers and marketing. "There are obstacles around people, data collection and data quality. It's time to switch gears and focus on the customers and the operations side," said Sungkyu.

He urged banks to harness data analytics to interact more effectively with customers and deliver products and services which deliver that elusive "Wow!" moment. For example, local banks can pick up best practices from competing markets such as Singapore, where data analytics is utilised to improve processes and performance, such as better management of cash flows and improved branch management. "Use data to interact with customers better and to manage your resources better. Data analytics should focus on what we need to do to gain the kind of economy where we manage to do more with less, while moving ahead of the competition. Timing is critical, yet it's not about spending alone; it's about what benefits you reap," advised Sungkyu.

At the end of the day, organisations need to persevere and be resilient in managing data analytics. "The biggest challenge is not technology but change management. It never ends. This is a continuous journey," concluded Chow, who commended Malaysia-based banks for embarking on tough change management initiatives to protect and optimise their data assets. ✱

'C-Suite's Next Game Plan: Data Analytics?' was developed with the purpose of understanding the current status of big data transformation among Malaysia-based banks and deriving insights on developments made in implementing and enhancing data analytics practices. The survey along with the exclusive briefing on Data Analytics is part of AICB's continuous learning programme and thought leadership development on key issues and trends impacting the Malaysian banking industry. For more information on the survey and AICB's thought leadership programmes, please visit *https://www.aicb.org.my/thought-leadership/.*

BY AMALINA ANUAR

Banking on Full Reserves

THE 2008 **FINANCIAL CRISIS EXPOSED SEVERAL CHINKS IN THE ARMOUR OF THE GLOBAL FINANCIAL SYSTEM,** CATALYSING CALLS FOR REFORM. ONE OF THESE INCLUDE SUGGESTIONS FOR FULL RESERVE BANKING AS AN ALTERNATIVE WAY FORWARD TO INFUSE MORE STABILITY TO A FRAGILE GLOBAL FINANCIAL SYSTEM. BUT IS AN UNTRIED BANKING SYSTEM TRULY A FEASIBLE OPTION, ESPECIALLY IN A SENSITIVE AND INTERDEPENDENT ECONOMY?

In the aftermath of the 2008 Financial Crisis, regulators, economists and other thought leaders have been tinkering around with different theories and ideas to provide sustainable and just growth and improve the integrity and stability of the global financial system. One of these ideas which has been gaining traction and mainstream interest is the proposal to replace fractional reserve banking with full reserve banking, also known as 100% reserve banking, where there is a 1:1 ratio of reserves or deposits to every loan distributed.

If it were ever to be implemented, it would be a watershed moment, as this would displace the very foundations of the current monetary system, or what chief economics commentator at the *Financial Times Martin Wolf* described as "the creation of money, out of nothing, by private banks' often foolish lending". The UK's *Telegraph* hailed the suggestion as a "turnaround in the history of modern finance", as no modern country in the world practices full reserve banking. According to Patrizio Laina, Chair of Economic Democracy Finland, in a paper entitled 'Proposals for Full Reserve Banking: A Historical Survey from David Ricardo to Martin Wolf', it has not been implemented since the 19th Century.

Lack of experience hasn't stopped proponents from trying. Switzerland's Vollgeld, or Full Money Initiative collected enough signatures for a public referendum to vote on adopting full reserve banking. Iceland too has proposed monetary reform

Reserve Banking

One of these ideas which has been gaining traction and mainstream interest is the proposal to replace fractional reserve banking with full reserve banking, also known as 100% reserve banking, where there is a 1:1 ratio of reserves or deposits to every loan distributed.

through the national inauguration of full reserve banking. According to Frosti Sigurjónsson, Icelandic lawmaker and writer of the 'Monetary Reform: A Better Monetary System for Iceland' report, full reserve banking is a way to address the fundamental failings of the current financial system: "the ability of banks to create credit, money and purchasing power, and the instability which inevitably follows".

The snowballing enthusiasm for full reserve banking reflects the mood of antagonism towards unbridled credit creation and private lending by commercial banks, whose actions were a key factor in instigating the biggest economic catastrophe since the Great Depression. Under fractional reserve banking, commercial banks need not have sufficient legal tender or reserves in order to distribute loans. Instead, banks only need to have 10% in reserves for every deposit and matching loan. The other 90% constitutes new money, which is created in excess of whatever monetary reserves the bank holds. Theoretically, this should generate more money due to returns on interest. Unless, of course, people are unable to pay back their loans and begin defaulting, resulting in a domino effect of insolvency and contagion which paralyses lenders who constitute major players in the global financial system and economy.

Furthermore, in fractional reserve banking, the central bank wears the mantle of regulator, acting as a financial watchdog. However, oversight becomes challenging in an economy wherein the central bank is not in control of the quantity of money in circulation. According to the Bank of England's bulletin entitled 'Money Creation in the Modern Economy', 97% of the broad money in circulation comprises bank deposits created by commercial banks and not the central authority; Sigurjónsson puts forth a similar number, with 91% of money existing as bank deposits. Thereafter, regulation occurs via price setting for the reserves, i.e. through controlling interest rates, or quantitative easing, i.e. purchasing assets.

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This means that what is arguably the most pivotal aspect of the monetary system, the creation of money itself, does not fall completely within the dominion of the central bank. This is exactly the issue full reserve banking, which is also sometimes referred to as a sovereign money economy, seeks to solve. Laina writes that advocating for full reserve banking denies private money creation; instead, in a sovereign money economy, only the central bank authorities have the authority to create money. As IMF economists Jaromir Benes and Michael Kumhof argued in their paper entitled 'The Chicago Plan Revisited', "providing a money supply does not need to involve risk" and can be done "by the sovereign, debt-free, at much lower cost".

Full reserve banking further augments sustainable, accountable, and transparent practices. By requiring a matching amount of deposits for every loan, the financial system can no longer operate in an unfettered manner. This can eliminate what the Bank of England terms 'fountain pen money', or money created with every stroke of a banker's pen whenever they approve loans, in their report. Consequently, this would help contain asset bubbles, speculation, and unproductive investments, wrote Charlotte Van Dixhoorn for the Sustainable Finance Lab in a paper entitled 'Full Reserve Banking: An Analysis of Four Monetary Reform Plans'.

Commercial banks would then be relegated to the role of intermediaries, surviving on commissions made on basic payments - an operational process not unlike Paypal's, noted Leonid Bershidsky for *Bloomberg* in an article titled 'What if Banks didn't Create Money?'. Moreover, under the full reserve banking model, banks can also accept time deposits, It's also possible that full reserve banking could drive demand in the unregulated banking sector or shadow bankers, which could increase risks. Indeed, the US Federal Reserve Governor Daniel Tarullo noted that "risks to financial stability may arise anew from activities mostly or completely outside the ambit of prudentially regulated firms".

which are investments not covered by the full reserves, and borrow from the central bank to make loans albeit the central bank would still have full control over money supply.

THE CHALLENGES

Though full reserve banking on a global scale seems an unprecedented and novel idea, this is technically not the first time that the notion has been making waves. Previously, full reserve banking was initially proposed by leading economists including Henry Simons and Irving Fisher in 1933. The Chicago Plan identified the causes of the Great Depression and aimed to mitigate its effects accordingly. According to these economists, wrote Valentin Katasonov for the Strategic Culture Foundation, fractional reserve banking was a primary instigator of the Great Depression: fiat money in the form of credit flooded the market, subsequently creating a debt pyramid.

While this seems a familiar story, the narrative is playing out in unfamiliar territory. The financial landscape of today is obviously more complex. Implementing full reserve banking could be problematic now, considering just how interconnected and interdependent the financial system is today after decades of surging globalisation and liberalisation. If certain countries chose to implement this alternative paradigm while others refrain, key concerns include being unable to effectively compete on full reserve banking in a fractional reserve banking world as well as potentially problematic transactions between regimes due to different operating systems.

Plus, there's also the question of what happens to the vast amounts of money created by commercial banks. To put things into perspective, the Positive Money Organisation estimated that an average of 11.5% of new money has been created annually over the past four decades; thus, it's an especially relevant question in countries where fountain pen money outnumbers the supply of legal tender by an overwhelming margin. As the Strategic Culture Foundation emphasised, this money cannot suddenly be erased. So many operations are contingent upon it, as it is the seemingly indispensable fuel driving the engine of the current global economy.

It's also possible that full reserve banking could drive demand in the unregulated banking sector or shadow bankers, which could increase risks. Indeed, the US Federal Reserve Governor Daniel Tarullo noted that "risks to financial stability may arise anew from activities mostly or completely outside the ambit of prudentially regulated firms". In a paper entitled 'The Solution is Full Reserve / 100% Reserve Banking', Ralph Musgrave argued that the simplest way to overcome this is to regulate shadow banking - a policy goal Hillary Clinton aims to implement should her bid for the US presidency succeed. However, whether shadow banking regulation can be achieved in the near future, much less on a worldwide scale, remains to be seen.

Nevertheless, despite the various criticisms put forth by opponents, full reserve banking has its merits. In their paper, Benes and Kumhof modelled the modern US economy on a sovereign money economy. The evidence strongly suggests that the benefits of the Chicago Plan hold true even today, engendering better control over money supply that significantly influences business boom and bust cycles, unpredictable surges and contractions of bank credit, and over the quantity of bank-created money. A full reserve banking system could theoretically rebuild public trust in banks, as well as dramatically reduce net public and private debt. Additionally, a sovereign money economy also benefits the state, since income earned from creating all types of money becomes accrued to them.

Moreover, full reserve banking would enhance governance because "the power to create money is kept separate from the power to decide how that new money is used", wrote Sigurjónsson. At the same time, it could also translate into increased market efficiency because as Laina explains, while money creation is nationalised, credit allocation will generally be in the hands of the private sector. Though think tank Avenir Suisse claims that the notion of any national or central bank being able to "determine the optimal quantity of money fully objectively and without any political influence is unrealistic", it must be remembered that the decentralisation and distribution of credit creation capabilities to entities not operating in the public interest have not induced positive change either and arguably, even led to the 2008 Financial Crisis.

RIPPLE EFFECTS

If successful, such a shift would not simply affect the banking system, however, but would change the fabric of our global financial reality. Firstly, it could pose a potential setback for electronic cashless payments, which are based on the same *ex nihilo* money that full reserve banking aims to displace, wrote Katasonov. In Switzerland, for example, more than 90% of money in circulation exists in the form of electronic cash from commercial banks. Without the ability to create credit, the push for cashless economies spearheaded by the financial sector may be stonewalled.

As it is, many countries are reluctant to execute this alternative against fractional reserve banking. However, without any entity actually attempting to install the system, the full reserve banking debate will likely remain just that: a debate with much theoretical grandstanding and modelling, but little real-life evidence to either prove or disprove it.

Secondly, a sovereign money economy implemented in ASEAN could manifest in increased macroeconomic stability. Issues like overexposure to cyclical economic activities - which plagued the region during the Asian Financial Crisis and still constitute current risks, especially with increased cross-border linkages, as noted by the IMF in its 'ASEAN Financial Integration' report - could be mitigated under a full reserve banking model. Of course, there are understandable concerns that credit scarcity within a full reserve banking system could impede growth and development in emerging economies. However, Benes and Kumhof claimed that a functioning full reserve banking system would entail not only the substitution of debt-laden private money with debt-free government-issued money, but also the provision of credit lines for productive investments in order to build a sustainable stable financing and financial support from the state.

CONCLUSION

Considering how fractional reserve banking has been the hallmark of the global financial system until now, the fact that Iceland is establishing a parliamentary committee to review full reserve banking arrangements - and that Switzerland is holding the Vollgeld referendum - marks new milestones in the search for more sustainable and just prospects in global finance.

Of course, the sheer complexity of the proposal could deter adoption. Bershidsky notes that this monetary reform is so momentous that other countries are unlikely to even mull the idea over; Katasonov also highlights that should the public not quite grasp exactly what the Vollgeld initiative entails, the full banking reserve debate may not be suffering a premature death so much as a stillbirth. As it is, many countries are reluctant to execute this alternative against fractional reserve banking. However, without any entity actually attempting to install the system, the full reserve banking debate will likely remain just that: a debate with much theoretical grandstanding and modelling, but little real-life evidence to either prove or disprove it.

Nevertheless, though full reserve banking may not gain traction and critical mass immediately, it is certainly not an idea to be written off so soon - especially when viewed in tandem with other alternatives, such as the gold standard, which is inherently problematic because of resource asymmetry. Perhaps one of full reserve banking's greatest contributions then is how it is urging mindset changes and paradigm shifts in redefining what a healthy and stable financial system can look like. Even if full reserve banking may not be the utopian alternative, the debate opens the door for game changers that could reengineer the global financial system for the better.. ✱

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